

INTRODUCTION: The Most Serious Problems Encountered by Taxpayers: The Taxpayer's Journey

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 (MSPs) 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.

As in earlier years, this report discusses at least 20 of the most serious problems encountered by taxpayers—but not necessarily *the top 20* most serious problems. That is by design. Since there is no objective way to select the 20 MSPs, we consider a variety of factors when making this determination. Moreover, while we carefully rank each year's problems under the same methodology (described below), the list remains inherently subjective in many respects.

To simply report on the top 20 problems would limit our effectiveness in focusing congressional, IRS, and public attention on critical issues. It would require us to repeat much of the same data and propose many of the same solutions year to year. Thus, the statute gives the National Taxpayer Advocate flexibility in selecting both the subject matter and the number of topics discussed and to use the report to put forth actionable and specific solutions instead of mere criticism and complaints.

Methodology of the Most Serious Problem List

The National Taxpayer Advocate considers a number of factors in identifying, evaluating, and ranking the MSPs encountered by taxpayers. In many years, the National Taxpayer Advocate identifies a theme or groupings of issues for the Annual Report that is reflected in the selection of issues. For example, this year the MSPs illustrate the taxpayer's journey. The MSPs are grouped by the stages of the journey as follows:

- The Prefiling Stage: Taxpayer Access to Information;
- The Return Filing Process: Balancing Ease and Efficiency with Revenue Protection;
- The Examination Process: Minimizing Taxpayer Burden in the Selection and Conduct of Audits;
- The Notice Function: IRS Written Communication with Taxpayers;
- The IRS Collection Function: Minimizing Taxpayer Burden and Addressing Taxpayers' Ability to Pay; and
- The Litigation Stage: Access to Representation.

The 20 issues in this year's report are ranked according to the following criteria:

- Impact on taxpayer rights;
- Number of taxpayers affected;
- Interest, sensitivity, and visibility to the National Taxpayer Advocate, Congress, and other external stakeholders;
- Barriers these problems present to tax law compliance, including cost, time, and burden;
- The revenue impact of noncompliance; and
- Taxpayer Advocate Management Information System (TAMIS) and Systemic Advocacy Management System (SAMS) data.

Finally, the National Taxpayer Advocate and the Office of Systemic Advocacy examine the results of the ranking on the remaining issues and adjust it where editorial or numerical considerations warrant a particular placement or grouping.

Taxpayer Advocate Management Information System (TAMIS) List

The identification of the MSPs reflects not only the mandates of Congress and the IRC, but TAS's integrated approach to advocacy—using individual cases as a means for detecting trends and identifying systemic problems in IRS policy and procedures or the Code. TAS tracks individual taxpayer cases on TAMIS. The top 25 case issues, listed in Appendix 1, reflect TAMIS receipts based on taxpayer contacts in Fiscal Year 2018, a period spanning October 1, 2017, through September 30, 2018.

Use of Examples

The examples presented in this report illustrate issues raised in cases handled by TAS. To comply with IRC § 6103, which generally requires the IRS to keep taxpayer returns and return information confidential, the details of the fact patterns have been changed. In some instances, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to that taxpayer's case. These exceptions are noted in footnotes to the examples.

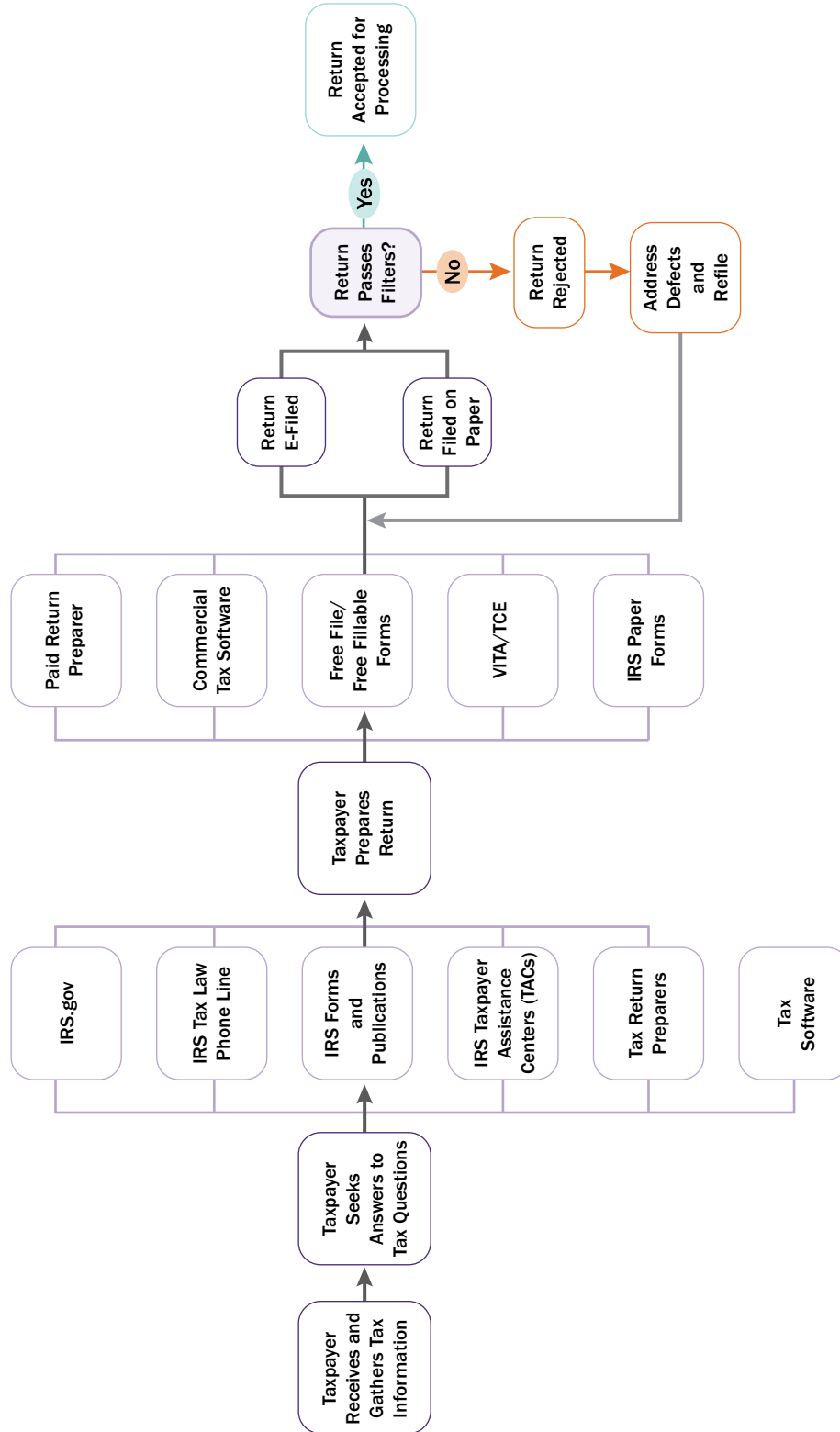
Data Compilation and Validation

The data cited in the National Taxpayer Advocate's annual reports generally come from one of three sources: (i) publicly available data such as the IRS Data Book, Government Accountability Office reports, and Treasury Inspector General for Tax Administration reports; (ii) IRS databases to which TAS has access; and (iii) IRS data that is provided by the Operating Divisions pursuant to TAS information requests. Once data has been compiled, TAS's Office of Research and Analysis double checks it. Then TAS sends all data included in the "most serious problems" section of the report to the IRS for final verification prior to publication.

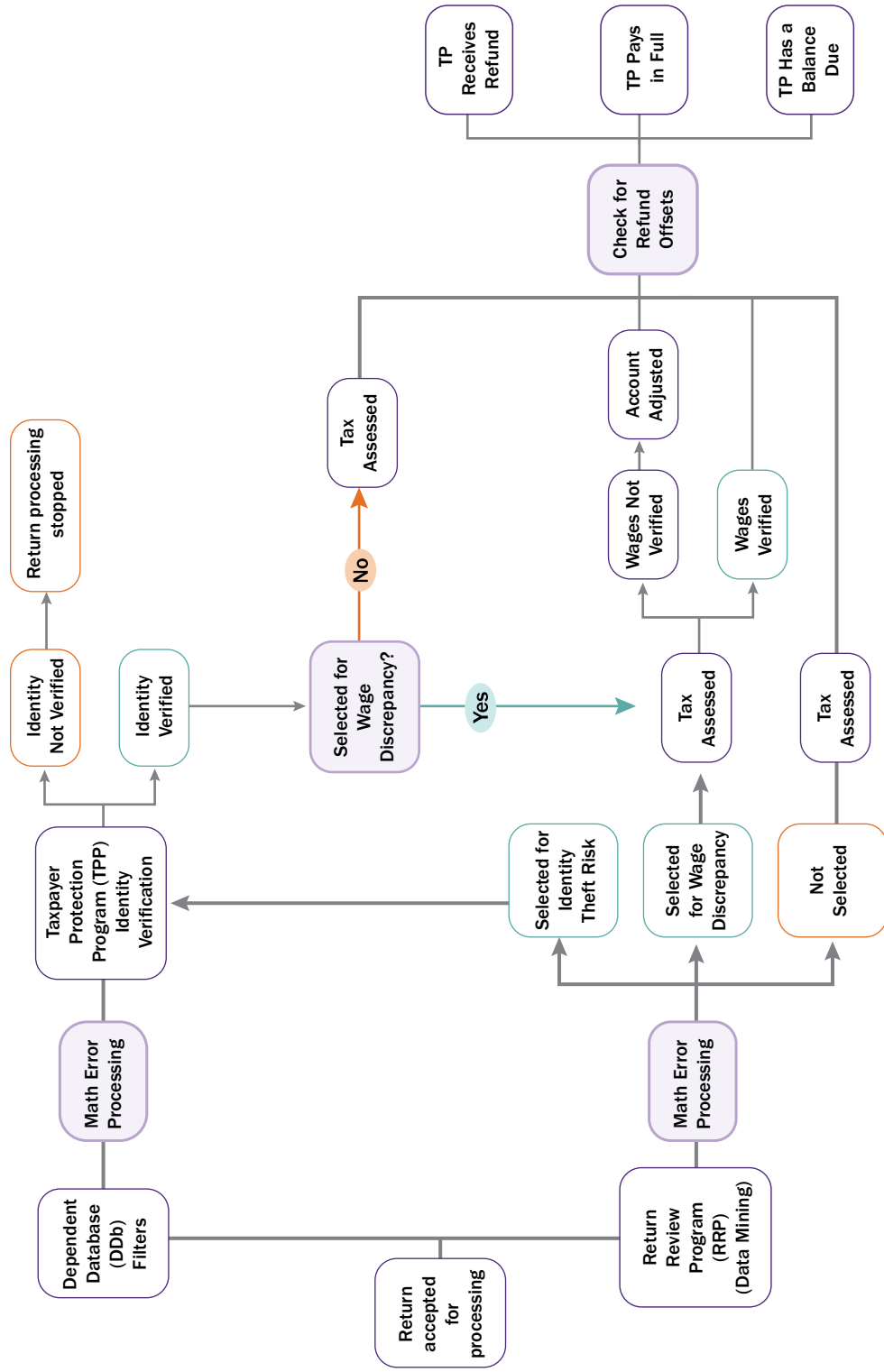
On the rare occasion where TAS and the IRS have a disagreement about data, we generally meet to discuss it, and if a disagreement persists, we note it in the report. This process ensures data integrity and full transparency regarding data sources and reliability.

THE TAXPAYER'S JOURNEY: Roadmaps of the Taxpayer's Path Through the Tax System

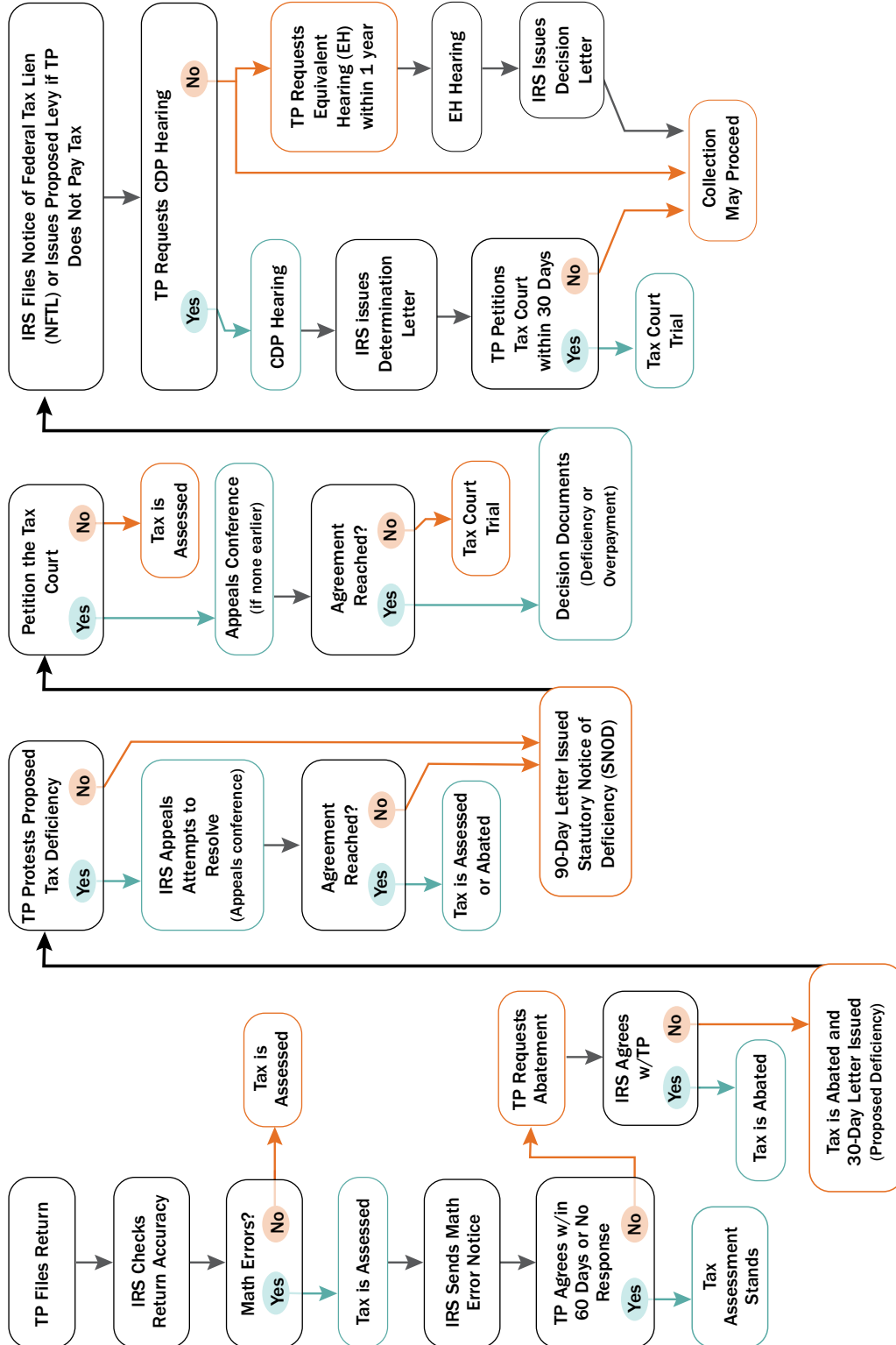
Tax Return Preparation Roadmap



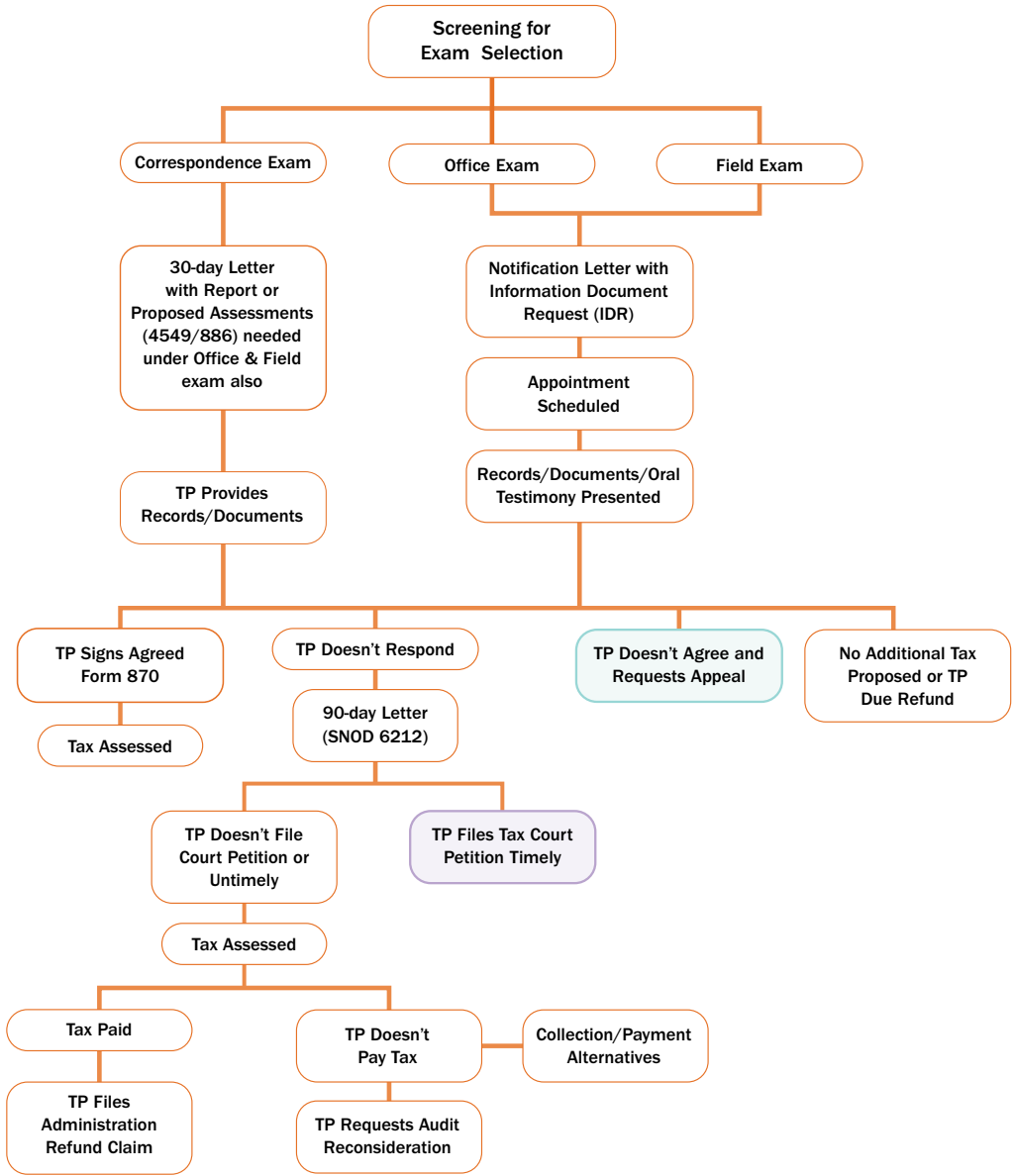
Tax Return Processing Roadmap



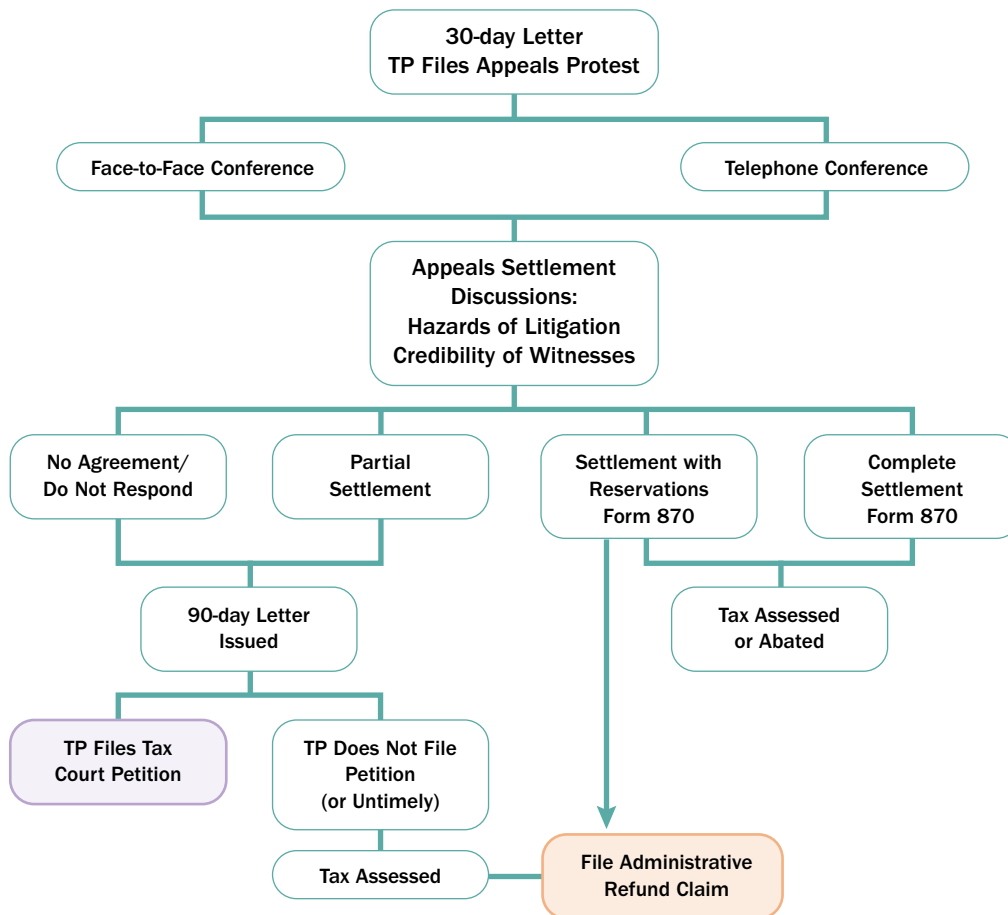
Notices Roadmap



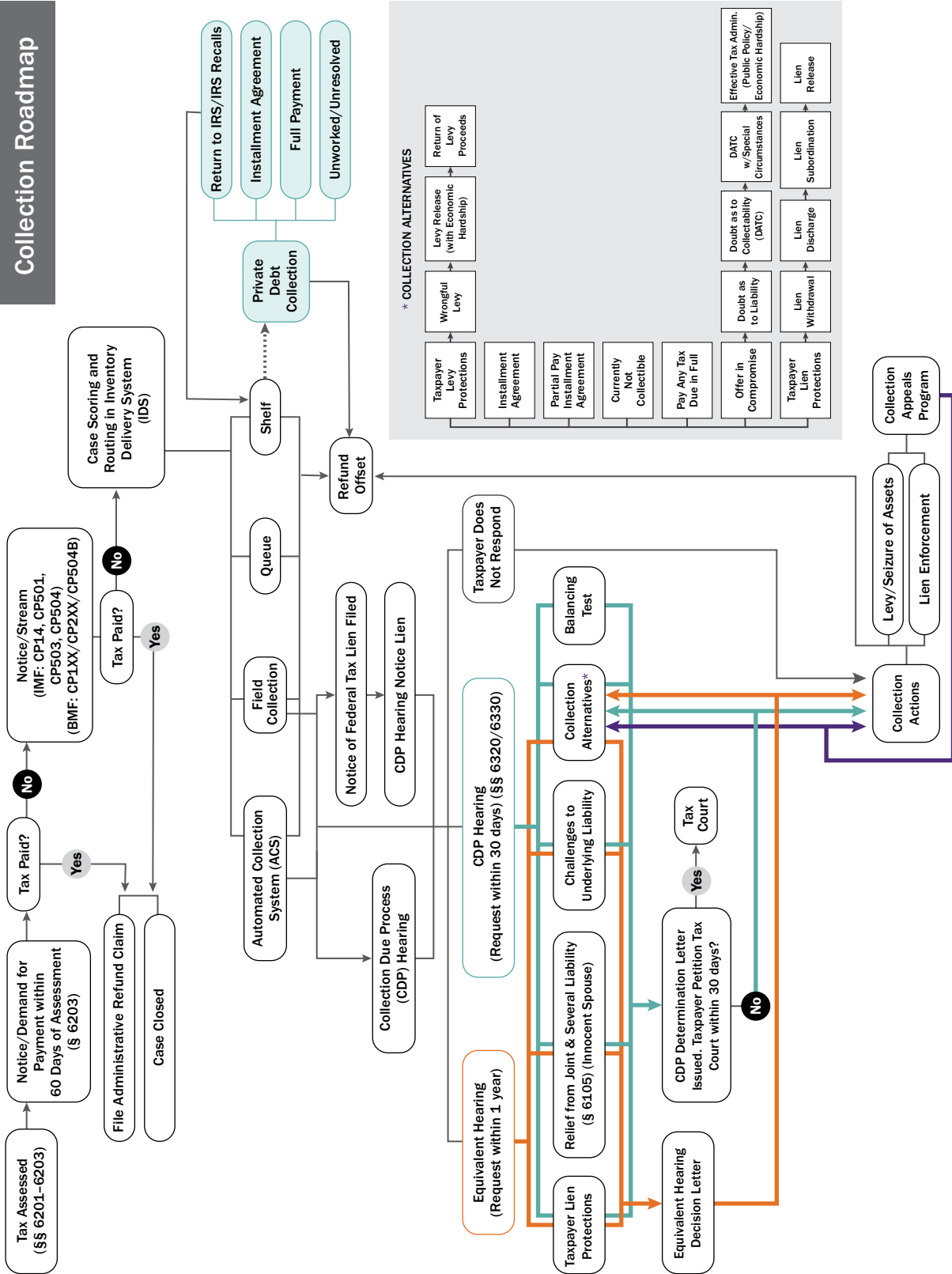
Exam Roadmap



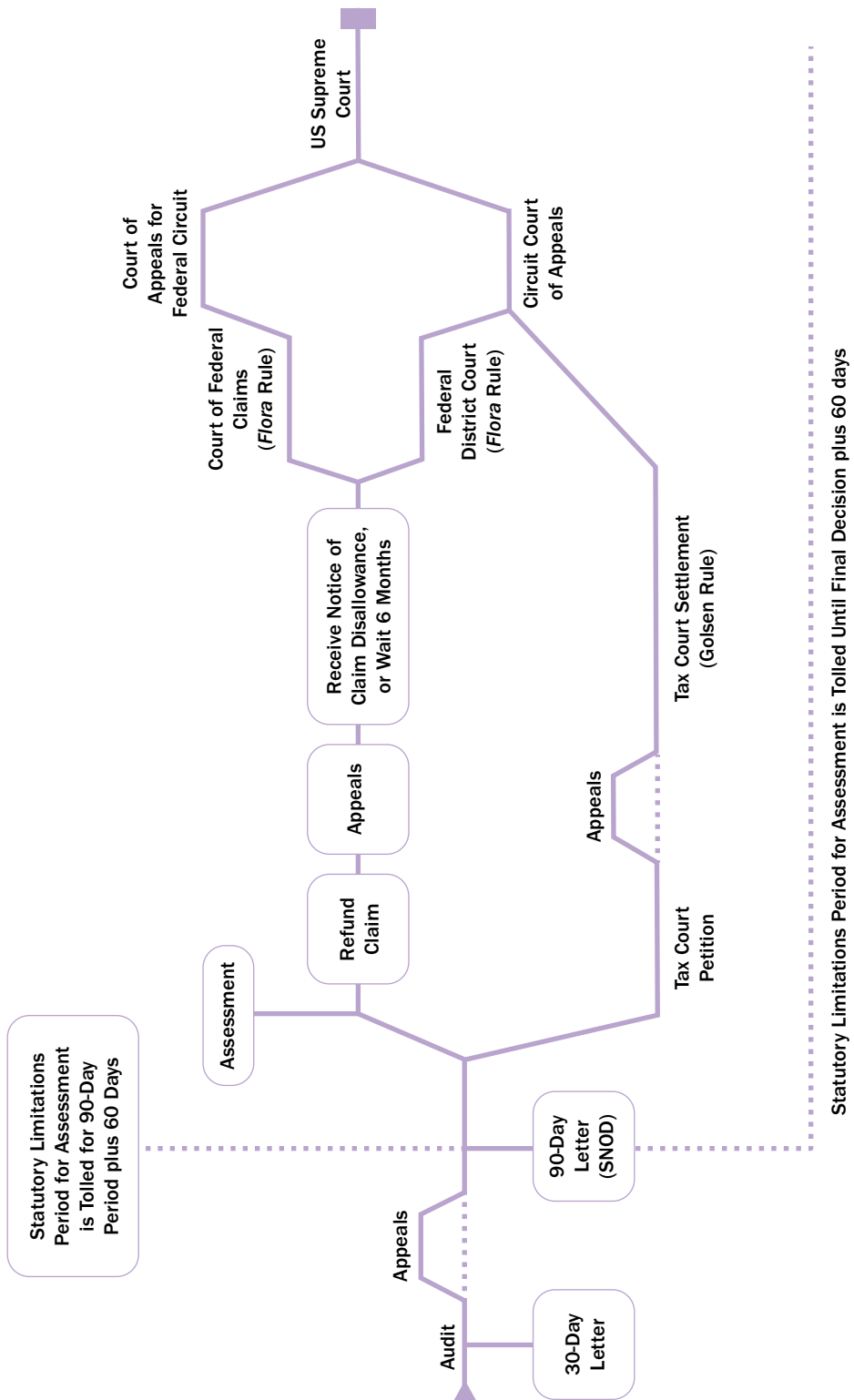
Appeals Roadmap



Collection Roadmap



Litigation Roadmap



**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****RESPONSIBLE OFFICIAL**

Ken Corbin, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The Internal Revenue Code (IRC) is a behemoth document containing nearly four million words, further complicated by the most sweeping tax reform since 1986, the Tax Cuts and Job Act (TCJA), passed in December 2017.² Taxpayers need answers to tax law questions, both basic and complicated, and they need those answers quickly and accurately to meet their obligations for the upcoming year. The *right to be informed* is fundamental to exercising all other taxpayer rights and serves as a cornerstone for taxpayers to understand their tax rights and responsibilities. This is why it is the first right in the Taxpayer Bill of Rights.³ If the IRS fails to meet the *right to be informed*, it undermines all other taxpayer rights, including the *rights to quality service* and *to a fair and just tax system*.

Calling the tax agency, charged with implementing and administering the nation's tax law, and being told your question is out-of-scope (*i.e.*, the IRS does not answer that question, during filing season or otherwise), that the employee can only answer your question during filing season, or that the employee who answers your call is not trained to answer your question violates taxpayer rights. Expecting taxpayers to fit all tax law questions into a 3.5-month window during filing season results in frustration for taxpayers, lowers confidence in the service the IRS provides, and may force taxpayers to use costly third-party options to accurately answer their questions. Further, the downstream consequences of not answering taxpayer questions at all or not answering questions accurately creates rework for the IRS and burden for the taxpayer to seek a correct answer elsewhere.

The National Taxpayer Advocate has identified the following problems associated with the IRS's approach to answering tax law questions:

- Failure to collect information about calls regarding out-of-scope issues prevents the IRS from educating taxpayers about those issues via alternative methods;

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 A search of the IRC conducted using the "word count" feature in Microsoft Word turned up nearly four million words. National Taxpayer Advocate 2012 Annual Report to Congress 6. See also Pub. L. No. 115-97, 131 Stat. 2054 (Dec. 22, 2017).

3 See TBOR, www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

- Test calls to the IRS reveal inconsistent service for taxpayers; and
- The IRS has not adopted best practices to address tax law questions.

ANALYSIS OF PROBLEM

Background

In 2014, the IRS implemented a policy to only answer tax law questions during filing season,⁴ 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.

For tax returns due in 2015, 2016, and 2017, over 13 million individual taxpayers per tax year filed returns with extensions of time to file.⁵ An average of 9.5 million taxpayers per year filed quarterly estimated taxes.⁶ All of these taxpayers have legitimate needs for IRS tax law assistance year-round. Further, taxpayers have ever-changing tax situations. People move, open a business, close a business, get married, get divorced, have children, and 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.

Failing to Track Out-of-Scope Topics Taxpayers Ask About Is a Missed Opportunity

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.⁷ In the past, taxpayers could electronically submit questions on out-of-scope topics via the R-mail system, but the IRS discontinued the program in 2015.⁸ The IRS does not track what taxpayers ask about if the topic is out-of-scope.⁹ 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. If the IRS tracked the out-of-scope topics taxpayers called or visited a Taxpayer Assistance Center (TAC) about, it could use the information to refine its services.

Particularly in TACs, the IRS could use this information to determine if there are topics specific to a certain location and add services on topics that would be useful in that area. Further, tracking the scope of all taxpayer contacts provides a better picture to the IRS of the types of contacts taxpayers make and the scope of work received by the IRS. If many taxpayers are calling about similar issues, the IRS can use such information to better refine its outreach strategy or to develop more robust information on its website, in press releases, or publications. TAS has recently begun tracking all taxpayer contacts to

4 Internal Revenue Manual (IRM) 21.3.4.9.1(2) (Oct. 1, 2018). See also IRM 21.3.4.9.1(3) (Oct. 1, 2018) (providing topics that will be answered all year and allowing for a manager discretion for answering post-filing season individual tax law questions).

5 IRS, Compliance Data Warehouse (CDW) (data retrieved Nov. 13, 2018).

6 IRS, CDW (data retrieved Nov. 13, 2018). This number includes taxpayers who elected to have their current year tax refund applied to the following year's estimated tax liability, however, these taxpayers may also need assistance during the year regarding the application of their pre-payment.

7 IRM 21.1.1.3.1, *Out of Scope and Limited Service* (Oct. 1, 2018); IRM 21.1.1-1, *Out-of-Scope Topics and Forms* (Oct. 1, 2017).

8 IRM 21.3.8.6, *R-Mail and Out of Scope Procedures* (Oct. 1, 2015).

9 IRS response to TAS information request (Oct. 24, 2018).

inform our resource allocation and better understand the types of issues taxpayers bring to TAS, which in turn will inform our outreach strategy.¹⁰

The IRS offers the Interactive Tax Assistant (ITA) to taxpayers seeking assistance via the internet.¹¹ Taxpayers can look for popular topics or search to find out if a particular topic is available. If a topic is available, the taxpayer can answer a series of questions to determine an answer based on his or her situation. If the IRS tracked search terms entered into ITA, it could develop additional materials or interactive tools to answer commonly asked questions. The IRS could also use artificial intelligence and pattern-recognition technology to develop answers or help direct taxpayers to the correct information.

Results of TAS Test Calls Show Inconsistent Service and Answers

In order to test the customer experience with respect to tax law questions, TAS developed and tested a series of questions relating to areas of the law that are deemed in-scope and had not changed under the TCJA, issues that are deemed out-of-scope, and topics impacted by the TCJA.¹² Between April and October 2018, TAS conducted test calls to the IRS to discover what might happen when a taxpayer calls the IRS.

TAS conducted two rounds of test calls in 2018, in April and May, and again in September and October.¹³ In both rounds of test calls, TAS callers experienced inconsistent service, even when asking questions about changes under the TCJA, which the IRS previously indicated it would now answer year-round. Several callers reported the same script being read over the phone, telling the callers:

There is no tax law personnel at this time due to budgetary cuts. This tax topic cannot be answered at this time. The employees that will be able to answer this question will be available beginning January 2, 2019 through April 15, 2019.

This is particularly concerning given the IRS is supposed to be answering TCJA calls year-round. In one instance, a caller was told she needed to hire a paid professional to answer her question. On many calls, the employee told the caller the call would be transferred, and the transfer ended in a pre-recorded message telling the caller the question was out-of-scope and then disconnecting the call.

On a test call made in April 2018, a TAS representative asked a question regarding the home office deduction under the TCJA. The answer is simple: the home office deduction (IRC § 280A) did not change under the TCJA. However, the customer service representative who answered the phone after the TAS caller pushed the selection to ask a question about tax reform apologized and explained that he had not yet received training on the TCJA and did not expect to receive training until the end of calendar year. Later calls in September and October featured additional employees relating that they had little training in the new tax law and also apologizing for being unable to help.

10 The Contact Record screen captures specific data on all customer contacts and provides TAS with additional quantifiable information on what drives taxpayers to contact TAS.

11 IRS, *Interactive Tax Assistant*, <https://www.irs.gov/help/ita>.

12 TAS employees called the main IRS 1040 phone line in two rounds of tests between April 2018 and October 2018. Callers were assigned specific questions about various topics, some impacted by the TCJA, some topics that are considered year-round tax law topics, and some that are answered only during filing season. The calls were limited in number and do not represent a statistically valid sample. We relate our findings here solely as qualitative and anecdotal evidence of the taxpayer's experience. A record of the test calls made to the IRS is contained in Appendix A.

13 For further discussion of the test tax law calls, see National Taxpayer Advocate Fiscal Year 2019 Objectives Report 36-40.

Taxpayers have legitimate needs for IRS tax law assistance year-round. Further, taxpayers have ever-changing tax situations. People move, open a business, close a business, get married, get divorced, have children, and many other life changes that affect their tax obligations.

While it is understandable that the specific details of the application of tax law changes may not be determined in the early months following enactment, it is unacceptable that employees answering a telephone line designated for tax reform did not have a basic outline of the law and what high level provisions had or had not changed. The failure to provide its employees with this information, so they provide even rudimentary service to taxpayers, is demoralizing for the workforce and frustrating for taxpayers.

Assistance With the Tax Cuts and Jobs Act May Not Meet Taxpayer Needs

While the decision to answer TCJA questions year-round is the right thing to do, it is unclear how long the IRS will continue to answer TCJA questions outside of filing season.¹⁴ Further, the IRS did not begin answering questions about the TCJA until after the beginning of 2019.¹⁵ Taxpayers who have called (as demonstrated by the results of the TAS test calls) to date seeking assistance with meeting their tax year 2018 obligations were told to call back in January 2019, to seek assistance from third parties, or to research the question on the IRS website. However, information has been slow to roll out to the IRS website, and taxpayers may have needed to make adjustments to their withholding at the beginning of tax year 2018 to avoid penalties and interest when they file their returns in 2019.

In an attempt to fill the void of information, TAS developed a Tax Changes website in August that includes line-by-line explanations of the tax changes for individuals under the TCJA.¹⁶ The topics compare the law in 2017 to the new law and provide scenarios that may impact the taxpayer based on the changes and links to other resources that may be useful in determining how the new law applies to the taxpayer's situation. TAS continues to add materials to the Tax Changes tool as they become available. The website is now available in Spanish.

While the IRS is currently working on training its employees on the TCJA, as of late October, much of the training was not yet finalized.¹⁷ Several annual trainings were updated to reflect the TCJA changes; however, the updated forms for taxpayers were not yet available at the time, so the trainings could not reflect the new forms and thus could only reference the new forms rather than demonstrating them for employees.¹⁸ Finally, the IRS has designated some topics related to the TCJA out-of-scope, even though the law has changed in those areas, such as treatment of student loans discharged on account of death or disability or limitation on losses for taxpayers other than corporations.¹⁹

14 IRS response to TAS information Request (Oct. 24, 2018); IRS response to TAS information request (Mar. 2, 2018).

15 *Id.*

16 TAS, *Tax Changes by Topic*, <https://taxchanges.us/?source=ttk>.

17 IRS response to TAS information request (Oct. 24, 2018).

18 *Id.*

19 *Id.*

The IRS Is Not Providing World-Class Service in Relation to Tax Law Questions

While countries around the world differ in how they provide advice or answer taxpayer questions, several countries have much more robust and diversified channels to answer questions than the IRS provides. An approach that meets taxpayers where they are, whether that is online, in-person, on the phone, or another method provides more opportunities for taxpayers to receive information and would support the *right to be informed*. The IRS could adopt these methods and use emerging techniques such as artificial intelligence and pattern recognition technology to identify uncommon or complex topics.

Her Majesty's Revenue and Customs (HMRC), the United Kingdom's taxation authority, has dozens of dedicated phone lines, email addresses, and mail addresses available to taxpayers depending on topic.²⁰ HMRC also offers live chat for specific topics, including self-assessment and pay-as-you-earn income tax.²¹ Further, taxpayers can use Twitter to ask general questions to HMRC.²²

Taxpayers in Norway also have multiple ways to receive tax law assistance from The Norwegian Tax Administration. Taxpayers can call for assistance, but they can also chat live online from 9 a.m. to 3:30 p.m. on weekdays.²³ Taxpayers may also ask questions on the Administration's Facebook page with assistants standing by to answer, email, or book an appointment in-person.²⁴

Helping taxpayers get the right answer should be a focus of any tax administration. By getting the correct answer up front, taxpayers will be able to more easily comply correctly with their tax obligations and prevent rework on the part of the taxpayer or the IRS.

CONCLUSION

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. 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. The IRS can and should track what topics taxpayers seek assistance with that it does not currently answer and use that data to better inform and refine its strategy for answering tax law questions, particularly in light of the recent changes to the tax code, which impact all taxpayers.

20 Her Majesty's Revenue and Customs (HMRC), *Contact HM Revenue & Customs* <https://www.gov.uk/government/organisations/hm-revenue-customs/contact> (last visited Nov. 14, 2018).

21 HMRC, *Self Assessment: general enquiries* <https://www.gov.uk/government/organisations/hm-revenue-customs/contact/self-assessment> (last visited Nov. 14, 2018).

22 *Id.*

23 The Norwegian Tax administration, *Contact us* <https://www.skatteetaten.no/en/contact/> (last visited Nov. 14, 2018).

24 *Id.*

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Answer in-scope tax law questions year-round.
2. 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.
3. Track calls and contacts about out-of-scope topics and develop Interactive Tax Law Assistant (ITLA) scripts for frequently asked questions or consider declaring topics in-scope.
4. 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 utilizing artificial intelligence and pattern recognition.

Appendix A

Question 1: For tax year 2018, can I still use the "Simplified Method" for claiming the home office deduction?						
Date of Call	Start Time	End Time	Question Call Summary	Question Answer	Question Selection	Question Answer Comments
May 2018	10:14	10:40	Asked if self-employed or employee, did research, nothing that lists home office on his info, may be qualified business income deduction, transfer me to SE assistant, SE CSR said they have no specifics on this subject right now, provided irs.gov to link to Tax Reform, IRS has not implemented new guidance.	No Answer Given	CSR read me some information, but the information did not respond to question; #CSR's answer did not leave me with any sense how to proceed; #Although listed as in-scope, the CSR did not answer the question.; #Other	Told me there were some new changes for sole proprietorships but had no specifics of home office in her information and if it had changed under the tax reform. Provided Pub 535 for additional information on home office. (Note home office specific information is in Pub 587)
May 2018	17:08	17:16	Don't know if it had changed or not. We have not received any updated information about tax reform issues. Suggested I keep checking irs.gov for latest updates. Asked what Pub I would find home office information, they did not know, referred me to irs.gov and then search self-employment issues.	No	Although listed as in-scope, the CSR did not answer the question.; #CSR's answer did not leave me with any sense how to proceed; #Other	Did not try to find correct answer for question. Did not try to find publication number for home office deduction, kept referring me to irs.gov to check status for tax reform updates.
Sept. 2018	14:23	14:37	He attempted to research for me but said he could not locate any information on my question and that probably meant it did not change. Explained how to get to tax reform provisions on irs.gov, then business deductions/depreciation, should be in that section. Stated they do not have a lot of information on the new tax reform provisions. Expect to learn more when they go to training later in the year.	No Answer Given	CSR's answer did not leave me with any sense how to proceed; #Although listed as in-scope, the CSR did not answer the question.	Was sorry he could not help me.
Sept. 2018	14:44	14:52	First off initial assistant answering refused to repeat her ID number, told me she already gave it to me not going to give in again, then transfer me to next assistant. Next assistant told me he was not trained for home office deduction questions. Told me they don't have any live assistants on that topic this time of year. Told me to check the website, didn't give any additional information. Told me due to budgetary concerns and staffing shortfall IRS has no one can answer tax reform questions. Told me that I needed to seek paid assistance if I could not find answer on IRS website.	No Answer Given	CSR said question was not in-scope; #CSR's answer did not leave me with any sense how to proceed; #Although listed as in-scope, the CSR did not answer the question.	

Question 2: Has the additional standard deduction for the blind or elderly changed for tax year 2018?

Date of Call	Start Time	End Time	Question Call Summary	Question Answer	Question Selection	Question Answer Comments
May 2018	14:23	14:33	<p>First assistor stated she would need to transfer me to the correct area of Tax Reform that would be able to answer my question. She stated she would be placing me on hold for probably five to seven minutes. She came back on in a minute and said she was transferring me.</p> <p>The second assistor stated that all of the standard deductions have changed but let me look it up. The Form 1040ES has all of the information regarding standard deductions listed on the form. She stated that I would be able to view the information online on page 2 of the Form 1040ES. She stated for single, unmarried for the tax year of 2018, I would be entitled to an additional \$1,600 for each checkbox checked for over 65 and blind. If MFJ or MFS, I would be entitled to an additional \$1,300 for each checkbox checked.</p>	Yes	Other	CSR provided the correct information and advised me where I could locate the information online.
May 2018	14:34	14:41	<p>Ok so your question is in regard to Tax Reform Act. The best way for you to get the information is to review the Form 1040ES. Even though the Form 1040ES is for making estimated tax payments and you may not be required to make estimated tax payments, the form has information regarding standard deduction. He asked my filing status, I said single. He stated the standard deduction would be \$12,000 plus an additional \$1,600 for over 65 and an additional \$1,600 if blind for an additional total of \$3,200 if both over 65 and blind. He stated that the IRS will have additional information regarding the changes later this year.</p>	Yes	Other	He referred me to the Form 1040ES to review the information. He did state that even though I may not be required to make estimated payments that the Form 1040ES contains information regarding the standard deduction amounts for 2018.
Sept. 2018	12:41	12:52	<p>I need to review Congress overview that has recently been disseminated. We may also get information closer to filing season. Placed on hold while he reviewed for the information. The information from Congress does not have this information on it. Let me check the standard deduction. Asked my filing status, I stated single. He stated that the standard deduction was \$6,350 now being increased to \$12,000 no information is available for the blind and elderly at this time. He suggested I research irs.gov using 2018 standard deduction info when it got closer to filing season.</p>	No	CSR read me some information, but the information did not respond to question	
Sept. 2018	13:00	13:07	<p>The assistor tried to find the answer but came back on the line and stated that he needed to send my call to the Basic Tax Law line.</p>	No	Other	The assistor stated he did not have the information that he needed to send me to the Basic Tax Law line. A message came on the line and stated that the line was only answered during the filing season. If calling after filing season, advised to access irs.gov for additional information.

Question 3: Has the taxation of social security changed for tax year 2018?

Date of Call	Start Time	End Time	Question Call Summary	Question Answer	Question Selection	Question Answer Comments
May 2018	09:14	09:20	No answer given	No Answer Given	Other	"There is no Tax Law personnel at this time due to budgetary cuts. This tax topic cannot be answered at this time. The employees that will be able to answer this question will be available beginning January 2, 2019 through April 15, 2019."
May 2018	09:22	09:42		No Answer Given	Other	Both CSR's stated that they did not know the answer and would transfer to someone that can answer tax law questions. I was on hold for 20 minutes and then disconnected.
Sept. 2018	09:05	09:17	"There is no Tax Law personnel at this time due to budgetary cuts. This tax topic cannot be answered at this time. The employees that will be able to answer this question will be available beginning January 2, 2019 through April 15, 2019."	No	CSR's answer did not leave me with any sense how to proceed	"There is no Tax Law personnel at this time due to budgetary cuts. This tax topic cannot be answered at this time. The employees that will be able to answer this question will be available beginning January 2, 2019 through April 15, 2019."
Sept. 2018	10:15	10:41	Stated they do not have a lot of information on the new tax reform. "There is no Tax Law personnel at this time due to budgetary cuts. This tax topic cannot be answered at this time. The employees that will be able to answer this question will be available beginning January 2, 2019 through April 15, 2019."	No	CSR's answer did not leave me with any sense how to proceed; #Other	Stated they do not have a lot of information on the new tax reform. "There is no Tax Law personnel at this time due to budgetary cuts. This tax topic cannot be answered at this time. The employees that will be able to answer this question will be available beginning January 2, 2019 through April 15, 2019."

Question 4: I heard there are new limits on how much I can deduct for state and local income and property taxes in tax year 2018. Is that right? If so, what is the limit?

Question 4b: I heard that New York recently passed a law to set up charitable funds. Donors can make the contributions to these charitable funds instead of paying local taxes. They also get a state income tax credit for a portion of the prior year contribution. If I make a contribution to these funds, can I claim a charitable deduction on my federal return (in 2018)?

Date of Call	Start Time	End Time	Question Call Summary	Question Answer	Question Selection	Question Answer Comments
May 2018	16:55	17:01	CSR apologized, stated they currently do not have reps handling tax law questions. Those reps were laid off due to budget issues. Tax law reps are only available from January 2nd to April 15th. CSR stated I could call back next year around January 2 and April 15th for assistance. CSR also suggested irs.gov site and offered to transfer me to automated tax topic line for information about my related tax topic. I agreed to listening to the Tax Topic automated line response. I was directed to the IRS site.	No Answer Given	Other	CSR did not answer my question and stated tax law questions are only handled between January 2nd and April 15th. Per CSR I can go to the IRS website for immediate assistance or I can call back between January 2 and April 15, 2019.
May 2018	08:16	08:20	As soon as I asked my question, the CSR advised me she was transferring to an area where I could type my question. I was transferred to the Tax Topic line where I received an automated response indicating questions are only answered during tax filing season and call got disconnected.	No Answer Given	Other	

Date of Call	Question 4b Summary	Question 4b Comment
May 2018	N/A	N/A
May 2018	N/A	No Answer Given

Question 5: I have a child who lives in Canada. Can I claim a dependency exemption for my child on a 2018 tax return?

Question 5b: Can I claim the child tax credit or additional child tax credit (CTC/ACTC) for my child this year (Tax Year 2018)?

Question 5c: Can I claim a tax credit for my child as a qualifying relative?

Date of Call	Start Time	End Time	Question Call Summary	Question Answer	Question Selection	Question Answer Comments
May 2018	16:55	17:01	CRS insisted she was not allowed to answer my question.	No Answer Given	Other; #CSR said question was not in-scope	CSR refused to answer my questions because she was "only allowed to answer those types of questions during the filing season." I tried to see if she maybe knew whether the dependency exemption had changed for next year and she said she was not sure about the requirements and pointed me to the website. She was very nice and apologized for the frustration of not being able to ask a person my question. When I asked her if the information about the changes as a result of the new tax law were on the website, she checked the website and said yes, it did explain what the differences were for 2018.
May 2018	08:16	08:20	The assistor said she couldn't answer my question because it was out of scope, there were budget cuts, and it could only be answered during the filing season. She referred me to the ITA. I asked if the ITA was updated to reflect the tax reform law because I wanted to make sure the tax reform law didn't change whether I could claim a dependent. She said she didn't know, it may not be updated, and I may want to get help from a private practitioner. I asked her if there was someone I could talk to ask if the tax reform law changed the dependency exemption. She was very rude and told me it was out of scope. She practically hung up on me as I thanked her and said goodbye.	No	CSR said question was not in-scope	

Date of Call	Question 5b Summary	Question 5b Answer	Question 5b Comments	Question 5c Summary	Question 5c Answer	Question 5c Comments
May 2018	She had the same response—she was not allowed to answer that kind of question and was not sure about the requirements for the credit. She advised to check the website.	No Answer Given		I didn't ask the third question since it was clear the answer would be the same as the first two and I didn't want to bully the CSR at this point.	No Answer Given	
May 2018	I couldn't ask this because she wouldn't answer my first question.	No	Assistor said she couldn't answer personal tax questions		No	Same as prior questions

Question 6: I Live in Virginia and have a child who lives in Mexico. Can I claim a dependency exemption for my child on my 2018 tax return?

Question 6b: Can I claim the CTC/ACTC for my child on my 2018 tax return?

Question 6c: Can I claim a credit for my child as a qualifying relative?

Date of Call	Start Time	End Time	Question Call Summary	Question Answer	Question Selection	Question Answer Comments
May 2018	14:24	14:40	CSR first mentioned looking to irs.gov for guidance and after referencing his "job aid," he stated that changes to the tax law included elimination of the personal and dependency exemptions.	Yes	CSR read me some information, but missed key issues that should have been raised	The CSR stated incorrectly that the new laws regarding the specific provisions of child tax credit and dependent credit had not yet been determined but would be contained in upcoming IRS publication later this year.
May 2018	15:16	15:20	N/A			
Oct. 2018	09:41	09:45	Assistor told me questions about dependents can only be answered by an assistor during the filing season. Assistor transferred me to an automated message that instructed me to visit irs.gov for answers.	No Answer Given	CSR said question was not in-scope	

Date of Call	Question 6b Summary	Question 6b Answer	Question 6b Comments	Question 6c Summary	Question 6c Answer	Question 6c Comments
May 2018	The CSR indicated that under the new tax law, the CTC was still available. I asked him if it was available to me, and he was unable to tell me at all. He said the specific rules had not yet been issued. I said: "I pay all the support for my 10-year-old son, but he doesn't live with me." CSR told me he was totally reliant on his job aid and read me a couple sentences indicating the credit would be available, but he didn't know any of the requirements to claim the credit and told me to check the IRS website later in the year for upcoming new publications.	No		After about 8 minutes of talking, the CSR was clearly trying to end the call, but I asked him to repeat the last thing he had read about the \$500 dependency exemption because I think that might apply to me. He reread from the job aid but was unable to tell me if the credit was available to me. He said the specific provisions had not yet been released and would be released in and IRS publication later in the year.	No	
Oct. 2018		No Answer Given			No Answer Given	

Question 7: I understand there is a new 20% deduction for pass-through entities. Can I claim the new 20% pass-through deduction on income from my law practice in 2018?

Date of Call	Start Time	End Time	Question Call Summary	Question Answer	Question Selection	Question Answer Comments
May 2018	10:14	10:40	The CSR read me a short script about the new deduction and then told me to go to IRS.gov and search for tax reform. She read the script very quickly, so I had a hard time absorbing the information. The script said sole proprietors can deduct qualified business income. Said, what is qualified business income, but she said she could not answer that question because she didn't have any guidance. I asked if the new deduction applied to lawyers and she said to check the website.	Partially	CSR read me some information, but the information did not respond to question	The CSR did not tailor her the response to the facts or ask about key facts that could change the answer. She said she did not know that lawyers are not permitted to take the 20% deduction for self-employed and pass-through entities if their income exceeds a threshold. She was unwilling to address whether any limits applied to the deduction.
May 2018	17:08	17:16	N/A	No Answer Given	Other	I reached the CSR and asked my question. He said he would transfer me to a department that could answer it. I tried to ask what department he was transferring me to, but he didn't answer. He transferred me to a recording that said the question would no longer be answered by an IRS representative and said I could find my answer on IRS.gov.
May 2018	14:23	14:37	The CSR, who was the tax law specialist, read me a paragraph that she found on IRS.gov, but it did not answer my question. She just confirmed that a 20% deduction existed for qualified business income and that it applied to sole proprietors. She could not tell me how to compute qualified business income or whether the deduction applied to lawyers. She spent a few minutes telling me how to navigate IRS.gov. She said they had until Dec. 31 to provide guidance and that I should check the website. She also said I could check the instructions to the 1040ES worksheet or Publication 525.	No	CSR read me some information, but the information did not respond to question	I reached a CSR before reaching the CSR, who was the tax law specialist, and I had to repeat my question twice to the first CSR because she didn't understand at first. Then she said she had to transfer me to the tax law department where I had to repeat the question a third time.
Sept. 2018	14:44	14:52	The CSR answered. I asked my question. She transferred me to an expert in the tax law area. The transfer was picked up quickly. I repeated my question to the second CSR and she said she was not aware of any 20% deduction for pass-through entities. She asked if my business was a corporation. I said no. It is a passthrough entity. Then she put me on hold and transferred me to another CSR who answered. I repeated my question a third time. She asked if I had checked the web. I said I hadn't found the answer on the web. She said the question was out of scope. I asked what I should do. She said to check the web.	Don't Know	CSR said question was not in-scope	

Question 8: I need to compute my estimated tax payments (due April 15, June 15, September 15 and January 15) I heard that passthrough entities can deduct 20% of their income. Assuming I can claim the new 20% deduction, do I deduct 20% from my income before I calculate my self-employment tax or after?

Date of Call	Start Time	End Time	Question Call Summary	Question Answer	Question Selection	Question Answer Comments
May 2018	13:29	13:52	After my call was first answered, I was informed my call had to be transferred to an individual in the business section. I was then placed on hold and received an automated message that my call would be answered in 15-30 minutes. My call was then answered at 13:49 a CSR, after an 18-minute hold time at which time I asked my question, after I asked my question, the CSR informed me that my question was a tax law question and that there are certain areas that the we [IRS] can't answer and then directed me to irs.gov and to research the issue through the Q&A. He informed me to input key words to refine my search and if I wasn't able to find the answer I was looking for, then I may need to consult with a tax practitioner. He then continued to explain that they [IRS] used to answer tax law questions but now they are directing taxpayers to the website and other online information such as publications to get answers to tax questions. He apologized for any inconvenience and the call ended. Total time on the call was 23 mins. . 35 sec.	No Answer Given	Although listed as in-scope, the CSR did not answer the question.	Assistor directed me to irs.gov specifically the Q&As on the topic using a key word search and if that didn't answer my question, to consult a tax practitioner.
May 2018	09:00	09:02	No response was given. Automated message directing me to IRS.gov. See comments	No Answer Given		Called business line at 800-829-4933 and followed the prompts to SE tax questions. After 2 minutes of following the prompts, I received an automated message that this type of question is only answered during filing season and for questions after filing season, to go to irs.gov for more information. Afterwards, the call automatically ended. This was the first time I had heard this type of automated message.
Oct. 2018	16:09	16:12	The CSR mentioned that her system was down and was unable to pull up any specific account info but may be able to assist me if my question was general in nature. I posed the scenario in Q8 and was informed that she would have to look up my individual account in order to answer that question and since her system was down, she was not able to assist me and to call back later.	No Answer Given	Although listed as in-scope, the CSR did not answer the question.	
Oct. 2018	16:18	16:58	Called and spoke to a CSR who mentioned she only dealt with payroll issues (F940/941s) and transferred me to Tax Law line. Waited on hold until 16:55 and spoke to another CSR who mentioned that the IRS is not currently answering tax law questions due to budget cuts but referred me to the Interactive Tax Assistant (ITA) online and walked me through the process to get my question answered. She also mentioned IRS Pubs 505 and 334. She apologized she could not offer further assistance. I thanked her and mentioned I would try the ITA.	Partially	Other	

Question 9: I am married but considering filing using the married filing separate status. What are the key differences?
Question 9b: Both my spouse and I own stocks separately. We might have losses on these stocks. Does filing separately make a difference in the treatment of these losses?
Question 9c: We both receive social security benefits, does filing separately affect the tax treatment of those benefits?
Question 9d: If I file jointly with my spouse, and he doesn't tell me or the IRS about all of his income, could I be liable?
Question 9e: Can I claim the Earned Income Tax Credit (EITC) if I file separately from my spouse?
Question 9f: Can I itemize if I file separately from my spouse and she takes the standard deduction?
Question 9g: If my spouse itemizes, can I take the standard deduction?

Date of Call	Start Time	End Time	Question Call Summary	Question Answer	Question Selection	Question Answer Comments
May 2018	23:10	23:13		No Answer Given		I was transferred automatically to a recording because my question was about filing status and the recording indicated that these questions would only be answered during filing season and rattled off a list of online self-help options.
May 2018	15:19	15:26	I was transferred again to the same recording that said this question can only be answered during the filing season.	No Answer Given		
Oct. 2018	08:47	08:58	Rep gave me the basic key differences of filing married vs married filing separate. Rep also advised me 1040A, 1040EZ etc. will no longer be available. Schedules will be available and referred me to irs.gov to view form and schedule if needed (draft view). Rep suggested assistance of tax preparer if not able to follow instructions.	Yes		
Sept. 2018	15:47	15:51	N/A - I got a recording	No Answer Given		

Date of Call	Question 9b Summary	Question 9b Answer	Question 9b Comments	Question 9c Summary	Question 9c Answer	Question 9c Comments	Question 9d Summary	Question 9d Answer
Oct. 2018	Provided limits of FS2 vs FS3	Yes	Rep referred me to irs.gov for additional info.	No % provided, refer me to irs.gov and worksheets for computation.	Partially	Rep referred me to irs.gov for additional info.	Rep did not go in details but referred me to irs.gov site	Partially

Date of Call	Question 9d Comments	Question 9e Summary	Question 9e Answer	Question 9e Comments	Question 9f Summary	Question 9f Answer	Question 9f Comments
Oct. 2018	No mention of Innocent Spouse	No EIC if FS3	Yes	Rep referred me to irs.gov for additional info.	For FS3 both need to itemize (if applicable or take the standard deduction.	Yes	Rep referred me to irs.gov for additional info.

Question 10: We are a military family. We will be moving to our next duty station soon. In order to deduct our unreimbursed moving expenses, what distance and time tests apply to our move?

Question 10b: Where on Form 1040 will we need to take the moving expense deduction?

Date of Call	Start Time	End Time	Question Call Summary	Question Answer	Question Selection	Question Answer Comments
May 2018	14:54	1525	Initiated phone call at 14:54. The first time I called, I was ultimately transferred to a recording where I was directed to online resources before the call ended. The second time I called, I correctly selected prompts for a tax reform question 5 times. I reached an IRS rep. I asked my question, and she transferred me to "Special Service" to assist with a military tax question. The next person picked up at 15:07 hours. She responded that she had not been trained on my topic and told me to go on IRS.gov and search ITA for an answer.	Yes	Other	I responded that it was a tax reform question. She became frustrated with me and asked whether I now had a different question. She explained that the only questions they are answering under the tax reform line is about disaster related issues. At 15:15, she put me on hold and then I was transferred to another CSR. He was very nice, and although he had to put me on hold once while he looked for an answer, he returned and read general information about my topic. The information he read contained the answer to my question. The call ended at 15:25 hours.
Sept. 2018	14:16	14:32		No	CSR read me some information, but the information did not respond to question	A CSR answered call and transferred to a special military unit. Another CSR answered the phone. I asked the first question. She responded, "That's a tax law question and there is nobody here at this time that can answer that question. However, it falls under Tax Reform, so I'd like to read a blurb to you." Two minutes later, she came back and read a blurb about Qualified Moving Expenses, and an exception for active duty service members. However, the blurb still did not answer what time and distance tests apply. When I asked my question again, she responded, "The IRS has no information on this at this time. They will provide information as it becomes available."

Date of Call	Question 10b Summary	Question 10b Answer	Question 10b Comments
May 2018	I asked the second CSR my question, to which he replied that I would report the deduction on the front page, similar to how it's been done in the past, towards the bottom of the Form 1040.	Yes	As opposed to the first IRS rep with whom I spoke, the second CSR was very cordial. He ended the phone call with, "Thank you. Have a great day and thank you for your service."
	I very clearly asked the second part of my question—where on the Form 1040 do I report the moving expense deduction? The CSR immediately became irritated and said, "I told you already that we have no additional information to give you! If you have other questions on technicalities, you'll have to call back on January 2nd to ask them." I politely and calmly explained that this was a different question than the first question and that I just needed to know where to report this moving expense deduction on the Form 1040. "She was very aggravated and responded, "I have nothing to add. You'll have to call back in January. Good-bye!" And she promptly hung up on me. No kidding.	No	

Question 11: I heard the new tax law got rid of the penalty for not having health insurance. Does that mean that if I don't have health insurance this year (2018), I won't have to pay the penalty?

Date of Call	Start Time	End Time	Question Call Summary	Question Answer	Question Selection	Question Answer Comments
May 2018	11:57	12:12	The CSR was very polite. She clarified which tax year I was asking about and put me on hold for two mins. She came back and read a statement saying shared responsibility payment eliminated after 2018. I asked for clarification that it is still in place in 2018 and she agreed.	Yes		Assistor read the statement which used the official term (ISRP) requiring me to seek clarification, but she was polite and answered accurately.
Oct. 2018	16:28	16:33	If I selected health care law rather than new tax law option, it directs you to automated answer system. The answer was technically correct—you have to pay the ISRP but it assumes the listener is sophisticated and has basic knowledge of the ISRP.	Yes		If you select health care law option in phone tree, it directs you to the automated answer line.
Oct. 2018	16:38	17:07	Once I reached the CSR in individual accounts (after being transferred and waiting 25 minutes), she knew off the top of her head that I would still need to pay the ISRP when I filed my TY 2018 return	Yes		The CSR knew the correct answer off the top of her head.
Oct. 2018	08:03	08:47	The penalty of \$695 applies for TY 2018 but \$0 will be charged after.	Yes		Rep referred to irs.gov for additional information.

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**

RESPONSIBLE OFFICIAL

William M. Paul, Acting Chief Counsel

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The IRS Office of Chief Counsel (OCC) provides advice to headquarters employees, which is called Program Manager Technical Advice (PMTA). PMTA must be disclosed to the public pursuant to a settlement with Tax Analysts.² Moreover, taxpayers need prompt guidance now more than ever, due to the recently enacted Tax Cuts and Jobs Act (TCJA).³ Thus, the National Taxpayer Advocate is concerned that the OCC:

- (1) Has been disclosing fewer PMTAs (as shown on Figure 1.2.1);
- (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.

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 *Tax Analysts v. IRS*, Stipulation of Decision, CA No. 1:96-2285-CKK (July 23, 2007).

3 Pub. L. No. 115-97, 131 Stat. 2054 (Dec. 22, 2017). We are referencing the short title of the bill, H.R. 1, rather than the law.

ANALYSIS OF PROBLEM

Background

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*).⁴

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.”⁵ Consistent with this view, the OCC has sometimes adopted strained legal interpretations to avoid transparency. For example, in addition to PMTA, the IRS is required to disclose certain advice issued to employees in field offices under IRC § 6110 (called Chief Counsel Advice (CCA)).⁶ In 2004, the OCC declined to disclose CCA rendered in less than two hours (generally emails).⁷ A court found there was no legal basis for this “two-hour rule.”⁸

IRC § 6110 does not apply to the advice the OCC provides to headquarters employees, such as PMTA issued to program managers, but such advice may still have to be disclosed under the Freedom of Information Act (FOIA).⁹ In 2006, to investigate the IRS's compliance with the disclosure rules, TAS requested a sample of nonpublic legal memos. The OCC initially refused to provide any memos to TAS, citing pending litigation with Tax Analysts in which it had argued the memos could be withheld under the “deliberative process” privilege. It received considerable criticism for its refusal, and ultimately gave TAS the memos.¹⁰ Tax Analysts subsequently reopened its stalled litigation.¹¹

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- 4 For prior discussions of transparency, see, e.g., National Taxpayer Advocate Fiscal Year 2019 Objectives Report to Congress 43-50 (Area of Focus: *The Offshore Voluntary Disclosure (OVD) Programs Still Lack Focus Transparency, Violating the Right to Be Informed*); National Taxpayer Advocate 2011 Annual Report to Congress 380-403 (Most Serious Problem: *The IRS's Failure to Consistently Vet and Disclose its Procedures Harms Taxpayers, Deprives It of Valuable Comments, and Violates the Law*); National Taxpayer Advocate 2010 Annual Report to Congress 71-84 (Most Serious Problem: *IRS Policy Implementation Through Systems Programming Lacks Transparency and Precludes Adequate Review*); National Taxpayer Advocate 2007 Annual Report to Congress 124-139 (Most Serious Problem: *Transparency of the Office of Professional Responsibility*); National Taxpayer Advocate Fiscal Year 2008 Objectives Report to Congress xxi-xxvii (Area of Emphasis: *Update on Transparency of the IRS*); National Taxpayer Advocate 2006 Annual Report to Congress 10-30 (Most Serious Problem: *Transparency of the IRS*).
- 5 Office of Chief Counsel (OCC) response to TAS information request (Sept. 11, 2018) (hereinafter, “OCC response,” reprinted in the Appendix).
- 6 See also Treas. Reg. § 301.6110-1 et seq. IRC § 6110 was expanded by the IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3509, 112 Stat. 685 (1998) to ensure “all taxpayers can be assured of access to the ‘considered view of the Chief Counsel’s national office on significant tax issues.’” Joint Committee on Taxation (JCT), JCS-6-98, General Explanation of Tax Legislation Enacted in 1998, 120 (Nov. 24, 1998) (quoting *Tax Analysts v. IRS*, 117 F.3d 607, 617 (D.C. Cir. 1997)).
- 7 Chief Counsel Notice 2004-012 (Feb. 19, 2004).
- 8 See *Tax Analysts v. IRS*, 495 F.3d 676 (D.C. Cir. 2007), *aff'g* 416 F. Supp. 2d 119 (D.D.C. 2006). See, e.g., Sheryl Stratton, *Court Rejects Two-Hour Rule for Withholding Chief Counsel Advice*, 110 TAX NOTES 1015 (Mar. 6, 2006); Jeremiah Coder, *Something for Everyone in Initial Batch of Two-Hour Rule Advice* 119 TAX NOTES 30 (Apr. 7, 2008).
- 9 5 U.S.C. § 552 et. seq.
- 10 National Taxpayer Advocate Fiscal Year 2007 Objectives Report to Congress xxi-xxvii; Allen Kenney, *Uncooperative Counsel Irks Olson, Confuses Crowd*, 114 TAX NOTES 278 (Jan. 22, 2007) (reporting that former Senator Bob Kerrey recommended that former IRS Commissioner Everson “intercede” on the advocate’s behalf and that Congress “back the advocate up for fear that Olson’s position would lose its ‘teeth.’”).
- 11 See Sheryl Stratton and Lisa M. Nadal, *ABA Tax Section Meeting: Olson Discusses Chief Counsel’s Undisclosed Legal Advice*, 114 TAX NOTES 401 (Jan. 29, 2007).

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*).

The IRS settled with Tax Analysts in July 2007, agreeing to disclose PMTA dated or prepared after 1994 “on the basis of the standards announced by” the U.S. Court of Appeals for the District of Columbia Circuit in its June 14, 2002 opinion in *Tax Analysts v. IRS*, “as applied by the district court” in its February 7, 2007 opinion.¹²

These cases generally permit the OCC to withhold deliberative and pre-decisional communications, but not OCC’s final legal positions. The Circuit Court explained “[i]t is not necessary that the TAS [advice] reflect the final *programmatic* decisions of the program officers who request them. It is enough that they represent OCC’s final *legal* position....”¹³ Only legal conclusions issued to other attorneys within the OCC or to the Commissioner of Internal Revenue (*i.e.*, the Chief Counsel’s supervisor under IRC § 7803(b)(3)(A)) could be withheld.

Advice to other decision makers with words like “we suggest” could be withheld as pre-decisional, whereas those indicating “we conclude” generally could not.¹⁴ Documents with both deliberative and non-deliberative material were released with redactions so that the OCC’s final legal positions and underlying analyses could be disclosed.¹⁵ Notably, neither court decision authorized the OCC to withhold advice simply because it contained the analysis underlying the OCC’s final legal conclusions, even if those conclusions would be released in another form.

The OCC Is Disclosing Fewer PMTAs

Although one might expect the TCJA to increase the need for PMTA, the number posted on IRS.gov is substantially below its historical average, as shown in Figure 1.2.1.

¹² *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002), *remanded*, 483 F. Supp. 2d 8 (D.D.C. 2007).

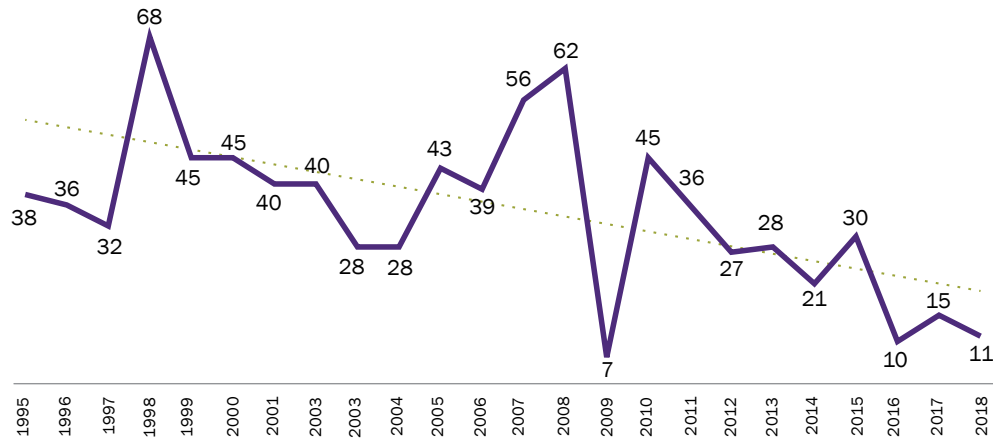
¹³ *Tax Analysts v. IRS*, 294 F.3d at 81.

¹⁴ *Id.*

¹⁵ See *Tax Analysts v. IRS*, 294 F.3d at 75 (citing *Tax Analysts v. IRS*, 97 F. Supp. 2d 13, 17-18 (D.C. Cir. 2000) (approving the practice of redacting only the “portions of LMs that reflect the opinions and analysis of the author and did not ultimately form the basis of the final revenue ruling.”).

FIGURE 1.2.1¹⁶

**Program Manager Technical Advice Posted Items on IRS.gov
by Calendar Year of Issuance**



Following tax legislation enacted in 1998, the IRS issued 68 PMTAs, but there has been no similar uptick in PMTAs following the TCJA. As of this writing, only 11 PMTAs were issued and released in 2018 (*i.e.*, PMTA 2018-11 to -20), and only one of these related to the TCJA (*i.e.*, PMTA 2018-16, as discussed below).¹⁷ Moreover, the OCC has suggested that it was not even required to release the TCJA-related PMTA.¹⁸

The OCC Does Not Disclose Email as PMTAs

PMTAs may be declining because, according to the OCC, it is not required to disclose advice as PMTA unless it is in “*memorandum form*.”¹⁹ In other words, any OCC attorney can avoid disclosing PMTA by copying the memo’s analysis into an email.

The OCC says that it “does not encourage its attorneys to provide legal advice in a manner that circumvents” the disclosure rules.²⁰ Most attorneys, however, are not going to want to disclose their advice lest the public spot an error. The OCC has historically opposed transparency (as illustrated by the Tax Analysts litigation), and this “form over substance” loophole gives OCC attorneys an easy way to avoid disclosure. Unlike the two-hour rule, which was based on the reasonable assumption that quick

¹⁶ TAS analysis of Program Manager Technical Advice (PMTA) posted on IRS.gov. The number of a PMTA reflects the date it was released, rather than the date it was issued. For example, ten PMTAs have numbers beginning with “2017-”, suggesting that they were *released* in 2017, but 15 were *issued* in 2017, as shown on the chart. Nine of the PMTA issued in 2017 have numbers beginning with “2018-”, suggesting they were not released until 2018. The figures in the chart reflect the number issued each year, provided they were later released. For a few PMTAs that did not have an issue date, TAS either omitted them or estimated the year they were issued based when the casefile was closed and the date of memos the OCC posted before and after them. Some PMTAs that were issued in 2018 may not have been released.

¹⁷ See IRS, *Legal Advice Issued to Program Managers*, <https://www.irs.gov/privacy-disclosure/legal-advice-issued-to-program-managers> (last updated Nov. 16, 2018).

¹⁸ OCC response to TAS information request (Sept. 11, 2018) (reprinted in the Appendix) (Q12: “Does the Tax Analysts settlement require the OCC to release the memo underlying the IRS’s position in section 965 FAQ 14?” A12: “The Office of Chief Counsel published this memorandum at the request of the Division Commissioner, LBI.”).

¹⁹ OCC response (A5). Emails have been released as PMTA, which suggests the OCC has changed its position. See, e.g., PMTA 2008-01567 (Sept. 28, 2007); PMTA 2007-01190 (Aug. 14, 2007); PMTA 2007-01186 (June 11, 2007).

²⁰ OCC response (A21).

Following tax legislation enacted in 1998, the IRS issued 68 Program Manager Technical Advice (PMTAs), but there has been no similar uptick in PMTAs following the Tax Cuts and Job Act.

responses are not as well thought out as those that take longer, this email loophole has no basis in law. Nor is it a rational policy. The form of the advice has no bearing on how much thought went into the analysis or how it will be used.

The OCC Has Not Provided Its Attorneys With Written Guidance Describing What Must Be Disclosed as PMTA, and Its Oral Guidance Is Inadequate

OCC: TRANSPARENCY IS NOT OUR JOB, WE AVOID WRITING THINGS DOWN, AND THAT'S NOT A PROBLEM

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.”²¹ Consistent with this view, the OCC has no written training materials to explain what needs to be disclosed as PMTA,²² and the Chief Counsel Directives Manual (CCDM) provides no specific guidance on how its attorneys should determine whether advice to program managers needs to be disclosed.²³

ORAL EXPLANATION AND TRAINING: CLEAR AS MUD?

OCC attorneys orally explained to TAS that if advice is not adopted by the IRS, then it does not need to be disclosed, and if it is adopted and incorporated into another document, it also does not need to be disclosed.²⁴ Because positions the IRS adopts are incorporated into public documents, this logic seems to suggest the OCC does not believe *any* PMTA must be disclosed. The OCC attorneys also said advice to some headquarters employees, including the National Taxpayer Advocate, does not need to be disclosed because the employees are not program managers.²⁵ They did not identify any category of advice that would have to be disclosed as PMTA.

The OCC says it has provided oral training to about 207 attorneys since 2015 (*i.e.*, less than 40 percent of those employed in Washington DC).²⁶ However, the attorneys were not given written materials, and there is no way to know if their oral training was any more illuminating than these statements.

21 OCC response (preamble).

22 OCC response (A24) (no written training).

23 OCC response (A22 and A23).

24 TAS meeting with OCC concerning disclosure issues (July 9, 2018).

25 TAS received conflicting information in subsequent meetings with OCC management, but the OCC declined to clarify its position in its formal response, which referred to this meeting. See OCC response (A6). As noted below, the OCC has often provided advice to the National Taxpayer Advocate that was disclosed as PMTA.

26 OCC response (A24). There were an average of about 566 OCC attorneys in Washington, DC during this period. IRS Human Resources Reporting Center, *POD and Building Reports, Counts by State, City and Building* (Nov. 2, 2018) (showing 580, 558, 538, and 587 at the end of FYs 2015-2018, respectively).

OCC: WE WON'T VERIFY OUR ORAL EXPLANATION, EXCEPT FOR THE HUGE LOOPHOLE

The OCC declined to verify its oral explanation of the PMTA rules in writing. In its formal response (reprinted in the Appendix), the OCC described what must be disclosed as “advice [that] is in *memorandum form* and otherwise meets the standards announced by the circuit court in *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002), and as applied by the district court in *Tax Analysts v. IRS*, 483 F. Supp. 2d 8 (D.D.C. 2007).” [Emphasis added.]²⁷ It described what can be withheld as anything that “is properly determined to be privileged under the standard described” by the circuit court’s decision.²⁸ The only specific item that this written response verified was that the OCC can avoid disclosure by issuing the advice as an email, rather than in “memorandum form.”²⁹

The OCC Has No Systems to Ensure All PMTA Are Timely Identified, Processed as PMTA, and Disclosed

The OCC’s written response also revealed that it has no system to determine whether the attorneys who issue PMTAs have provided them to the function responsible for making disclosure determinations (*e.g.*, OCC attorneys assigned to Procedure & Administration (P&A)).³⁰ Further, the OCC has no guidelines for how quickly PMTA must be sent to this function and posted, saying only that they are generally processed quarterly.³¹ As a result, PMTAs may be posted long after the IRS has implemented the advice—and long after it could benefit taxpayers and their representatives (*e.g.*, by avoiding positions that would incur penalties or ensnare them in audits or litigation). Moreover, the lack of any timeliness goals makes it difficult to determine whether a particular PMTA was withheld or whether its disclosure was merely delayed.

OCC Seems to Release PMTAs Because the Program Managers Want It To, Rather Than Because of the Settlement

Although the settlement seems to require the OCC to release some PMTAs that the program manager would probably not want to release, it is not clear that the IRS has released any such documents in recent years. Moreover, the effort that TAS has expended in trying get a few memos released—memos that the National Taxpayer Advocate believes should have been released under the settlement without any advocacy by TAS—confirms what OCC’s oral explanation and written response suggest—that OCC believes almost nothing needs to be disclosed as PMTA under the settlement. In these recent cases, the OCC agreed to release advice only upon request of the program manager (*e.g.*, by asking that the advice be issued as a memo, rather than as an email). The proposition that advice is released only when an agency affirmatively wants to release it makes a mockery of the Tax Analysts settlement and the FOIA.

EXAMPLE 1: “CALLS” NEEDED TO COMPLY WITH THE TAX CUTS AND JOBS ACT

Following enactment of the TCJA, IRS program managers and other headquarters employees asked the OCC to make “calls” about what the new law required so that they could update hundreds of tax forms, instructions, and publications, and issue “soft guidance,” such as FAQs and Fact Sheets.³² It would have been helpful for the public—including tax advisors and companies that write tax software—to see OCC’s final legal calls, which were made long before they were incorporated into items that would be

27 OCC response (A5).

28 OCC response (A6, A13, A14).

29 OCC response (A5).

30 OCC response (A27).

31 OCC response (A28).

32 IRS, *Tax Reform Implementation Office (Q&As), Frequently Asked Questions: Implementing the New Tax Law* (Feb. 8, 2018).

released to the public. Even when the OCC's conclusions were incorporated into other guidance, the reasons for the conclusions generally remained undisclosed. TAS urged the IRS and the OCC to post more of the OCC's legal calls as PMTA, but they declined.³³

The District Court in *Tax Analysts* said that “[e]ven if the document is pre-decisional at the time it is prepared, it can lose that status if it is adopted, formally or informally, as the agency position on an issue or is used by the agency in its dealings with the public.”³⁴ This raises questions about why the OCC seemed to believe it could withhold the OCC's calls once they were adopted or incorporated into other documents, such as instructions, publications, and FAQs, particularly if the calls explained why the agency adopted the positions and the documents the IRS disclosed did not.

Along the same lines, the Circuit Court in *Tax Analysts* allowed the IRS to redact *only* the portions of Legal Memoranda (LM) (the successor to General Counsel Memoranda) that reflected the opinions and analysis of the author and that did not ultimately form the basis for the final revenue ruling.³⁵ There was no suggestion in the *Tax Analysts* decisions that the IRS could publish conclusions and withhold the underlying analysis in its entirety.

EXAMPLE 2: ADVICE CONCERNING POST-PROCESSING MATH ERROR ADJUSTMENTS

In early 2018, TAS asked the OCC about the legality of plans by the Wage & Investment Division (W&I) to use math error authority (MEA) to disallow tax credits long after the IRS had processed the returns (*i.e.*, post-processing) and issued refunds.³⁶ The OCC responded by issuing a memo on April 10, 2018, approving the practice. The OCC released the memo during the week of September 10, 2018, only because “[t]here was an agreement between the W&I Commissioner and the National Taxpayer Advocate to release this memorandum,” and not because of the settlement.³⁷ It is unclear why the OCC thought it needed *IRS permission to release* this memorandum as opposed to being *required to disclose* it under the settlement. Moreover, it is unclear why its release was delayed for five months.

EXAMPLE 3: ADVICE CONCERNING THE TRANSITION TAX UNDER IRC § 965³⁸

The TCJA imposed a new transition tax under IRC § 965, which had to be reported on 2017 returns but that could be paid over an eight-year period without interest under IRC § 965(h). The IRS issued an FAQ in March 2018 that directed taxpayers to separately designate estimated tax payments to cover

33 In separate internal meetings, employees from the Tax Reform Implementation Office (TRIO) and the OCC discussed a legend that would be affixed to any advice OCC provided to the TRIO so that the advice would not have to be disclosed, but the OCC denied it was using any such legend in its formal response to TAS. See OCC response (A28).

34 *Tax Analysts v. IRS*, 483 F. Supp. 2d at 13.

35 *Tax Analysts v. IRS*, 294 F.3d at 75.

36 National Taxpayer Advocate Fiscal Year 2019 Objectives Report to Congress 114-118 (Area of Focus: *The IRS Has Expanded Its Math Error Authority, Reducing Due Process for Vulnerable Taxpayers, Without Legislation and Without Seeking Public Comments*).

37 See OCC response (responding to question 11, “Does the Tax Analysts settlement require the OCC to release as PMTA the memo about post-processing math error, which was issued to the W&I Commissioner and the NTA on April 10, 2018? If the answer is no, please explain.”); Christine Speidel, *Retroactive Math Error Notices May Be on the Horizon*, PROCEDURALLY TAXING BLOG (Sept. 13, 2018), <http://procedurallytaxing.com/retroactive-math-error-notices-may-be-on-the-horizon/> (noting PMTA 2018-17 was released “earlier this week”).

38 For a more detailed discussion of this issue, see National Taxpayer Advocate, *IRS Administration of the Section 965 Transition Tax Contravenes Congressional Intent and Imposes Unintended Burden on Taxpayers*, NTA BLOG (Aug. 16, 2018), [https://taxpayeradvocate.irs.gov/news/nta-blog-irs-administration-of-the-section-965-transition-tax-contravenes-congressional-intent-and-imposes-unintended-burden-on-taxpayers?category=Tax News](https://taxpayeradvocate.irs.gov/news/nta-blog-irs-administration-of-the-section-965-transition-tax-contravenes-congressional-intent-and-imposes-unintended-burden-on-taxpayers?category=Tax%20News) (hereinafter “NTA 965 Blog”).

The District Court in *Tax Analysts* said that “[e]ven if the document is pre-decisional at the time it is prepared, it can lose that status if it is adopted, formally or informally, as the agency position on an issue or is used by the agency in its dealings with the public.”

section 965 liabilities (e.g., by writing “Section 965 payment” on a check).³⁹ That led some taxpayers who had already paid sufficient estimated tax to make another payment. On Friday, April 13, 2018—a few business days before the filing and payment due date—the IRS issued FAQ 14, which said any excess estimated tax payments could not be refunded or credited to other liabilities unless they exceeded the entire 2017 liability, including transition taxes payable in subsequent years.⁴⁰

Perhaps due to its narrow view of what needs to be disclosed as PMTA and when, the IRS did not timely release the legal analysis underlying FAQ 14. Had its legal analysis been released before the extra transition tax payments were made, it would have been clear that the OCC did not believe the IRS had the legal authority to refund or credit these excess amounts. The IRS’s lack of transparency, thus, encouraged taxpayers to make unnecessary payments.

After the IRS issued FAQ 14, some corporate taxpayers scrambled to file Form 4466, *Corporation Application for Quick Refund of Overpayment of Estimated Tax*, so that they could recover excess estimated tax payments before their returns were due and the tax was assessed—a situation not addressed by the FAQs.⁴¹ Stakeholders, including the American Institute of Certified Public Accountants (AICPA) and the U.S. Chamber of Commerce, argued that FAQ 14 was inconsistent with the purpose of IRC § 965(h).⁴² Others suggested the IRS had no authority to deny pre-assessment refund requests on Form 4466.⁴³ TAS immediately elevated these concerns to the Tax Reform Implementation Office (TRIO). The TRIO explained that the OCC had written a detailed memo,

39 IRS, *Questions and Answers about Reporting Related to Section 965 on 2017 Tax Returns*, <https://www.irs.gov/newsroom/questions-and-answers-about-reporting-related-to-section-965-on-2017-tax-returns> (FAQ 10, issued on Mar. 13 and amended on Apr. 13, 2018).

40 IRS, *Questions and Answers about Reporting Related to Section 965 on 2017 Tax Returns*, <https://www.irs.gov/newsroom/questions-and-answers-about-reporting-related-to-section-965-on-2017-tax-returns> (FAQs 13 and 14, posted Apr. 13, 2018). Due to computer problems, the due date was extended to April 18. IR-2018-100 (Apr. 17, 2018).

41 KPMG, *IRS updates FAQs, “transition tax” under Code section 965* (Apr. 14, 2018), <https://home.kpmg.com/us/en/home/insights/2018/04/tnf-irs-updates-faqs-transition-tax-section-965.html>.

42 Letter from American Institute of Certified Public Accountants (AICPA) to Acting IRS Commissioner and Large Business and International (LB&I) Commissioner, *Questions and Answers about Reporting Related to Section 965 on 2017 Tax Returns - IRS Update of April 13, 2018* (Apr. 29, 2018), <https://www.aicpa.org/advocacy/cpaadvocate/2018/aicpa-urges-irs-action-on-section-965.html>; Letter from U.S. Chamber of Commerce to Commissioner of Internal Revenue (Oct. 9, 2018), https://www.uschamber.com/sites/default/files/u.s._chamber._s._corp_coalition_965_letter_mnuchinrettigkautter.pdf. In some cases, the IRS stretches the plain language of the law to harm taxpayers. See, e.g., *Summa Holdings, Inc. v. Comm’r*, 848 F.3d 779, 785 (6th Cir. 2017) (rejecting the IRS’s argument that it should be permitted “to recharacterize the meaning of statutes—to ignore their form, their words, in favor of [its] perception of their substance” in order to deny tax benefits that Congress may have intended). In others, it does so when a technical reading would be difficult to administer. See, e.g., Alice G. Abreu and Richard K. Greenstein, *Defining Income*, 11 FLA. TAX REV. 295 (2011) (discussing how IRS has avoided technical applications of the law to frequent flier miles, home run balls and other situations where doing so would be controversial or difficult to administer). Thus, stakeholders may have been surprised at the OCC’s inability to reach the result seemingly intended by Congress in connection with IRC § 965(h).

43 Tom Greenaway and Mike Zima, *Unlucky Friday the 13th: No Refunds this Year for Taxpayers Who Defer Paying Mandatory Repatriation Tax?*, PROCEDURALLY TAXING BLOG (Jul. 19, 2018), <http://procedurallytaxing.com/unlucky-friday-the-13th-no-refunds-this-year-for-taxpayers-who-defer-paying-mandatory-repatriation-tax/>.

which said the IRS was legally required to retain the payments—a document (probably an email) that has never been disclosed to TAS or the public.

When TAS requested the transition tax memo, the TRIO referred us to the OCC. The OCC initially said the memo was pre-decisional and would not be released to the public *or to TAS*. The OCC eventually released a new memo (digitally signed on August 1) to TAS on the same day it was released to the public.⁴⁴ As with the PMTAs discussed above, it only released this memo because of a “request” by the Large Business and International Division (LB&I), and not because of the settlement or TAS’s request.⁴⁵

However, neither this memo nor any of the IRS’s FAQs addressed whether the IRS could grant applications on Form 4466 for refunds of excess estimated tax payments pursuant to IRC § 6425, before any tax had been assessed for 2017. Accordingly, TAS asked the OCC for legal advice about whether the IRS was authorized to pay these refunds.⁴⁶ The OCC said it would only answer this question if the business owner (LB&I) requested it.⁴⁷ LB&I said it did not want the OCC to issue the advice, and OCC did not provide the advice to TAS.⁴⁸

Lacking access to the legal support necessary to help taxpayers, TAS issued several Taxpayer Assistance Orders (TAOs) and a proposed Taxpayer Advocate Directive (TAD) to prevent W&I from processing and rejecting Forms 4466 before TAS could elevate these decisions to the IRS Commissioner.⁴⁹ The OCC and the IRS’s active efforts to avoid disclosing its legal analysis to TAS and the public undermined taxpayer rights, including the *right to pay no more than the correct amount of tax*. They also undermined TAS’s ability to assist taxpayers as well as to identify the problem and propose administrative or legislative changes to address it, as required by IRC § 7803.⁵⁰

44 See PMTA 2018-16 (Aug. 2, 2018), https://www.irs.gov/pub/lanoa/pmta_2018_16.pdf.

45 OCC response (A12).

46 See, e.g., IRC § 7803(c)(2)(A) (requiring TAS to assist taxpayers in resolving problems with the IRS, identify areas in which taxpayers have such problems, and to propose legislative and administrative changes to mitigate the problems). Stakeholders raised the same questions. See, e.g., Letter from AICPA to Secretary of the Treasury and Assistant Secretary for Tax Policy, *Application of 2017 Estimated Tax Payments to Section 965(h) Installment Obligations* (Sept. 17, 2018), <https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/20180917-aicpa-comments-on-965-overpayments.pdf>.

47 For an example of the types of questions TAS asked OCC to answer, see *NTA 965 Blog*.

48 On August 8, TAS formally asked the OCC for the advice by August 31, 2018. On August 20, 2018, the Commissioner of Large Business and International Division informed TAS that he did not want the OCC to issue the advice.

49 See IRC § 7811 (Taxpayer Assistance Order authority); Internal Revenue Manual (IRM) 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1) (Jan. 17, 2001) (Taxpayer Advocate Directive authority). Although OCC has still not issued the formal opinion TAS requested, those at the highest levels of the IRS, the OCC, and Treasury considered the matter and informed TAS that, in their view, the IRS was not authorized to pay the refunds. In that way, the IRS complied with the TAOs.

50 The IRS Commissioner subsequently clarified that the National Taxpayer Advocate has the right to request and receive legal advice analysis from the OCC and to review the legal analysis that the OCC issues to other business units, unless the IRS Commissioner determines that she should not have access to the analysis. IRS response to TAS (Dec. 18, 2018). On November 26, 2018, Congress proposed IRC § 965(h) to fix the problem, but the legislation could have been proposed sooner if the IRS had been more transparent about the reason for the problem. See House Amendment to the Senate Amendment to H.R. 88, Division A, *The Retirement, Savings, and Other Tax Relief Act of 2018* § 501 (Nov. 26, 2018).

The Office of Chief Counsel does not acknowledge that a function of its advice is “to inform taxpayers or practitioners about how it interprets the law.” This view explains why it has interpreted the settlement narrowly, created a huge loophole for emailed advice, avoided writing down what needs to be disclosed under the settlement, and avoided establishing systems to ensure Program Manager Technical Advice (PMTA) are identified and timely disclosed.

CONCLUSION

The taxpayers’ *right to be informed* includes the right to “clear explanations of the laws and IRS procedures.”⁵¹ However, the OCC does not acknowledge that a function of its advice is “to inform taxpayers or practitioners about how it interprets the law.” This view explains why it has interpreted the settlement narrowly, created a huge loophole for emailed advice, avoided writing down what needs to be disclosed under the settlement, and avoided establishing systems to ensure PMTA are identified and timely disclosed. The National Taxpayer Advocate respectfully disagrees with OCC’s cramped interpretation of the disclosure requirements.

RECOMMENDATIONS

The National Taxpayer Advocate recommends the OCC:

1. Develop clear written guidance that defines when advice constitutes PMTA that must be disclosed.
2. Require disclosure of any advice that is, in substance, PMTA. For example, the OCC’s guidance should not permit attorneys to withhold advice because of its form or mode of transmission (*e.g.*, email), because of the title of the recipient, or because a business unit does not want the advice to be disclosed.
3. Establish a written process to monitor whether advice that should be disclosed as PMTA is being identified and disclosed to the public in a timely manner. For example, consider aiming to disclose PMTAs no later than when the IRS issues guidance (*e.g.*, FAQs, Publications, News Releases, IRMs, etc.) that reveals the agency’s position.
4. Incorporate the new PMTA guidance and monitoring procedures into the Chief Council Directives Manual, distribute it at PMTA training classes, and release it to the public.

51 IRS, Pub. 1, *Your Rights as a Taxpayer* (2016).

Appendix: OCC response to TAS information request (Sept. 11, 2018)⁵²

Basic Description of Project:

While the OCC has an interest in protecting documents from disclosure under the deliberative process privilege, taxpayers and practitioners also need timely details about how the OCC interprets the law, such as recent changes made to the Internal Revenue Code by the Tax Cuts and Jobs Act (TCJA) that are not purely deliberative. As an advocate for taxpayers, the National Taxpayer Advocate has been urging the IRS to release to the public more of the guidance it receives from the OCC (*e.g.*, guidance referred to as OCC “calls” that the IRS has immediately adopted and used to create forms, instructions, publications, news releases, fact sheets, and FAQs (called “soft guidance”)).

TAS discussed the parameters under which the National Taxpayer Advocate and TAS can receive legal advice from the OCC with CC:P&A on July 9, and again on July 30, and on August 2, 2018. In addition, TAS discussed at those meetings what constitutes Program Manager Technical Advice (PMTA), who is a Program Manager (PM), and what procedures OCC attorneys follow to ensure adherence to the terms of the settlement with Tax Analysts. Most of the questions below are intended to confirm information discussed at these three meetings, and some require only a Yes/No answer.

Information Requested:

[Preamble to OCC response] Section 7803(b) established in the Department of the Treasury the Chief Counsel for the Internal Revenue to serve as an independent legal advisor to the Commissioner and to his officers and employees. The Chief Counsel reports both to the General Counsel and to the Commissioner with respect to legal advice and interpretation of the tax law not relating solely to tax policy. The Chief Counsel reports solely to the General Counsel with respect to legal advice and interpretation of the tax law relating solely to tax policy. As an independent legal advisor, the Office of Chief Counsel is not subject to the direction of or oversight by the National Taxpayer Advocate. The function of the legal advice provided by the Office of Chief Counsel is not to inform taxpayers or practitioners about how it interprets the law, but to assist the Commissioner and his officers and employees in administering the Internal Revenue Code. The Office of Chief Counsel releases certain legal advice because decisions of the courts have interpreted the Freedom of Information Act to require the release of certain types of legal advice it provides. The Office of Chief Counsel takes seriously its responsibility to comply with the FOIA and the decisions of the courts interpreting that law. The issue of whether the Office of Chief Counsel is releasing advice in compliance with court decisions interpreting the FOIA and the process for performing that function is not a problem that taxpayers have with the Internal Revenue Service and it is not a serious problem encountered by taxpayers. We are nonetheless responding to these questions in the spirit of transparency and cooperation.

[TAS comment: IRC § 7803(c)(2)(B)(ii) says the National Taxpayer Advocate’s annual report must “contain recommendations for such administrative and legislative action as may be appropriate to resolve problems encountered by taxpayers,” as well as “such other information as the National Taxpayer Advocate may deem advisable.” The statute does not empower the OCC to determine whether an issue

⁵² TAS’s questions are in black, OCC’s answers and comments are in green boxes, and TAS’s comments to OCC’s answers are in [brackets]. TAS has generally removed the portions of this document that discuss the National Taxpayer Advocate’s access to legal advice for the reasons described in footnote 50.

is a problem for taxpayers. The first provision in the Taxpayer Bill of Rights is the *Right to Be Informed*, and the *Right to Be Informed* encompasses the right to understand the IRS's legal reasoning. One cannot accept or challenge an agency's legal position without understanding what it is and the basis for it. Therefore, we believe OCC's policy of keeping legal advice secret from the taxpaying public to the maximum extent possible does, indeed, constitute a serious problem for taxpayers. In addition, we note that the authorizing statute charges the National Taxpayer Advocate with identifying the most serious problems encountered by taxpayers. The statute does not empower the OCC to determine which issues to designate as problems, nor does it limit what other information the National Taxpayer Advocate may include in her report.]

- (5) Would advice the OCC drafted for the National Taxpayer Advocate concerning a program that the National Taxpayer Advocate does not directly administer be released under the Tax Analysts settlement as PMTA, assuming it is not pre-decisional or subject to another privilege?

[A5] Yes, if the advice is in memorandum form and otherwise meets the standards announced by the circuit court in *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002), and as applied by the district court in *Tax Analysts v. IRS*, 483 F. Supp. 2d 8 (D.D.C. 2007).

[TAS Comment: A5 suggests the OCC does not disclose advice unless it is in “memorandum form.”]

Questions Concerning the Public's Access to OCC's Advice

- (6) Can the OCC withhold advice (that would otherwise be characterized as PMTA and posted) on the basis that it is issued to a headquarters employee who is not a PM?

[A6] The Office of Chief Counsel will withhold advice when it is properly determined to be privileged under the standard described by the D.C. Circuit Court of Appeals in *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002).

- (7) Are all the individuals listed in this chart under the “HQ” heading, including the Operating Division Commissioners and the National Taxpayer Advocate, considered PMs for purposes of the disclosure rules? <http://ccintranet.prod.irsounsel.treas.gov/OrgStrat/Offices/PA/CCA%20Check/FIELD%20VS%20HQ.htm>. If not, please identify those who are not.

[A7] Yes.

- (8) Does the Tax Analysts settlement require the OCC to release advice to PMs concerning options not taken because they are not permissible as a legal matter (e.g., advice that the IRS does not have legal authorization to use math error authority under a specific set of circumstances)?

[A8] The Office of Chief Counsel releases advice in accordance with *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002), *Tax Analysts v. IRS*, 483 F. Supp. 2d 8 (D.D.C. 2007), and the settlement reached subsequent to those decisions. As noted by the D.C. Circuit Court of Appeals, the distinction between deliberative technical assistance memoranda (TAs) and TAs that represent Counsel's considered legal

conclusions is not amenable to a categorical formula. It can turn on the subject matter of the TA, on its recipient, on its place in the decision-making process, and even on its tone. This question suggests the resolution of this issue is susceptible to a categorical approach, an approach that the D.C. Circuit specifically rejected.

[TAS Comment: The OCC attorneys who administer the PMTA program informed TAS that advice concerning options that the IRS did not adopt would always be withheld. Questions 8 and 9 were aimed at identifying OCC’s reasons for withholding such advice.]

- (9) Does the Tax Analysts settlement require the OCC to release advice to PMs concerning options not taken because it concludes they are policy calls (*e.g.*, advice that the IRS is legally authorized to use math error authority under a specific set of circumstances, but the IRS decides not to use this authority)?

[A9] Counsel releases advice in accordance with *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002), *Tax Analysts v. IRS*, 483 F. Supp. 2d 8 (D.D.C. 2007), and the settlement reached subsequent to those decisions. As noted by the D.C. Circuit Court of Appeals, the distinction between deliberative technical assistance memoranda (TAs) and TAs that represent Counsel’s considered legal conclusions is not amenable to a categorical formula. It can turn on the subject matter of the TA, on its recipient, on its place in the decision-making process, and even on its tone. This question suggests the resolution of this issue is susceptible to a categorical approach, an approach that the D.C. Circuit specifically rejected.

- (10) If the answer to either of the prior two questions is no, please reconcile the OCC’s position with the statement by the Circuit Court in *Tax Analysts* (on p. 81) that “[i]t is not necessary that the TAs [advice] reflect the final *programmatic* decisions of the program officers who request them. It is enough that they represent OCC’s final legal position”

[A10] N/A.

- (11) Does the Tax Analysts settlement require the OCC to release as PMTA the memo about post-processing math error, which was issued to the W&I Commissioner and the National Taxpayer Advocate on April 10, 2018? If the answer is no, please explain.

[A11] There was an agreement between the W&I Commissioner and the National Taxpayer Advocate to release this memorandum, and it was released in accordance with that agreement.

- (12) Does the Tax Analysts settlement require the OCC to release the memo underlying the IRS’s position in section 965 FAQ 14? If the answer is no, please explain.

[A12] The Office of Chief Counsel published this memorandum at the request of the Division Commissioner, LBI.

- (13) Will the OCC withhold advice as pre-decisional solely because its legal conclusions will be disclosed later by the IRS as soft guidance?
- a. If yes, please reconcile the OCC's position with the rationale of the Circuit Court in *Tax Analysts* (see p. 75), which suggests that memoranda (not just the conclusions) which form the basis for the agency's conclusions should be disclosed (*i.e.*, the court cited *Tax Analysts v. IRS*, 97 F. Supp. 2d 13, 17-18 (D.C. Cir. 2000), which approved the practice of redacting only the portions of memos "that reflect the opinions and analysis of the author and did not ultimately form the basis" for the conclusions adopted by the agency).

[A13] The Office of Chief Counsel will withhold advice when it is properly determined to be privileged under the standard described by the D.C. Circuit Court of Appeals in *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002).

[TAS Comment: The OCC attorneys who administer the PMTA program informed TAS that advice the IRS adopted and incorporated into any kind of guidance or published product (*e.g.*, soft guidance, a form, or the IRM) would always be withheld. They reasoned that although the IRS's conclusion had to be disclosed, if those conclusions would be incorporated into a product that would be disclosed, then the OCC's underlying legal analysis could be withheld. A13 says that the OCC will withhold advice "when it is properly determined to be privileged" under the *Tax Analysts* decision. The response states the obvious and provides no useful information. The purpose of our question—which the response avoids answering—was to elicit information regarding which factors go into determining how that decision is made, so the public is not effectively told "trust us."]

- (14) If the OCC's advice is pre-decisional when issued, does the *Tax Analysts* settlement require the OCC to disclose it as PMTA later if the IRS ultimately adopts the positions taken in the advice (*e.g.*, the IRS adopts the positions in soft guidance)?
- a. If not, please reconcile OCC's position with the statement of the District Court in the *Tax Analysts* case (on p. 13) that "[E]ven if the document is pre-decisional at the time it is prepared, it can lose that status if it is adopted, formally or informally, as the agency position on an issue or is used by the agency in its dealings with the public." (Quotation omitted.)

[A14] The Office of Chief Counsel will withhold advice when it is properly determined to be privileged under the standard described by the D.C. Circuit Court of Appeals in *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002).

[TAS Comment: The OCC attorneys who administer the PMTA program informed TAS that once advice was withheld as pre-decisional, it would never be disclosed.]

- (15) Will the OCC withhold advice to a PM in its entirety (rather than disclosing a redacted version) if the advice is "primarily" pre-decisional?
- a. If so, please reconcile the OCC's position with the Circuit Court's approval in *Tax Analysts* of the District Court's decision to allow the IRS to withhold documents covered by the attorney work product privilege, but to require it to disclose redacted documents that were primarily pre-decisional.

[A15] The Office of Chief Counsel will release legal advice under the standard described by the D.C. Circuit Court of Appeals in *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002), as well as any other relevant court opinions requiring the release of agency working law that is not otherwise privileged.

[TAS Comment: The OCC attorneys who administer the PMTA program told TAS that OCC could withhold in its entirety, any advice that was “primarily” pre-decisional.]

- (16) What legend does the OCC put on tax reform advice issued to the TRIO and why?

[A16] The Office of Chief Counsel does not put a legend on legal advice to TRIO, because legends are not determinative of whether or not advice is privileged.

[TAS Comment: TAS representatives attended meetings with both the IRS and OCC where such a legend was discussed. On July 9, 2018, we were even told the legend had been approved by the Chief Counsel.]

- (17) Who determines whether OCC advice to PMs is pre-decisional or otherwise privileged?

[A17] The Office of Chief Counsel.

[TAS Comment: A17 does not indicate whether the person who determines whether OCC’s advice is privileged is the OCC attorney(s) issuing the advice or the OCC attorneys who administer the PMTA program.]

- (18) Our understanding is that a document released as PMTA is generally considered to be “agency working law” that is not “pre-decisional.” Is that accurate?
- a. If yes, please describe what “agency working law” is. If not, please define PMTA.

[A18] The Office of Chief Counsel releases as PMTA non-privileged legal advice according to the standards announced by *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002), *Tax Analysts v. IRS*, 483 F. Supp. 2d 8 (D.D.C. 2007), and the settlement reached subsequent to those decisions.

- (19) If advice is PMTA does that mean it must be released?

[A19] The Office of Chief Counsel releases as PMTA non-privileged legal advice according to the standards announced by *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002), *Tax Analysts v. IRS*, 483 F. Supp. 2d 8 (D.D.C. 2007), the settlement reached subsequent to those decisions, and any other court opinions requiring the release of legal advice.

[TAS Comment: A18 and A19 do not define PMTA or acknowledge that when something constitutes PMTA, then it must be released.]

- (20) How many documents that constitute PMTA have been withheld in full in each of the last 5 years?

[A20] We do not keep this statistic, but we have reviewed the information we have, which covers nearly four years (October 2014 - August 2018). During that time, one PMTA document was withheld in full, and it was withheld as tax convention information under section 6105.

[TAS Comment: Because the OCC response does not define PMTA or indicate whether something classified as PMTA must be released, A20 is impossible to interpret.]

- (21) Is email advice subject to disclosure as PMTA?

[A21] The Office of Chief Counsel releases as PMTA non-privileged legal advice according to the standards announced by *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002), *Tax Analysts v. IRS*, 483 F. Supp. 2d 8 (D.D.C. 2007), and the settlement reached subsequent to those decisions.

- a. Can legal analysis that must be disclosed as PMTA if it is transmitted by memo be shielded from disclosure by transmitting the same analysis in the body of an email?

[A21a] Legal advice that is sent by email is released under the provisions of section 6110. Contrary to what is implied by this question, the Office of Chief Counsel does not encourage its attorneys to provide legal advice in a manner that circumvents our obligations under the Code and case law to release legal advice. In fact, our recent training sessions have begun by emphasizing that employees should treat compliance with the disclosure of legal advice requirements as seriously as they take compliance with the tax laws, noting that the obligation to release CCA is a part of Title 26.

[TAS Comment: A5 acknowledges the OCC does not disclose advice unless it is in “memorandum form.” Our concern is that OCC attorneys can defeat the PMTA disclosure requirements entirely if, once PMTA has been written, an attorney transmits it by email rather than by memo. A21a says the OCC does not encourage its attorneys to provide legal advice in a manner that circumvents the disclosure requirements of IRC § 6110. A21a is unresponsive to Q21a because IRC § 6110 does not apply to PMTA. The disclosure of PMTA is governed by the FOIA and the settlement with Tax Analysts, rather than Title 26. A21a does not address whether the OCC encourages its attorneys to circumvent the rules that apply to PMTA.]

- (22) Is there a definition of PM or PMTA anywhere in the CCDM?

[A22] No. Technical Assistance Memoranda are described in historical parts of the IRM (Part 39.8).

- (23) Please identify the sections of the CCDM that provide the standards that OCC attorneys are supposed to apply when determining whether to forward memos to the PMTA mailbox for posting to the FOIA library at <https://www.irs.gov/privacy-disclosure/legal-advice-issued-to-program-managers>?

[A23] Legal Advice is covered in Part 33 of the CCDM.

[**TAS Comment:** Although CCDM 33.1.2.2.4 references PMTA, it does not provide any specific guidance about when PMTA should be disclosed. Thus, A22 and A23 confirm that the CCDM contains no specific guidance that OCC attorneys can use to determine whether advice should be disclosed as PMTA.]

- (24) Please provide the dates of any training conducted within the last 5 years addressing the disclosure of PMTA and identify the group of attorneys who were invited.
- a. For each of these training sessions, approximately how many attorneys attended?
 - b. Please provide any written training materials distributed to attendees at each of the training sessions identified in response to this question.

[**A24**] We do not keep this data in one location but have reviewed our recent records and found the following training discussing the disclosure of PMTA (and there may be others):

- Training was held in October 2015 for about 20 ACCI attorneys and managers.
- Training was held in December 2015 for about 15 new national office hires as part of New Attorney Orientation.
- Training for FIP was held in 2015 for approximately 20-30 attorneys and managers.
- Training was held in October 2015 for about 5 new attorneys.
- Training was held in February 2016 for about 5 new attorneys.
- Training for ACCI was held in FY 2017 for about 20 attorneys and managers.
- Training was held in December 2016 for about 15 new national office hires as part of New Attorney Orientation.
- Training was held for P&A in FY 2017 for about 25 attorneys and managers.
- Training was held for Corporate in FY 2017 for about 20 attorneys and managers.
- Training for ACCI was held in August 2017 for about 20 attorneys and managers.
- Training was held in September 2017 for about 7 new attorneys.
- Training was held in November 2017 for about 25 new national office hires as part of New Attorney Orientation.

No written training materials were distributed.

- (25) Is it accurate that CC:P&A is responsible for developing, teaching, and administering the disclosure standards and OCC managers generally are responsible for ensuring compliance with those standards?
- a. If yes, have written standards been provided to all OCC managers? Please provide copies of any standards they are given.

[**A25**] P&A has subject matter responsibility for interpreting the requirements imposed by FOIA and section 6110, and administers the release of legal advice identified as subject to release under the procedures in the CCDM. P&A regularly provides training as outlined above.

- (26) Are all items that are forwarded to the PMTA mailbox posted as PMTA?
- a. If the answer is no, please explain what criteria is used to decide whether to post the advice.

[A26] The Office of Chief Counsel releases as PMTA non-privileged legal advice according to the standards announced by *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002), *Tax Analysts v. IRS*, 483 F. Supp. 2d 8 (D.D.C. 2007), and the settlement reached subsequent to those decisions.

- (27) How does the OCC know if all PMTA that are required to have been disclosed have been identified and timely posted to the FOIA library at <https://www.irs.gov/privacy-disclosure/legal-advice-issued-to-program-managers>?

[A27] P&A emails the redacted PMTAs to F&M for posting on the website. Once the F&M employee has posted the documents to the Electronic Reading Room, she lets P&A know. We are not aware of any failure in the posting of documents identified and processed as PMTA.

[TAS Comment: A27 does not address how the OCC knows whether its attorneys are timely and properly forwarding PMTA to P&A or whether P&A attorneys are timely and properly forwarding them to F&M to be posted.]

- (28) How quickly after PMTA is issued do OCC guidelines require it be made public?
- a. In practice, how quickly after PMTA is issued is it made public?

[A28a] PMTA is generally processed quarterly and posted in groups. If an office had a need to have publication of a particular document expedited, the offices would accommodate that request.

[TAS Comment: A28a suggests the OCC has no guidelines regarding how quickly a PMTA must be made public.]

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****RESPONSIBLE OFFICIALS**

Ken Corbin, Commissioner, Wage and Investment Division
 Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division
 Douglas O'Donnell, Commissioner, Large Business and International Division
 David Horton, Acting Commissioner, Tax Exempt and Government Entities Division
 Donna Hansberry, Chief, Office of Appeals
 John D. Fort, Chief, Criminal Investigation

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*

DEFINITION OF PROBLEM

A key factor in the success of any public-facing enterprise is the ability to provide an effective and efficient mechanism for addressing customer inquiries.² The IRS administers the government's constitutional authority to assess and collect federal taxes. Although taxpayers are required by law to pay their duly owed taxes, they are also the agency's "customers." Unlike the private sector, the agency's failure to adequately engage these customers cannot cause taxpayers to take their business elsewhere, but it will jeopardize the voluntary compliance on which the U.S. tax system depends.³ As a result, the challenges faced by taxpayers when attempting to contact IRS personnel knowledgeable about their accounts pose substantial risks to all parties.⁴

-
- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code. See Internal Revenue Code (IRC) § 7803(a)(3).
 - 2 Bobby Cameron and Tim Harmon, Forrester Research, *Elevate Omnichannel Customer Experience With Continuous Business Services* 3 (May 4, 2015); Deanna Laufer, Forrester Research, *How to Build the Right CX Strategy* 4 (Jan. 10, 2017).
 - 3 Nina E. Olson, *Telephone Service in an Omnichannel Environment (Part 2 of 2)*, NTA BLOG, (Feb. 8, 2018), [https://taxpayeradvocate.irs.gov/news/nta-blog-telephone-service-in-an-omnichannel-environment-part-2?category=Tax News](https://taxpayeradvocate.irs.gov/news/nta-blog-telephone-service-in-an-omnichannel-environment-part-2?category=Tax%20News); National Taxpayer Advocate 2016 Annual Report to Congress vol. 3, 44-45.
 - 4 Additionally, as discussed in 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*, *supra*, taxpayers wishing to accurately prepare their tax returns have been receiving decreases levels of individual support from the IRS.

Although these difficulties have been discussed by the National Taxpayer Advocate in earlier reports, they continue to beset taxpayers.⁵ For example, the IRS was recently ranked last in quality communication in a survey of 15 federal agencies undertaken by Forrester Research.⁶ All too often, taxpayers wishing to obtain information must embark on a voyage that requires them to interpret obscure IRS acronyms and function names, navigate a complex and multifaceted phone tree, and identify unnamed and often-changing responsible IRS officials. This journey is by no means a seamless one, and in many cases, taxpayers are left floundering on the rocks of confusion, frustration, and misinformation.

As a result, the National Taxpayer Advocate remains concerned that:

- Taxpayers often have difficulty locating IRS personnel who can provide accurate and responsive information regarding their cases;
- Even if taxpayers are tenacious enough to reach a helpful IRS employee, they may not be able to work with that person again; and
- Taxpayers have trouble holding IRS personnel accountable, as managers can be hard to find and no mechanism for tracking complaints generally exists.

ANALYSIS OF PROBLEM

Taxpayers Often Have Difficulty Locating IRS Personnel Who Can Provide Accurate and Responsive Information Regarding Their Cases

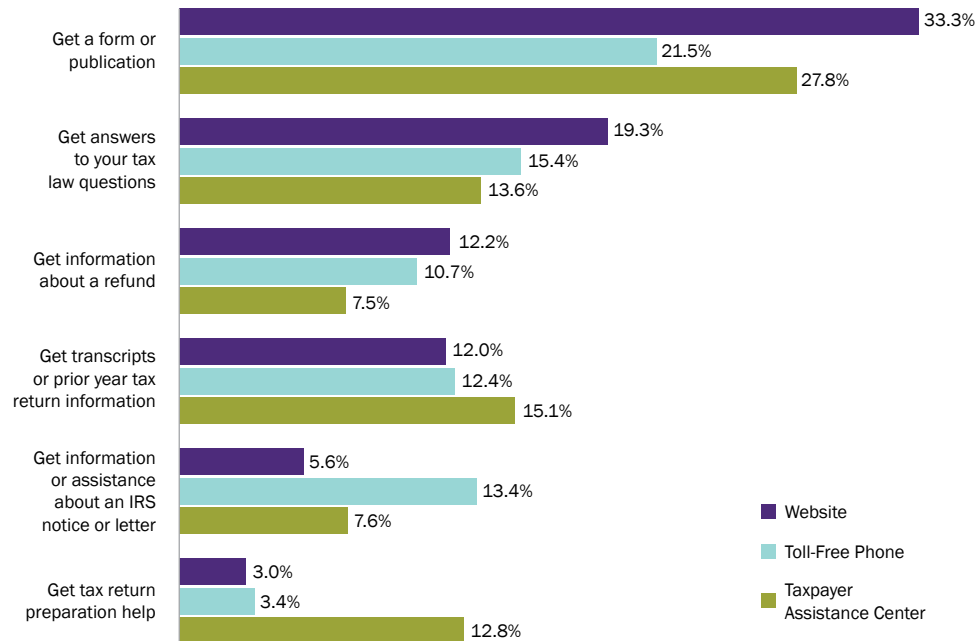
For many taxpayers, navigating their way through the IRS to obtain the answers and the support they desire can be a challenging and frustrating undertaking. In part, this situation is attributable to the reality that taxpayers prefer different methodologies of assistance for different issues and tasks. These preferences are illustrated in Figure 1.3.1:

5 National Taxpayer Advocate 2017 Annual Report to Congress 22-35; National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, 229-244; National Taxpayer Advocate 2014 Annual Report to Congress 123-133; National Taxpayer Advocate 2008 Annual Report to Congress 114-125.

6 Faith Adams and Rick Parrish, *Clear Communication is Vital for Government CX Success*, Forrester Research 4 (Feb. 14, 2018).

FIGURE 1.3.1⁷

Top Needs for Those Using Only One Service by Delivery Channel



Nevertheless, the IRS does its best to push everyone into a “one size fits all” virtual environment. This effort, typically justified by the desire to preserve resources, has resulted in the ongoing closure of Taxpayer Assistance Centers (TACs) and substantial limitations placed on when taxpayers can receive answers to tax law questions.⁸ Further, the IRS has attempted to design letters that artificially suppress the number of follow-up calls, even when the outcome is bad for the IRS and worse for taxpayers.⁹

This effort is nothing new, as the IRS has long resisted publishing the names of key offices or otherwise facilitating communication. For example, the IRS has historically refused to make any telephone directories for practitioners or similar directories available to the general public.¹⁰ Moreover, some practice units, including Individual Taxpayer Identification Number (ITIN) processing and the

⁷ National Taxpayer Advocate 2017 Annual Report to Congress 27. This information, which was compiled by TAS Research, highlights the most used services for each delivery channel. We focus on the top three services for each channel, but the graph includes more than three services since not every channel had high demand for the same preferred services. The percentages shown represent the portion of taxpayers who used that particular delivery channel and only needed help with one IRS service. National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, 82.

⁸ See 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*, *supra*; National Taxpayer Advocate 2017 Annual Report to Congress 117; National Taxpayer Advocate 2017 Annual Report to Congress 34.

⁹ IRS, Automated Collection System (ACS) Optimization/Research, Applied Analytics, and Statistics (RAAS), ACS LT16 Notice Test Pilot Report, 3 (Sept. 27, 2017); National Taxpayer Advocate Fiscal Year (FY) 2019 Objectives Report to Congress 42.

¹⁰ National Taxpayer Advocate Fiscal Year (FY) 2016 Objectives Report to Congress vol. 2, 45. The Integrity and Verification Operation (IVO) seeks to identify potentially false returns, usually through income documents reported by third parties. National Taxpayer Advocate 2017 Annual Report to Congress 221.

Integrity and Verification Operation (IVO), lack taxpayer-facing phone numbers altogether.¹¹ The IRS continues to limit the ability of taxpayers to contact IRS personnel directly, even though this transparency and accessibility would be helpful to taxpayers, and in spite of prior recommendations by the National Taxpayer Advocate.¹²

In the IRS Restructuring and Reform Act of 1998 (RRA 98), Congress required the IRS to make itself accessible to taxpayers, specifically by placing the addresses and telephone numbers for local offices in local phone directories across the country.¹³ Although the IRS technically complies with these requirements, live telephone contact with a local office is impossible as a practical matter. Rather than reaching a person, taxpayers in search of local assistance from a TAC receive a recorded message accompanied by a menu that transfers them to the national IRS telephone line where they can speak with telephone assistors.¹⁴ Only if the assistors cannot resolve the issues are taxpayers able to schedule in-person appointments with IRS local offices. This attempt to satisfy the congressional mandate with general numbers, which can be difficult and frustrating to navigate when seeking to obtain direct account information or negotiate account-related agreements, is in keeping neither with the spirit of RRA 98, nor the prior recommendations of the National Taxpayer Advocate.¹⁵

The IRS should seek to exceed minimum Congressional requirements and make contact information of local offices and particular practice units available online. The general public should have readily available access to an easily searchable, accessible IRS directory that incorporates metadata and common-speech terminology. If the IRS would then supplement this enhanced online access by having local- and unit-specific personnel answer phone calls, taxpayers could deal directly with issues and IRS personnel would find it easier to think of taxpayers as more than work objects in need of processing.

No such progress has yet been achieved, however. In the National Taxpayer Advocate's 2014 Annual Report to Congress, TAS diagrammed the journey of a hypothetical taxpayer calling to ask questions about filing a request for an offer in compromise.¹⁶ In that example, a taxpayer navigated a maze of menus and options, and ended up waiting on hold until they were cut off after approximately six minutes on the phone. In another simulated taxpayer phone call placed at 3:00 p.m. Eastern time on July 18, 2018, TAS sought to reproduce the same journey in an effort to evaluate how IRS telephone accessibility has evolved over the last four years. This time, the call was not cut off; instead, the taxpayer waited on hold for approximately one hour before giving up and terminating the call.¹⁷ This telephonic odyssey is shown below:

11 National Taxpayer Advocate 2017 Annual Report to Congress 225-226. Only after taxpayers are issued Individual Taxpayer Identification Number (ITIN) notices are they provided with a phone number through which to pursue inquiries. IRS response to TAS fact check request (Oct. 25, 2018).

12 National Taxpayer Advocate 2014 Annual Report to Congress 123-133.

13 Section 3709 of the IRS Restructuring and Reform Act of 1998 (RRA 98), 105 Pub. L. No. 206, 112 Stat. 779 provides: "The Secretary of the Treasury or the Secretary's delegate shall, as soon as practicable, provide that the local telephone numbers and addresses of Internal Revenue Service offices located in any particular area be listed in a telephone book for that area."

14 National Taxpayer Advocate Fiscal Year (FY) 2019 Objectives Report to Congress vol. 2, 24.

15 RRA 98 § 3705(d), 105 Pub. L. No. 206, 112 Stat. 777; RRA 98 § 3709, 105 Pub. L. No. 206, 112 Stat. 779. See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 123-133.

16 National Taxpayer Advocate 2014 Annual Report to Congress 128-129.

17 If taxpayers call on cell phone plans with limited minutes, this extended hold time would cause not only substantial irritation, but also significant economic hardship for those already having difficulty paying their taxes.

FIGURE 1.3.2, Part 1 of 4

AN IRS TELEPHONE JOURNEY

- WHO** TAS, calling as a taxpayer with questions about filing a request for an offer in compromise
- WHAT** Length of time to reach a customer service representative and be transferred to the centralized offer in compromise unit for help
- WHEN** 07/18/18 at 3 p.m. ET

TAS

Taxpayer dials 1-800-829-1040.

IRS

Welcome to the Internal Revenue Service. You can also visit us at www.IRS.gov.

- 1 To continue in English, press 1.
- 2 Para continuar en Español, oprima 2.

TAS

Taxpayer presses 1.

IRS

We currently are experiencing high call volumes. IRS.gov allows you to check your refund, get a tax form, or find answers to tax law questions. You can also access your account online to view the amount you owe, make a payment, view your payment history, or get a transcript of your tax records. In addition, you can obtain your prior year AGI. If you are filing your return electronically, go to IRS.gov/account for more details. If you choose to wait, your call will be processed in the order it was received.

- 1 For questions about your refund, or to check the status of your Form 1040X, Amended Tax Return, press 1.
- 2 For answers about your personal income taxes, the tax reform law, or calculating your income tax withholding, or to order a tax form or publication or a tax transcript, press 2.
- 3 For answers about your business taxes, press 3.
- 4 To hear general information about the health care law, including how it may affect individuals, families, and employers, press 4.
- 5 For questions about your personal or business taxes as it relates to healthcare, press 5.
- 9 To repeat this menu, press 9.

1 of 4

FIGURE 1.3.2, Part 2 of 4

AN IRS TELEPHONE JOURNEY

TAS

Taxpayer presses 2.

IRS

- 7 If you are filing your return electronically and need to order a transcript to obtain your prior year AGI, press 7.
- 1 For questions about a form you have already submitted, or a payment, or to order a tax transcript, press 1.
- 2 For questions about the tax reform law, calculating your income tax withholding, or tax rules or help filing a form, or if you need to order a tax form or publication, press 2.
- 9 To repeat this menu, press 9.
- 6 To return to the previous menu, press 6.

At this point, the taxpayer may be confused as none of the prompts address his issue. He has questions about filing a request for an offer in compromise, but none of these prompts address his need.

TAS

Taxpayer presses 1.

IRS

- 1 For questions about your refund, or to check the status of your Form 1040X, Amended Tax Return, press 1.
- 2 If you need an account or tax return transcript, press 2.
- 3 For all other questions about your tax history or payment, press 3.
- 9 To repeat this menu, press 9.
- 6 To return to the previous menu, press 6.

The taxpayer is further confused by prompt one because the earlier announcement already asked the taxpayer if he had questions about his refund and amended tax return, and he did not select that option.

TAS

Taxpayer presses 3.

IRS

- 1 To find out how to correct a form you already filed, press 1.
- 2 For all other questions about your tax history or payment, press 2.
- 9 To repeat this menu, press 9.
- 6 To return to the previous menu, press 6.

2 of 4

FIGURE 1.3.2, Part 3 of 4

AN IRS TELEPHONE JOURNEY

TAS
Taxpayer presses 2.

IRS
Please wait. To access your account information, please enter the Social Security number or employer identification number for which you are calling.

TAS
Taxpayer enters Social Security number.

IRS

- 1 If you enter a Social Security number, press 1.
- 2 If you enter an employer identification number, press 2 now.

TAS
Taxpayer presses 1.

IRS
 The Social Security number you entered was XXX-XX-XXXX.

- 1 If this is correct, press 1 now.
- 2 If this is not correct, press 2 now.

TAS
Taxpayer presses 1.

IRS
 The Social Security number you entered was XXX-XX-XXXX.

- 1 If this is correct, press 1 now.
- 2 If this is not correct, press 2 now.

TAS
Taxpayer presses 1 to confirm again.

IRS
 Please listen to the following seven topics. Press the number given when you hear your topic.

- 1 If you have your notice, letter, or bill, and want to set up a payment plan, press 1.
- 2 If you want to know the amount needed to pay your bill in full, press 2.
- 3 To request a transcript of your tax return or a transcript of your account, press 3.
- 4 To verify we received a payment you made, press 4.
- 5 For a detailed review of your account information, press 5.
- 6 If your question is about your personal identification number, or PIN, that was established to use our automated system, or you have a question about the account you established to access your account information on the internet, press 6.
- 7 If you received a notice, letter, or bill, and want to know if the innocent spouse rule applies to you, press 7.
- 9 To hear the topics again, press 9.

 If you have not heard your topic, please hold.

3 of 4

FIGURE 1.3.2, Part 4 of 4

AN IRS TELEPHONE JOURNEY

Even though the taxpayer has misplaced his notice, he just wants to speak with someone so he presses a number.

TAS
Taxpayer presses 1.

IRS
Your call may be monitored or recorded to quality purposes. Please hold while we transfer your call. Please wait. *[hold music]*

After the taxpayer presses 1 to set up a payment plan, he waits on hold for an assistor for an hour. For a taxpayer using a phone with pay-as-you-go minutes, this would be an expensive call indeed, especially for someone who is already having problems paying his or her taxes.

During the hold, recorded messages repeatedly and with increasing urgency encourage the taxpayer to hang up and go online to set up a payment plan. One example states:

IRS
Calling to arrange payment? Did you know the IRS charges a user fee to set up a monthly payment agreement? You can save money on the setup fee by setting it up online yourself. Monthly payment agreement fees can be as much as \$225 if established over the phone while speaking to one of our representatives, or as low as \$31 if you go online and set up a direct debit installment agreement from your bank account. Please visit www.IRS.gov/opa for more information.

After being on the phone for over an hour, the taxpayer, who had a strong desire to speak directly with an IRS employee, hangs up, perhaps to call again, perhaps to go online, or perhaps to abandon the payment plan process altogether.

4 of 4

Even in the virtual realm, into which the IRS has been attempting to push taxpayers, substantial progress remains to be made. Another recent study by Forrester Research shows that most taxpayers found their digital experience with the IRS to be unsatisfactory in some important respects.¹⁸ *These results were found to exist across all generations: Millennials, Generation X, and Baby Boomers.* Figure 1.3.3 summarizes the results of this survey:

FIGURE 1.3.3, Poorly Rated Features of the IRS Website¹⁹

The IRS website is...	Millennials	Generation X	Baby Boomers+
An ideal government website	13%	14%	11%
Easily searchable	12%	17%	11%
Well organized	10%	15%	10%
User-friendly	10%	16%	12%

The IRS must seek to improve the quality of communications with taxpayers. This attentiveness is crucial because communication is one of the top five drivers of customer experience. Clear and effective communication makes taxpayers more likely to trust the agency, do what is asked of them, skip expensive customer service channels, view the agency more positively, and forgive the agency when it makes a mistake.²⁰ Given that the IRS is currently the lowest-ranked federal agency in this category, it is missing a significant opportunity to enhance customer satisfaction and improve tax compliance.²¹

One way of addressing sometimes differing taxpayer communication preferences, remedying occasionally frustrating IRS computer interactions, and helping taxpayers better navigate the IRS would be to establish a 311 type system. Generally speaking, such systems promptly connect callers to operators who research their questions to provide quick answers, or transfer callers to an appropriate office that can assist them. This 311 system can fit within a more comprehensive omnichannel environment that utilizes customer experience mapping and customer journey analytics now employed in private industry.²² Such a channel would facilitate increased efficiencies, diminished wait times, and improved interactions between taxpayers and appropriate IRS personnel. This approach, which has previously been recommended by the National Taxpayer Advocate, has been effectively adopted by several state and local governments, including large cities such as New York, Chicago, Minneapolis, and Jacksonville.²³ An omnichannel or similar type of mechanism should be embraced by the IRS as a centerpiece of its effort to improve communication and overall customer experience.

18 Consumer Technographics, *Digital Experience and Engagement with Government Agencies*, Forrester Research 7 (June 2018).

19 *Id.*

20 Faith Adams and Rick Parrish, *Clear Communication is Vital for Government CX Success*, Forrester Research 4-5 (Feb. 14, 2018).

21 *Id.*

22 National Taxpayer Advocate 2017 Annual Report to Congress 22-35; National Taxpayer Advocate Fiscal Year (FY) 2019 Objectives Report to Congress (Area of Focus: *Omnichannel*); Maxie Schmidt-Subramanian and Andrew Hogan, Forrester Research, *How to Measure Digital Customer Experience*, 3 (Jun 21, 2016).

23 Tod Newcombe, *Is the Price of 311 Systems Worth Knowing?* GOVERNING THE STATES AND LOCALITIES (Mar. 2014), <http://www.governing.com/topics/urban/gov-311-systems-cost.html> (last visited Nov. 2, 2018).

The IRS must seek to improve the quality of communications with taxpayers.

Even If Taxpayers Are Tenacious Enough to Reach a Helpful IRS Employee, They May Not Be Able to Work With That Person Again

Some of the obstacles to quality communication within the IRS are attributable to a diffusion of responsibility and a lack of continuity with respect to various categories of cases. Several IRS functions do not assign specific employees throughout the lifetime of a case. These functions include Correspondence Examination, Return Integrity Compliance Services (RICS), Automated Collection System (ACS), and math error.²⁴ Instead, taxpayers simply are assigned to the next available examiner when they call in. This lack of identification with a particular case substantially limits case familiarity and personal accountability on the part of IRS personnel working in these programs. Moreover, impacted taxpayers typically are forced to go through the arduous process of navigating the IRS to reach a responsive employee, only to find that they need to start all over again the next time they have a question or require a given action regarding their case.

Approximately 20 years ago, as part of RRA 98, Congress sought to address and remedy this specific problem. Among other things, RRA 98 required the IRS to develop a procedure “to the extent practicable and if advantageous to the taxpayer” to assign one IRS employee to handle a taxpayer’s matter throughout the life of the case.²⁵ Some IRS functions provide one employee for each case, such as Field Collection, while other IRS units, such as Correspondence Examination and others discussed above, circumvent the spirit, if not the letter, of this directive.²⁶ The IRS justifies this latter policy and supports the use of group phone numbers by asserting that, in these cases, assigning a single employee is not practicable.²⁷ The IRS also defends its “first available employee” approach as beneficial to taxpayers because it decreases wait times.²⁸ Nevertheless, the same problems facing taxpayers in 1998 continue to burden taxpayers today. These issues persist despite concerns registered by the National Taxpayer Advocate, the Treasury Inspector General for Tax Administration (TIGTA), and the Government Accountability Office (GAO) regarding the difficulties experienced by taxpayers in contacting the appropriate IRS personnel to answer their questions and resolve their cases.²⁹

24 National Taxpayer Advocate 2014 Annual Report to Congress 134-144.

25 RRA 98, Pub. L. No. 105-206 § 3705(b), 112 Stat. 685, 777 (1998).

26 National Taxpayer Advocate 2014 Annual Report to Congress 134.

27 National Taxpayer Advocate Fiscal Year (FY) 2016 Objectives Report to Congress vol. 2, 48-50.

28 *Id.*

29 Government Accountability Office (GAO), Report to the Committee on Finance, U.S. Senate, IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden 18-20 (June 2014); Treasury Inspector General for Tax Administration (TIGTA) Ref. No. 2012-30-093, Improved Toll-Free Telephone Services Should Make It Easier for Taxpayers to Obtain Assistance During a Correspondence Audit 7 (Aug. 17, 2012); National Taxpayer Advocate 2014 Annual Report to Congress 134; National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 78.

The following example illustrates some of these commonly occurring problems:³⁰

Assume that a married couple filing a joint return became the subject of a correspondence examination, during which a \$10,000 casualty loss claim was questioned. Taxpayers responded to the inquiry and mailed in additional evidence to support the claimed loss. They were therefore dismayed to receive an initial examination report that disallowed the casualty loss and that gave no indication that the additional evidence was ever considered.

Taxpayers attempted to speak directly to someone working the examination in the service center to which the case was assigned. However, they were provided with no phone number to contact the examiner directly and were not even able to leave a voicemail message. The best that Taxpayers could manage was to leave a general message with the service center asking that someone return their call. Taxpayers received the requested callback, but they were out at the time and, because they did not know to authorize that a message be left, they had no knowledge that the call was ever returned.

At this point, they engaged the services of a tax practitioner, who began the contact process via mail and telephone all over again to resubmit the evidence and find out what occurred. After several mailings and exchanged messages, Compliance issued a 30-day letter (examination report) denying the loss.

Eventually, the adjustment was protested to the IRS Office of Appeals and a settlement mutually acceptable to the IRS and the Taxpayers was negotiated. Tax Practitioner, however, walked away feeling that the same result could have been arrived at in the early stages of the examination if Taxpayers simply had been able to contact an assigned examiner accountable for analyzing the evidence. Instead, Taxpayers ended up incurring unnecessary representational expenses and suffering frustration and disillusionment because of the barriers they faced in attempting to *challenge the IRS's position and be heard*.³¹

As a means of decreasing these types of problems and enhancing continuity, the IRS should assign a single point of contact throughout the lifetime of a taxpayer's case or at least allow taxpayers the ability to communicate with such a person on a repeat basis.³² While this single point of contact is impracticable and generally unnecessary for isolated account issues or tax law questions, it is important and valuable for both taxpayers and the IRS in areas typically involving ongoing dialogue, such as compliance cases or offers in compromise.³³ This step, which has previously been recommended by the National Taxpayer Advocate, would itself make navigating the IRS a much easier process and lessen the

30 This example is developed based on testimony provided by practitioners and related in the National Taxpayer Advocate 2014 Annual Report to Congress 138-139. Although the testimony was furnished as far back as 2012, the problems described continue today.

31 IRC § 7803(a)(3)(d).

32 Improving taxpayer service in this area should present only minimal resource issues. To begin with, a single point of contact would only potentially be assigned once taxpayers affirmatively contact the IRS. Further, such an option could be presented in a way that taxpayers could exercise choice regarding whether to work with the next available examiner or with a single point of contact. Likewise, the IRS could manage possible staffing issues arising from the latter alternative by establishing a "buddy system" to provide coverage during extended personnel absences. Short-term unavailability could be addressed through the implementation of a callback system that allowed for appointment scheduling and the use of technology ranging from telephone calls to virtual conferencing.

33 Substantial progress remains to be made in addressing isolated account issues and related service requests. For example, the National Taxpayer Advocate has recently heard from a number of practitioners expressing concerns and frustrations regarding tax preparer authentication and the acquisition of client transcripts.

frequency with which it was necessary.³⁴ It would have the additional benefit of increasing the quality of interactions between taxpayers and IRS personnel.

Taxpayers Have Trouble Holding IRS Personnel Accountable, As Managers Can Be Hard to Find and No Mechanism for Tracking Complaints Generally Exists

Once taxpayers are successful in having their calls routed to the appropriate place, they all too often experience problems having those calls returned and receiving responsive information.³⁵ Further, managers of unresponsive employees can sometimes be equally difficult to locate and contact. Currently, there is no universal complaint mechanism within the IRS that allows taxpayers to address these issues and have the results monitored.³⁶

The IRS receives customer complaints through a variety of channels, including the IRS Commissioner's office, Treasury, Congress, and the Office of Presidential Correspondence.³⁷ Complaints are routed to the responsible office, where a manager completes a report that is logged in the e-Trak system.³⁸ That system, however, is neither searchable nor designed for easy analysis of systemic customer service or personnel issues.³⁹

A number of practice units within the Wage & Investment (W&I) and the Small Business/Self-Employed (SB/SE) Operating Divisions also allow taxpayers to seek direct contact with a manager to discuss questions or raise complaints and such inquiries are sometimes monitored to help ensure that they are answered by managers within 24 hours.⁴⁰ This access to managers by taxpayers is a step in the right direction. However, these complaints, the reasons they are made, and the quality of responses they generate are not tracked in such a way that they can be systematically analyzed to facilitate accountability and improved performance. Further, this lack of a tracking mechanism may cause taxpayers to be reluctant to lodge complaints with managers out of fear of retaliation.

In order to facilitate accountability, the IRS should create a comprehensive system through which taxpayers can ask to speak with managers and that tracks whether the manager contacts the taxpayer, how quickly this contact is made, what the issue is, and how the issue is addressed. This monitoring can be facilitated by a robust 311 system that not only helps taxpayers navigate, but that can be used as a tool to analyze the content of inquiries and track the resolution of complaints.⁴¹ Effective complaint monitoring also presupposes meaningful quality measures that provide an accurate picture of taxpayers' overall experiences and the resolutions they obtain.⁴² The IRS must commit to improving the overall customer experience by putting these mechanisms in place and holding employees and their managers accountable for their treatment of taxpayers.

34 National Taxpayer Advocate 2014 Annual Report to Congress 134-144.

35 *Id.* at 124-127.

36 IRS response to TAS information request (Jul. 10, 2018).

37 IRS response to TAS fact check (Oct. 25, 2018).

38 IRS response to TAS information request (Jul. 10, 2018).

39 *Id.*

40 IRS response to TAS fact check (Oct. 25, 2018); IRS response to TAS information request (Jul. 25, 2018).

41 Tod Newcombe, *Is the Price of 311 Systems Worth Knowing?* GOVERNING THE STATES AND LOCALITIES (Mar. 2014), <http://www.governing.com/topics/urban/gov-311-systems-cost.html> (last visited Nov. 2, 2018).

42 National Taxpayer Advocate 2017 Annual Report to Congress 28-30; National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, 229-244; Nina E. Olson, *Telephone Service in an Omnichannel Environment (Part 2 of 2)*, NTA BLOG, (Feb. 8, 2018) [https://taxpayeradvocate.irs.gov/news/nta-blog-telephone-service-in-an-omnichannel-environment-part-2?category=Tax News](https://taxpayeradvocate.irs.gov/news/nta-blog-telephone-service-in-an-omnichannel-environment-part-2?category=Tax%20News).

CONCLUSION

Taxpayers often have difficulty locating IRS personnel who can provide accurate and responsive information regarding their cases. All too often, their only way of speaking with an actual person is by means of the IRS's main toll-free phone line, which includes difficult-to-interpret options and can lead to extended and potentially expensive hold times. Additionally, the IRS tries hard to channel sometimes-unwilling taxpayers into online self-service venues, which the majority of users deem to be substandard in many respects. Accordingly, it is not surprising that the IRS has been recently ranked last in quality communication in a survey of 15 federal agencies undertaken by Forrester Research.⁴³

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. Compounding these circumstances, 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 in a timely and responsive manner.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Provide all members of the general public with an accessible and easily searchable IRS directory that incorporates metadata and common-speech terminology to assist taxpayers in contacting particular offices within the IRS.
2. 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.
3. Adopt a model for correspondence examinations and similar cases, such as those worked in ACS, in which a single employee is assigned to the case while it is open within the IRS function.
4. Establish a complaint and inquiry tracker that monitors and records requests to speak with supervisors, subsequent follow-up, and the results of that contact.

⁴³ Faith Adams and Rick Parrish, *Clear Communication is Vital for Government CX Success*, Forrester Research (Feb. 14, 2018).

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

RESPONSIBLE OFFICIAL

Ken Corbin, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*

DEFINITION OF PROBLEM

To fulfill its statutory duty to increase electronic filing (e-filing), the IRS partners with Free File, Inc. (FFI), a group of private-sector tax return preparation software providers.² The 12 members of FFI offer free federal tax preparation software products, accessible at IRS.gov, to eligible taxpayers. The participants in the program must ensure that their products in the aggregate are available to 70 percent of all taxpayers, or about 105 million taxpayers, particularly focusing on economically disadvantaged and underserved communities.³ Currently, taxpayers that have adjusted gross incomes (AGIs) of less than \$66,000 are eligible to use Free File software, while taxpayers with AGIs greater than that amount can use Free File Fillable Forms, the electronic version of IRS paper forms.⁴

Since 2002, the year the Free File program began, the number of individual tax returns increased by 15 percent and e-filing has increased by 180 percent.⁵ While electronic filing has increased greatly since 2002, the goals of the Free File program have stagnated and use of the program has steadily declined.⁶ Only about 2.5 million people filed returns using FFI software in fiscal year (FY) 2017 compared to over three million in FY 2014, and the peak of about 5 million taxpayers in tax year (TY) 2004.⁷ The IRS has not committed funding to advertise FFI and raise awareness of the services offered. It no longer produces a demographics report or satisfaction survey to help identify why the number of Free File users is decreasing or what other types of services would best attract new users.⁸

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).
- 2 See IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105–206, 112 Stat. 685.
- 3 Eighth Memorandum of Understanding on Service Standards and Disputes Between the Internal Revenue Service and Free File, Inc. (effective as of Oct. 31, 2018), <https://www.irs.gov/pub/irs-utl/Eight%20Free%20File%20MOU.pdf> (Hereinafter 2018 Free File MOU).
- 4 See *Free File Software Offers*, <https://apps.irs.gov/app/freeFile/jsp/index.jsp> (last visited on Oct. 10, 2018).
- 5 In fiscal year (FY) 2002, the IRS received 130,905,000 individual income tax returns, and received 150,690,787 in FY 2017. In FY 2002, the IRS received 46,890,813 e-filed individual income tax returns, and 131,641,943 in FY 2017. See IRS Data Book (FY 2002, 2017).
- 6 See IRS Data Book (FY 2017, FY 2016, FY 2015, FY 2014) (showing Free File software usage has declined from 3,261,248 returns filed in FY 2014 to 2,536,183 returns in FY 2017).
- 7 See IRS Data Book (FY 2017, FY 2016, FY 2015, FY 2014); Michelle S. Chu and Melissa M. Kovalick, IRS, *An Analysis of the Free File Program*, presented at 99th Annual Conference on Taxation at 117 (Nov. 16-18, 2006).
- 8 IRS response to TAS information request (Sept. 7, 2018). Due to the lapse in appropriations, IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

While some taxpayers may be unaware of FFI services, others are unable to use the program due to its eligibility restrictions and language limitations. Taxpayers that do use the program have little guidance about the strengths and weaknesses of each software package's offering prior to selection, and may begin a return only to find the program lacks the capability to prepare the return or to fully capture the deductions and credits available to the taxpayer. As a result of these shortcomings, the services provided by FFI do not meet the needs and preferences of eligible taxpayers, particularly within underserved populations, undermining taxpayers' rights to *quality service* and to *pay no more than the correct amount of tax*. Specifically, the National Taxpayer Advocate is concerned that:

- In TY 2016, 2.3 percent of eligible taxpayers used Free File software, and only 0.2 percent of eligible taxpayers used Free File Fillable Forms;⁹
- 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;¹⁰
- No Free File options were available for English as a Second Language (ESL) taxpayers in filing season 2018; and
- 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.¹¹

ANALYSIS OF PROBLEM

Background

The IRS Restructuring and Reform Act of 1998 (RRA 98) required the IRS to work with the private industry to increase e-filing, and set the goal of having 80 percent of all federal tax returns filed online by 2008.¹² Similarly, the George W. Bush administration's EZ Tax Filing Initiative directed the IRS to create "a single point of access to free on-line preparation and electronic tax filing services provided by Industry Partners to reduce burden and costs to taxpayers."¹³ Initially, the Administration wanted the IRS to develop its own digital Form 1040, *U.S. Individual Income Tax Return*, accessed through WhiteHouse.gov, but IRS leadership determined the IRS did not have the capacity or resources to develop that product. Instead, the IRS partnered with a consortium of private tax preparation software companies, then known as the Free File Alliance, after the Office of Chief Counsel determined this consortium did not violate anti-trust provisions.¹⁴

In an agreement signed on October 30, 2002, members of the consortium agreed to provide free online return preparation services on an IRS.gov webpage to 60 percent of taxpayers during the tax filing

9 IRS response to TAS information request (Sept. 7, 2018).

10 See *Free File Software Offers*, <https://apps.irs.gov/app/freeFile/jsp/index.jsp> (last visited Oct. 10, 2018).

11 Note: the information included in this report reflects observations from the Free File offerings available for the 2018 filing season.

12 RRA 98, Pub. L. No. 105–206, 112 Stat. 685.

13 Presidential Initiatives: *IRS Free File*, <https://georgewbush-whitehouse.archives.gov/omb/egov/c-1-3-IRS.html>.

14 Treasury Department, *Treasury, IRS Announce New Efforts to Expand E-Filing* (Jan. 30, 2002), <https://www.treasury.gov/press-center/press-releases/Pages/po964.aspx>; see Letter from Charles James, Assistant Attorney General, Antitrust Division, Department of Justice, to Stephen Ryan, Manatt, Phelps, & Phillips, LLP (representing Free File Consortium) (Oct. 7, 2002) (Hereinafter DOJ Antitrust Letter 1).

season.¹⁵ The agreement allowed the software providers to determine the scope of their offerings, but obligated the IRS to take oversight action, such as implementing usability performance measures and notifying the consortium if services are not being properly performed.¹⁶ The IRS also had authority to terminate the agreement if the consortium failed to provide appropriate coverage, taking into account “the extent to which actual usage of Free Services has increased.”¹⁷

The IRS intended the Free File partnership to be the “best method” to “promote higher quality Free Services by utilizing the existing expertise of the private sector, maximize consumer choice, promote competition for such Free Services, and thereby meet the objectives in the least costly manner.”¹⁸ In the Free File Memorandum of Understanding, the IRS “pledged to not enter the tax preparation software and e-filing services marketplace.”¹⁹ As a result, the IRS has not followed other countries’ tax administrations in developing its own innovative offerings, such as pre-populated returns, to reduce taxpayer burden.²⁰ While the complexity and structure of the U.S. tax system make it difficult to compare to other countries, the National Taxpayer Advocate does believe that following some innovations, such as an expanded “Pay-As-You-Earn (PAYE)” system, would allow for more accurate and efficient collection of tax liabilities.²¹

While the initial agreement required the Free File Alliance to provide free software services to only 60 percent of taxpayers, several members made their offerings available to all taxpayers without restrictions.²² Members were ranked in “tiers” on the IRS webpage, with the highest-tier members listed first.²³ As a result, use of Free File expanded greatly, as 5.1 million taxpayers filed Free File returns in tax year 2004, a 46 percent increase from the previous year.²⁴ In reviewing the Free File program for anticompetitive effects, the Department of Justice found that the providers’ expansion of services,

15 Free On-Line Electronic Tax Filing Agreement entered into between the IRS and the Free File Alliance, LLC (effective as of Oct. 30, 2002), <https://www.irs.gov/pub/irs-utl/2002-free-online-electronic-tax-filing-agreement.pdf> (Hereinafter 2002 Free File Agreement).

16 *Id.* at 3-4.

17 *Id.* at 2.

18 *Id.* at 1. Describing this decision, Treasury Secretary Paul O’Neil stated, “I don’t intend for the IRS to get into the software business, but rather to open a constructive dialogue with those who already have established expertise in this field.” Department of the Treasury, *Treasury, IRS Announce New Efforts to Expand E-Filing* (Jan. 30, 2002), <https://www.treasury.gov/press-center/press-releases/Pages/po964.aspx>.

19 2018 Free File MOU.

20 See Brookings Institute, Tax Policy Center, *Briefing Book*, 447, https://www.taxpolicycenter.org/sites/default/files/briefing-book/tpc-briefing-book_0.pdf (“At last count, 36 countries, including Germany, Japan, and the United Kingdom, permit return-free filing for some taxpayers.”). The National Taxpayer Advocate notes that many of these countries don’t deliver refundable credits through the tax code, and tax by the individual unit, rather than by the family, making for a more simplified tax system.

21 The IRS should analyze and report on the feasibility of and steps necessary for furnishing information return (e.g., Form W-2, 1099) data to taxpayers electronically for direct importation into Free Fillable Forms and software or for provision to authorized tax return preparers. See also Legislative Recommendation: *Tax Withholding And Reporting: Improve the Processes and Tools for Determining the Proper Amount of Withholding and Reporting of Tax Liabilities*, *infra*; Research Study: *A Conceptual Analysis of Pay-As-You-Earn (PAYE) Withholding Systems As a Mechanism for Simplifying and Improving U.S. Tax Administration*, vol. 2, *infra*.

22 Michelle S. Chu and Melissa M. Kovalick, IRS, *An Analysis of the Free File Program*, presented at 99th Annual Conference on Taxation at 117 (Nov. 16-18, 2006), <https://www.irs.gov/pub/irs-soi/06rpppchu.pdf>.

23 Letter from Renata Hesse, Chief, Networks and Technology section, Department of Justice Antitrust Division, to Lori Larson, Chief, Public Contracts and Technology Branch, General Legal Services (May 9, 2005) at 2 (Hereinafter DOJ Antitrust Letter 2).

24 Michelle S. Chu and Melissa M. Kovalick, IRS, *An Analysis of the Free File Program*, presented at 99th Annual Conference on Taxation at 117 (Nov. 16-18, 2006), <https://www.irs.gov/pub/irs-soi/06rpppchu.pdf>; see also Treasury Inspector General for Tax Administration (TIGTA), *Use of the Free File Program Declined After Income Restrictions Were Applied*, Report 2006-40-171 (Sept. 29, 2006).

even as a method of cross-selling their paid goods and services, was “precisely the sort of activit[y] the antitrust laws were designed to protect” and “should be encouraged” by the IRS.²⁵ However, the next Free File agreement ended the tiered structure and significantly curtailed the scope of free services that could be offered by each provider, specifying that no provider could cover over 50 percent of taxpayers.²⁶

The National Taxpayer Advocate continued to criticize the limitations of the Free File program, and advocated that the IRS provide all taxpayers, regardless of income, with a bare-bones digital version of the paper Form 1040 complete with fillable fields, links to instructions, and math and numeric transfer capacity, along with free electronic filing.²⁷ To meet this need, the 2009 Free Memorandum of Understanding (MOU) created “Free File Fillable Forms,” a forms-based product designed by the members to make electronic versions of IRS forms and schedules available to all taxpayers.²⁸

The IRS has renewed its agreement with the Free File Alliance, now called Free File, Inc. (FFI), multiple times, including the most recent agreement signed on October 31, 2018.²⁹ Amendments to the agreement have included broadening the scope of eligibility for the Free File program to 70 percent of all taxpayers, heightening security and privacy requirements, and requiring for members to provide an electronic Free File indicator.³⁰ However, the Free File program still falls short in addressing key areas in need of reform to better serve taxpayers, as discussed below.

The Goals for Free File, Inc., Have Not Evolved Since Its Creation and Its IRS Budget Has Decreased to Zero

Despite surpassing the e-filing goal of 80 percent set by RRA 98, the goals of the Free File program remain stagnant.³¹ The 2018 Free File MOU lists four objectives:

1. “Make tax return preparation and filing easier and reduce the burden on individual taxpayers, particularly the economically disadvantaged and underserved populations;
2. Support the IRS’s statutory goals of increased electronic filing, pursuant to the IRS Restructuring and Reform Act of 1998;
3. Provide greater service and access to the Services to taxpayers; and

25 DOJ Antitrust Letter 2 at 3-4.

26 Free On-Line Electronic Tax Filing Agreement entered into between the IRS and the Free File Alliance, LLC (effective as of Oct. 30, 2005), <https://www.irs.gov/pub/irs-utl/2005-free-online-electronic-tax-filing-agreement.pdf> (hereinafter 2005 Free File Agreement).

27 See, *IRS National Taxpayer Advocate Annual Report and IRS Oversight Board Annual Report: Hearing Before the H. Subcomm. on Oversight of the H. Comm. on Ways and Means*, 107th Cong. 23 (2002) (transcript of testimony); *Tax Return Preparation Options for Taxpayers: Hearing Before the S. Finance Comm.*, 109th Cong. (2006) (transcript of testimony); *Tax Return Filing Season, Internal Revenue Service Operations, Fiscal Year 2009 Budget Proposals*, and the *IRS National Taxpayer Advocates Annual Report: Hearing Before the H. Subcomm. on Oversight of the H. Comm. on Ways and Means*, 110th Cong. 82 (Mar. 13, 2008) (transcript of testimony); see also, National Taxpayer Advocate 2004 Annual Report to Congress 89-102 (Most Serious Problem: *Electronic Return Preparation and Filing*); National Taxpayer Advocate 2004 Annual Report to Congress 471-477 (Legislative Recommendation: *Free Electronic Filing For All Taxpayers*); S. 1321, 109th Cong. § 310 (2005).

28 Fifth Memorandum of Understanding on Service Standards and Disputes Between the Internal Revenue Service and Free File Alliance, LLC (effective as of Oct. 20, 2009), <https://www.irs.gov/pub/irs-utl/2009-fourth-ff-mou.pdf> (hereinafter 2009 Free File MOU).

29 2018 Free File MOU.

30 *Id.*

31 Nearly 130 million tax returns or about 88 percent of all individual income tax returns were e-filed in FY 2018. IRS, *Filing Season Statistics for Week Ending August 31, 2018*. Only about 40 million, or approximately 31 percent, were e-filed in FY 2001, prior to the creation of Free File. IRS Data Book (FY 2001).

4. Implement one of the proposals in the President's Fiscal Year 2003 budget, specifically to encourage further growth in electronic filing by providing taxpayers the option to file their tax return online without charge using cooperation with, and encouraging competition within, the private sector."³²

The objectives have remained substantively unchanged since the program's inception. They continue to reference statutory e-filing goals from 1998 and the President's 2003 budget, rather than identifying new areas for focus and ways to expand the program.

Furthermore, the program formerly had a minimal budget of about \$6 million, but that budget was reduced and ultimately eliminated over the years.³³ The current IRS marketing budget for the Free File program is zero.³⁴ Failing to set new goals for the Free File program or allocate sufficient money towards it reveals how the IRS prioritizes the Free File program and hinders the program from improving the e-filing services the IRS endorses for taxpayers.

The objectives have remained substantively unchanged since the Free File program's inception. They continue to reference statutory e-filing goals from 1998 and the President's 2003 budget, rather than identifying new areas for focus and ways to expand the program.

The IRS Has Not Provided Effective Oversight and Evaluation of the Free File Program

The IRS has not taken steps to evaluate whether the Free File program is even meeting the existing goals described above. To ensure program standards are being met, the 2018 Free File MOU emphasizes the "in-place review process" for the program rather than adding any new initiatives.³⁵ The current "in-place review process" occurs once prior to filing season and once during filing season. This review is mainly to ensure the software providers' technical compliance with the Free File MOU, and does not evaluate the quality of the offerings from Free File software providers.³⁶ Thus, the National Taxpayer Advocate is concerned that merely reemphasizing the limited reviews currently in place, without adding resources or creating new measures, will not adequately evaluate the experiences of taxpayers using the program.

32 2018 Free File MOU.

33 Max Cherney, *100 Million Americans Can File Their Taxes for Free, Yet Only 3 Million People Do It*, MARKET WATCH, (Apr. 17, 2018), <https://www.marketwatch.com/story/how-to-file-your-taxes-for-free-online-if-you-make-less-than-66000-a-year-2018-03-28>.

34 IRS response to TAS information request (Sept. 7, 2018).

35 IRS News Release IR-2018-213, IRS, *Free File Alliance Announce Changes to Improve Program; Improved Taxpayer Options Available for 2019 Free File Program* (Nov. 2, 2018), <https://www.irs.gov/newsroom/irs-free-file-alliance-announce-changes-to-improve-program-improved-taxpayer-options-available-for-2019-free-file-program>.

36 These reviews: validate that the software has acquired the appropriate security and privacy certifications; test that a filer can easily prepare, file, print, download and save a tax return using the Free File software; ensure ancillary services/products, Refund Anticipation Checks and Refund Anticipation Loans are not being offered; ensure third party security and privacy certifications have been acquired to assure industry security and privacy standards and practices are being used; and validate a guarantee of calculations is provided by each company. IRS response to TAS information request (Sept. 7, 2018).

In another example of the IRS's limited evaluation of its partnership, even though FFI members are required to provide a use indicator to identify returns filed using Free File, the IRS has not prepared a Free File demographics report since 2015.³⁷ Without conducting a demographics report, the IRS has no way to know which taxpayers are using Free File services. The IRS also no longer conducts Free File satisfaction surveys, which it claims is due to budget constraints.³⁸ However, the most recent Free File MOU from 2018 specifically assigns the members of FFI the responsibility to “provide the necessary support to accomplish a customer satisfaction survey.”³⁹ Thus, the IRS failure to avail itself of that support shows the IRS's failure to exercise oversight to enforce the standards set for the program.

Conducting robust demographics analysis and satisfaction surveys, along with testing of taxpayer scenarios, would help the IRS determine why particular groups use or do not use the Free File offerings, which providers are offering inadequate services, and how it can improve its agreement with FFI to better meet the needs of taxpayers.⁴⁰ There is an old adage that “you get what you measure.” By neglecting to measure and evaluate the Free File program, the IRS is missing a valuable opportunity to fulfill its promises in the 2018 Free File MOU to make the program more taxpayer friendly. The IRS should work with TAS to develop meaningful measures and better oversight, including routine testing, to better ensure the offerings provided on Free File fulfill the *right to quality service*.

Only About 2.5 Million People Filed Returns Using Free File, Inc. in Tax Year 2017, and Use of the Program Continues to Decline

The number of taxpayers filing online has greatly increased since the early 2000s, with almost 130 million or 88 percent of all tax returns being filed electronically in FY 2017. However, less than two percent, or only about 2.5 million of those returns, were filed using Free File.⁴¹ In comparison, paid preparers filed almost 78.6 million tax returns electronically in tax year 2017.⁴² Over 3.5 million returns were prepared through Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs, a higher number than prepared by FFI despite the fact that taxpayers must expend more time and resources to go to one of these sites.⁴³

37 IRS response to TAS information request (Sept. 7, 2018). Due to the lapse in appropriations, IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

38 IRS response to TAS information request (Sept. 7, 2018).

39 2018 Free File MOU at 17.

40 For example, the most recent Free File demographics report from 2015 does not show how many Spanish speaking taxpayers used its services. See *Demographics of TY 2015 Traditional Free Filers, Free File Fillable Form Users, True Paper Filers, V-code Filers, and Form 1040 Series Filers*, included in IRS response to TAS information request (Sept. 7, 2018).

41 IRS Data Book (FY 2017) and IRS, *2017 Filing Season Statistics* (Dec. 29, 2017). In tax year 2016, just under 2.3 percent of all eligible taxpayers submitted returns using the Free File software, and just 0.2 percent of taxpayers used Free File Fillable Forms to submit their returns. IRS response to TAS information request (Sept. 7, 2018).

42 IRS Data Book at 9 (FY 2017).

43 *Id.* at 47 (showing numbers of returns).

FIGURE 1.4.1⁴⁴

Individual Return Filings by Filing Type, FY 2017

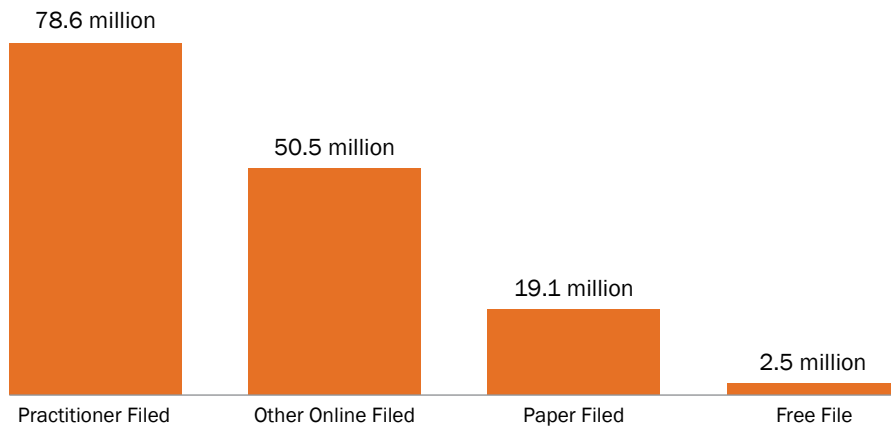
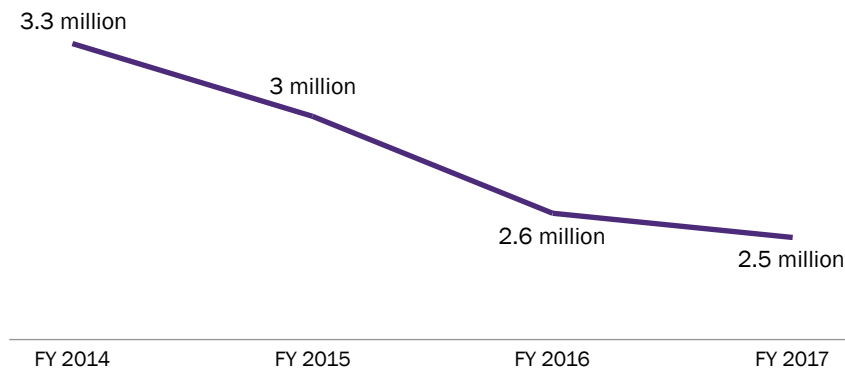


FIGURE 1.4.2⁴⁵

Free File Returns by Fiscal Year



44 IRS Data Book at 9 (FY 2017).

45 IRS Data Book (FY 2017, FY 2016, FY 2015, FY 2014).

Conducting robust demographics analysis and satisfaction surveys, along with testing of taxpayer scenarios, would help the IRS determine why particular groups use or do not use the Free File offerings, which providers are offering inadequate services, and how it can improve its agreement with Free File, Inc. (FFI) to better meet the needs of taxpayers.

As Figure 1.4.2 illustrates, use of Free File software has continued to decrease since 2014. This declining usage also shows the program's low retention rate, as only 44 percent of taxpayers that used Free File in FY 2014 and were eligible to use the program again in FY 2015 did so.⁴⁶ FFI usage was at its greatest when software providers could offer unrestricted services to more than 50 percent of taxpayers, as over 5 million taxpayers used FFI software in TY 2004.⁴⁷ While the 2005 restriction preventing each software provider from covering more than 50 percent of individual taxpayers was intended to make it easier for software providers to enter the Free File program, the number of participating providers has decreased from 20 providers in the program's early years to just 12 in FY 2018.⁴⁸ Thus, this restriction has failed to achieve its goal and, instead, has limited the options available to taxpayers.

The elimination of any marketing budget for the Free File program has made it difficult for the IRS to make taxpayers aware of the services available, as advertising for the program is limited to a few filing season press releases. There is virtually no marketing or promotion of Free File Fillable Forms on the IRS.gov homepage, even though this service is available for everyone. The IRS has mainly focused its efforts to increase awareness of the Free File program on making it easy to locate Free File on IRS.gov and IRS2Go, but these efforts do not show taxpayers the value of Free File or why they should use FFI instead of a paid return preparer. As stated above, because the IRS no longer conducts FFI customer satisfaction surveys, it does not have a way to know why the number of Free File users is decreasing or what other types of services would best attract new users. These questions must be answered to determine whether the program is worth continuing.

The Services Provided by Free File, Inc. Fail to Meet the Needs of Taxpayers, Particularly Within Underserved Populations

Free File Does Not Effectively Serve Its Targeted Demographics

The latest FFI operating agreement specifically highlights economically disadvantaged and underserved populations as the targeted groups for Free File services.⁴⁹ Taxpayers in vulnerable groups typically have limited disposable income and free time to spend on tax return preparation. However, FFI is failing to serve taxpayers within these populations, particularly low income taxpayers, elderly taxpayers, and ESL taxpayers.⁵⁰

46 Jacob Goldin, *Participation in the IRS Free File Program*, TAX NOTES (Oct. 23, 2017).

47 Michelle S. Chu and Melissa M. Kovalick, IRS, *An Analysis of the Free File Program*, presented at 99th Annual Conference on Taxation at 117 (Nov. 16-18, 2006).

48 See *Free File Software Offers*, <https://apps.irs.gov/app/freeFile/jsp/index.jsp> (last visited on Oct. 10, 2018).

49 2018 Free File MOU.

50 Stakeholders raised concerns that the Free File program would not serve its target audience adequately in comments to the Federal Register Notice on Free Internet Filing Agreement. Specifically, these comments noted that the program would not protect the interests of low income taxpayers and risked excluding English as a Second Language taxpayers. See IRS Electronic Tax Administration, *Responses to Federal Register Notice on Free Internet Filing Agreement* (Sept. 17, 2002).

First, while a high percentage of taxpayers using FFI software are low income, this number still constitutes a small proportion of low income taxpayers as a whole. Figure 1.4.3 illustrates the breakdown of income levels of Free File users in 2015, the last year the IRS prepared a demographics analysis report.

FIGURE 1.4.3, Percentage of Free File Users by Income Demographics (TY 2015)⁵¹

Adjusted Gross Income	Traditional Free File	Free File Fillable Forms
Negative AGI	1.00%	0.30%
\$0 to \$17,000	47.75%	13.10%
\$17,001 to \$25,000	15.91%	4.77%
\$25,001 to \$35,000	15.35%	5.58%
\$35,001 to \$50,000	14.13%	7.95%
\$50,001 to \$75,000	5.79%	20.56%
\$75,001 to \$100,000	0.03%	20.98%
\$100,001 or More	0.04%	26.75%
Total	100.00%	100.00%

Figure 1.4.3 shows the majority of all Free File software users had adjusted gross income of \$25,000 or less.⁵² However, this represents only about 1.5 million taxpayers, or just under 3 percent of all taxpayers in this demographic.⁵³ This shows that a substantial number of low income taxpayers are using other methods to file their returns or are not filing at all. If low income taxpayers pay for tax return preparation services instead of using the free ones offered by FFI, they would have less resources available to cover other basic living expenses. Although there may be legitimate reasons for using for-fee services—lack of tax knowledge, fear of making mistakes, desire for refund anticipation loans—the IRS has not conducted research to determine why low income taxpayer prefer for-fee services over free filing.

Second, elderly taxpayers are limited in the Free File software options available to them. While the IRS does offer the Tax Counseling for the Elderly program to assist taxpayers age 60 or older with return preparation, this program is only available during the filing season and is not designed to serve every taxpayer in this age range. Free on-demand electronic tax preparation service is still a valuable resource for taxpayers in this demographic. However, only three of the 12 FFI providers offer services to taxpayers of all ages, and even these have use restrictions based on the taxpayer's state of residence, income, or eligibility for the Earned Income Tax Credit.⁵⁴ Five of the 12 FFI providers have age limitations that start before the age of 60, with some even excluding taxpayers over the age of 50.⁵⁵ Age

51 See *Demographics of TY 2015 Traditional Free Filers, Free File Fillable Form Users, True Paper Filers, V-code Filers, and Form 1040 Series Filers*, included in IRS response to TAS information request (Sept. 7, 2018).

52 *Id.* Due to the lapse in appropriations, IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

53 Only 1,513,295 taxpayers out of 56.9 million total taxpayers with income \$25,000 or less used Free File software. *Id.*

54 For example, one Free File, Inc. (FFI) software provider makes its services available to all ages, but the taxpayer must have adjusted gross income of less than \$33,000 or be eligible for the Earned Income Tax Credit. See *Free File Software Offers*, <https://apps.irs.gov/app/freeFile/jsp/index.jsp> (last visited on Oct. 10, 2018).

55 *Id.*

restrictions like these sharply curtail the number of FFI options available to taxpayers, making it more difficult for them to choose a return package suited to their needs and preferences.

Third, ESL taxpayers face extreme difficulty navigating and using the Free File software, as no options were available in languages other than English in filing season 2018. The Hispanic community in the United States typically has a lower rate of electronic filing than other demographic groups.⁵⁶ A recent TAS study showed that because of language barriers and less education, Spanish-speaking taxpayers may be especially vulnerable to unscrupulous return preparers who promote high-interest loans and charge high fees.⁵⁷ Thus, there is a great need for free tax return preparation assistance, vetted by the IRS, to be made available to Spanish-speaking taxpayers. However, this need is not being met by FFI. While the IRS does provide some guidance to Spanish-speaking taxpayers on IRS.gov, the description and display for using Free File is only available in English.

FIGURE 1.4.4

IRS Free File Guidance in Spanish



Even if an ESL taxpayer can navigate through this screen, none of the return preparation software options available have a Spanish language option.⁵⁸ In its most recent Free File Memorandums of Understanding, the IRS made making tax filing easier for underserved populations a key objective, and even required members to provide a Spanish Free File indicator to show how many taxpayers took advantage of such services.⁵⁹ However, in another example of the IRS's lack of oversight and evaluation of the Free File program, there were zero providers offering such a Spanish-language version in filing season 2018. Because the IRS itself has not translated the Form 1040 into Spanish, Free File Fillable Forms are also only available in English.⁶⁰ These limitations in service can drive Spanish-speaking taxpayers to costly paid preparer options.

56 Sonja Pippin and Mehmet Tosun, *Electronic Tax Filing in the United States: An Analysis of Possible Success Factors* 12 ELECTRONIC JOURNAL OF E-GOVERNMENT, ISSUE 1, 22-38 (2014).

57 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 102 (Research Study: *Understanding the Underserved Hispanic Population*) ("Hispanics who use unregulated preparers run the risk of having their returns prepared incorrectly, either as a result of incompetency or willful misconduct."). TAS research has shown that only six percent of Hispanic taxpayers used a free tax preparation service by a trained volunteer, while 60 percent used a paid tax return preparer other than an attorney, CPA, or enrolled agent. *Id.*

58 Due to the lapse in appropriations, IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

59 2018 Free File MOU at 16; 2015 Free File MOU at 16.

60 In tax year 2017, TAS translated Form 1040 into Spanish, the first time ever this form has been available in a language other than English. TAS will update this form with changes for the 2018 Form 1040. The form is available at TAS's tax reform website, <https://taxchanges.us/es/>.

Testing by TAS Shows That Content Quality Is Not Consistent Among All Free File Software Providers, As Several Have Limitations in Their Navigation and Capabilities

The National Taxpayer Advocate continues to be concerned that the IRS does not sufficiently exercise its authority to set standards for what must be included in each Free File software provider's service offerings. The 2018 Free File MOU sets standards for core forms and schedules that must be offered by Free File software providers, but does not ensure that each offering covers specific deductions, credits, and exemptions.⁶¹ To evaluate each Free File software provider's ability to support items a taxpayer may include on a return, TAS tested several return preparation scenarios including Schedule C deductions, the tuition and fees credit, the Earned Income Tax Credit, casualty loss/disaster relief provisions, and the mortgage insurance premium deduction. Our testers had varying success completing their simulated return, depending on the provider they chose and the complexity of the scenario.⁶²

The perceived benefit of Free File software, as opposed to just Free File Fillable Forms, is that it gives guidance to help taxpayers navigate through the return filing process and alert them of all deductions and credits for which they may be eligible. However, testers noted that the quality of guidance provided during the process varied greatly among the software providers. Some sites had helpful tools like video tutorials, live chat features, explanations of deductions, and review features to help ensure taxpayers hadn't missed any credits or deductions. On others, however, the testers noted confusion in finding a help center, being overwhelmed by lists of unexplained deductions, and difficulty in correcting errors.

Testers of the casualty loss/disaster relief scenario noted that some providers failed to have prompts for how to claim this deduction, and they were left searching for the proper forms on their own. Testers of the Schedule C scenario noted that while all providers supported filing a Schedule C, some did not allow adding in depreciable assets or offer additional guidance on depreciation. Some sites also failed to explain how particular deductions or credits were calculated and selected, making it difficult for taxpayers to ensure they had selected the appropriate ones.⁶³ As a result of these limitations, taxpayers with limited knowledge of tax law depending on the Free File program for guidance may not realize they are eligible for some deductions and credits or claim them improperly, leading them to file incorrect returns.⁶⁴ If the service quality provided by Free File software fails to meet taxpayers' expectations, it can erode trust in the agency given the IRS's seeming endorsement of the Free File software offerings.

61 See 2018 Free File MOU. When TAS has conducted testing on Free File software in the past, our office found significant limitations in the coverage of some software providers. For example, testing by TAS in 2006 showed that a majority of providers did not include tax law benefits provided after Hurricane Katrina. See *Tax Return Preparation Options for Taxpayers: Hearing Before the S. Finance Comm.*, 109th Cong. (2006) (transcript of testimony). Similarly, testing in 2015 showed several Free File packages did not include info about exemptions from the Individual Shared Responsibility Payment of the Affordable Care Act, meaning some taxpayers paid a penalty they didn't owe. See National Taxpayer Advocate 2015 Annual Report to Congress 167-179, fn. 20 (Most Serious Problem: *Affordable Care Act (ACA) – Individuals: The IRS Is Compromising Taxpayer Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions*).

62 Please note: TAS's objective was to determine the existence and extent of limitations and problems that a typical user of the Free File sites would encounter. In some instances, the testers found the sites very difficult to navigate and were unable to locate forms or answers that later testers could locate. Therefore, the results described below reflect simply what our testers experienced and not necessarily what a site was capable of accomplishing.

63 For example, when testing the tuition and fees deduction scenario, one tester noted that some of the software providers did not explain the difference between the American Opportunity Credit, Lifetime Learning Credit, and the tuition and fees deduction. These providers would merely provide the credit or deduction determined to be most beneficial, without providing the bottom line value for all three.

64 Some software tested seemed overly focused on refund maximization, which could tempt taxpayers to provide incorrect information in hopes of getting a larger refund.

If the IRS continues to show no appetite for monitoring and overseeing, including testing, the products it gives the appearance of endorsing, the IRS should end its Free File offerings and, instead, focus on improving and promoting free fillable forms, which is the 21st century version of the Form 1040.

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

All Free File sites are accessed through the official IRS.gov website, yet cross-marketing of ancillary products and services is common on many of the sites. In the past, the National Taxpayer Advocate has raised concerns that cross-marketing and advertising on Free File software platforms can distract and confuse taxpayers as they complete their returns and undercut the value of the free services provided.⁶⁵

TAS commends the IRS for including important amendments to strengthen taxpayer protections and limit the marketing of paid services by FFI members in the 2018 Free File MOU.⁶⁶ The new MOU includes language requiring software providers to automatically return taxpayers to the IRS Free File page if they don't qualify for an offer, preventing software providers from upselling their other products through "value-add" buttons on landing pages.⁶⁷ The MOU also contains provisions for limiting email solicitations of taxpayers in subsequent years, and requiring Free File software providers to offer returning taxpayers Free File products as a first option in subsequent years.⁶⁸

While these amendments are important, the National Taxpayer Advocate continues to be concerned over the marketing of paid state tax filing services on Free File platforms. Our testing showed some providers required taxpayers to enter in state tax return information, even if the taxpayer did not intend to file a state return, and then advertised the price of the state return at the end of the process. While some states offer free filing independent of FFI, the 2018 Free File MOU prohibits the IRS from making

65 See *Tax Return Preparation Options for Taxpayers: Hearing Before the S. Finance Comm.*, 109th Cong. (2006) (transcript of testimony).

66 For a description of our prior testing, see *Tax Return Preparation Options for Taxpayers: Hearing Before the S. Finance Comm.*, 109th Cong. (2006) (transcript of testimony).

67 IRS News Release IR-2018-213, *IRS, Free File Alliance Announce Changes to Improve Program; Improved Taxpayer Options Available for 2019 Free File Program* (Nov. 2, 2018), <https://www.irs.gov/newsroom/irs-free-file-alliance-announce-changes-to-improve-program-improved-taxpayer-options-available-for-2019-free-file-program>. See also 2018 Free File MOU § 4.32.2 (Requiring Members to "provide, as a first option, a prominent hyperlink for the taxpayer to return to the IRS Free File Landing Page" if the taxpayer "enters a Member's Free File Landing Page and begins to complete a return but ultimately cannot qualify for the Member's free offer."); § 4.32.6 ("Members shall not include a "value-added" button (*i.e.*, an icon, link or any functionality that provides a taxpayer with access to a Member's commercial products or services) on the Member's Free File Landing Page.").

68 See also 2018 Free File MOU § 4.14 (A returning taxpayer must "be given a first option to return to the Member's Free File offer before receiving any other alternative choices for the Member's publicly available commercial tax preparation products or services."); § 4.32.4 ("Free File Members shall communicate not less than once annually via email with their taxpayer customers who used Free File services and completed their returns through Free File in the immediately preceding tax year prior to the opening of the following tax season. The content of this email(s) shall only remind the taxpayer about the availability of the Member's Free File offer and invite them to return to the Member's Free File Landing Page. Free File Members shall not use these communications to communicate with the taxpayer about any non-Free File commercial products or services. No marketing, soliciting, sale or selling activity, or electronic links to such activity, will be permitted in these email(s).").

taxpayers aware of these services.⁶⁹ By providing links to software providers marketing paid state-return options and not advertising the other free state options available, the IRS is in effect endorsing these for-fee products. Thus, rather than providing a service that meets taxpayers' needs, Free File software has the potential to mislead taxpayers and ensnare them in for-fee product offerings.

CONCLUSION

With no effective goals, measures, or budget, the IRS's Free File program in its current format has become an ineffective relic of early efforts to increase e-filing. Rather than being a beneficial program providing free return preparation services to all, it is an inadequate program that provides limited services and is used by only a small percentage of eligible taxpayers. The IRS is devoting zero 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 erode taxpayers' trust in fair tax administration.

If the IRS is going to promote the product, then it needs a dedicated budget and staff to set standards for the program, including what provisions products must incorporate in order to participate, to prevent taxpayers from being harmed. This starts with setting actionable goals that address issues currently faced by taxpayers and establishing measures to assess whether those goals are being met. The IRS must monitor and test with scenarios what the products do and present taxpayers with more information so they can make an informed choice about whether to use each product. Focusing on the taxpayer's experience using the Free File program will allow the IRS to identify how to best alter and develop the program to make free tax return preparation a more convenient and viable option for taxpayers.

If the IRS continues to show no appetite for monitoring and overseeing, including testing, the products it gives the appearance of endorsing, the IRS should end its Free File offerings and, instead, focus on improving and promoting free fillable forms, which is the 21st century version of the Form 1040.⁷⁰ This fillable electronic version of the Form 1040 should build on what is offered by Free File Fillable Forms, including linking from IRS form instructions to IRS publications, increased guidance for common areas of taxpayer confusion, creating versions available in other languages like Spanish, and providing a dedicated email where taxpayers can get help when experiencing technology glitches.

69 See 2018 Free File MOU § 4.22. The 2018 Free File MOU specifies that providing links from “the IRS Free File Website to Non-Free File State Department of Revenue websites is grounds for FFI to immediately dissolve its obligations in this MOU.” 2018 Free File MOU § 4.22.

70 For additional description of this recommendation, see Legislative Recommendation: *Tax Withholding And Reporting: Improve the Processes and Tools for Determining the Proper Amount of Withholding and Reporting of Tax Liabilities*, *infra*.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Develop actionable goals for the Free File program, including targeted-use percentages, prior to entering into a new agreement with Free File, Inc.
2. 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.
3. Provide Free File Fillable Forms and Software options for English as a Second Language taxpayers.
4. Prepare an advertising and outreach plan to make taxpayers, particularly in underserved communities, aware of the services available through the Free File program.
5. 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.
6. Redesign the Free File Software Lookup Tool to better direct taxpayers to software providers that best meet their circumstances.
7. Improve the capabilities offered to taxpayers through Free File Fillable Forms, including:
 - a. Linking from IRS form instructions to related IRS publications;
 - b. Providing increased guidance for common areas of taxpayer confusion;
 - c. Ensuring taxpayer's abilities to download, save, and print all forms with troubleshooting assistance; and
 - d. Creating a dedicated email where taxpayers can get help when experiencing technology glitches.
8. If the above recommendations are not substantially adopted, discontinue the Free File Program and create an improved electronic free fillable forms program including the features described in Recommendation 7.

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

RESPONSIBLE OFFICIAL

Ken Corbin, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

In calendar year (CY) 2016, tax refund fraud cost the government approximately \$1.6 billion.² The IRS's Return Integrity Operations office (RIO), which is housed in the Wage and Investment Division (W&I), is tasked with reducing this cost by detecting and preventing both identity theft (IDT) in the Taxpayer Protection Program (TPP) and non-IDT refund fraud in the Pre-Refund Wage Verification Program (WVP).³ The IRS primarily does this using two systems: the Dependent Database (DDb) and the Return Review Program (RRP).⁴ Although the fraud detection systems protected about \$7.6 billion in revenue between January 1 and September 30, 2018, they also delayed the processing of almost \$20 billion in legitimate refunds.⁵ Between January 1 and October 3, 2018, the False Positive Rate (FPR) for non-IDT refund fraud filters was 81 percent, while the FPR for IDT refund fraud filters was 63 percent.⁶

Further, according to the IRS, 64 percent of returns selected into the non-IDT refund fraud program in 2018 were legitimate even though more than two weeks elapsed from the time of selection until the IRS

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).
- 2 Government Accountability Office (GAO), GAO-18-224, Tax Fraud and Noncompliance: *IRS Can Strengthen Pre-Refund Verification and Explore More Uses 1* (Jan. 30, 2018).
- 3 Although not all tax refund fraud involves identity theft (IDT), and not all IDT involves tax refund fraud (e.g., employment-related IDT does not involve the theft of tax refunds), there are enough similarities between the two that it is appropriate to discuss them together.
- 4 The Dependent Database (DDb) and the Return Review Program (RRP) systems use filters, comprised of many rules or models, to score each return. If the return receives a certain score and is flagged as potentially fraudulent, the return goes to the Taxpayer Protection Program (TPP) or the Income Wage Verification (IWV) Program for further scrutiny. Internal Revenue Manual (IRM) 25.25.2.1, *Program Scope and Objectives* (May 7, 2018); IRM 25.25.6.1.7, *Taxpayer Protection Program Overview* (Aug. 28, 2018).
- 5 IRS response to TAS information request (Nov. 1, 2018).
- 6 A false positive occurs when a system selects a legitimate return and delays the refund past the prescribed review period. See IDT and IVO Performance Report, 19, 32 (Oct. 10, 2018).

Although the fraud detection systems protected about \$7.6 billion in revenue between January 1 and September 30, 2018, they also delayed the processing of almost \$20 billion in legitimate refunds.

released the refund—in addition to a two-week screening time prior to selection—for a total of about four weeks. The IRS refers to this 64 percent figure as the “operational performance rate” (OPR).⁷

While the National Taxpayer Advocate is very supportive of the IRS’s goal of detecting and mitigating refund fraud, she remains concerned about the fraud detection systems’ high FPR, long processing times, and unwieldy processes that are aggravated by outdated systems.⁸ More specifically, we have identified the following issues pertaining to the IRS’s fraud detection systems:

- The IRS does not capture all the information necessary to evaluate the accuracy and efficiency of its non-IDT and IDT refund fraud programs, and the information that it does track reveals significant delays in refunds due a large number of legitimate taxpayers.
- Factors contributing to high FPRs and refund processing delays include the fraud detection systems’ weekly check for third-party information, the IRS’s failure to consider if revenue lost is truly at risk for a selected return, and the barriers taxpayers face in authenticating their identity.
- The Electronic Fraud Detection System (EFDS) contributes to long processing times because it lacks systemic verification capabilities.
- 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. Further, in nearly half of the cases closed between January 15 and June 30, 2018, taxpayers ultimately received the refunds originally claimed on their returns.⁹

7 The IRS defines the Operational Performance Rate (OPR) as returns that are selected and not released by the pre-wage verification program within two weeks of selection. As discussed below, the National Taxpayer Advocate believes the OPR is not an accurate measure of the post-screening/selection False Positive Rate (FPR).

8 See, e.g., National Taxpayer Advocate 2016 Annual Report to Congress 151-160; National Taxpayer Advocate 2015 Annual Report to Congress 45-55, 180-187; National Taxpayer Advocate 2014 Annual Report to Congress, vol. 2, 44-90; National Taxpayer Advocate 2013 Annual Report to Congress 75-83; National Taxpayer Advocate 2012 Annual Report to Congress 42-67, 95-110; National Taxpayer Advocate 2011 Annual Report to Congress 48-73; National Taxpayer Advocate 2009 Annual Report to Congress 307-317; National Taxpayer Advocate 2008 Annual Report to Congress 79-94; National Taxpayer Advocate 2007 Annual Report to Congress 96-115; National Taxpayer Advocate 2005 Annual Report to Congress 25-54, 180-191; National Taxpayer Advocate 2004 Annual Report to Congress 133-136; National Taxpayer Advocate 2003 Annual Report to Congress 175-181.

9 Data obtained from Taxpayer Advocate Management Information System (TAMIS) (Feb. 1, 2018, Mar. 1, 2018, Apr. 1, 2018, May 1, 2018, Jun. 1, 2018, and Jul. 1, 2018).

ANALYSIS OF PROBLEM

Background

The IRS's efforts to detect and prevent refund fraud is managed by the RIO of the W&I, which oversees both the TPP (IDT refund program) and the WVP (non-IDT refund program).¹⁰

In the early days of its fraud detection program, the IRS relied solely on EFDS for detecting and preventing fraud detection.¹¹ However, EFDS's numerous inefficiencies impeded its ability to keep pace with the rapidly changing world of fraud.¹² In 2017, the IRS retired EFDS for fraud detection purposes; however, EFDS still remains a critical part of the IRS's fraud detection program.¹³ Two of the most significant EFDS components still in use are the final case selection function and the case management function. The outdated EFDS case management function poses significant problems for taxpayers and is further discussed below.

The IRS relies primarily on two systems to detect and prevent fraud: the DDb to detect IDT, and the RRP to detect IDT *and* non-IDT.¹⁴ The DDb contains filters which are comprised of rules that are binary in nature, (*i.e.*, if the rule is broken, the return will be selected for further analysis; if the rule is not broken, the return will continue through normal processing).

The RRP, on the other hand, contains filters which are comprised of both rules and models.¹⁵ The IRS uses the RRP rules and models in a variety of ways:

- **Predictive models.** The IRS develops many different models that help detect emerging fraud, outliers, and inconsistent, or suspicious behavior of taxpayers filing refund claims. These models also mine data and help IRS seek out patterns predictive of IDT and other refund fraud. For example, a model may use a combination of existing variables from the 1040 individual tax return, such as tax credits or income claimed.¹⁶
- **Business rules.** RRP contains over 1,000 rules (a “yes” or “no” outcome) developed by the IRS to flag returns for evidence of anomalous behavior. For example, RRP uses a business rule to distinguish between returns for which it has received an associated Form W-2, *Wage and Tax Statement (W-2)*, from those which it has not.¹⁷

10 See IRM 25.25.6.1.1, *Background* (Apr. 11, 2018); IRM 25.25.6.1 (1) and (3), *Program Scope and Objectives* (Apr. 11, 2018); and IRM 25.25.3.1(1), *Program Scope and Objectives* (May 10, 2018). For purposes of this Most Serious Problem, we have used “TPP” and “IDT refund fraud program” interchangeably, as well as the terms, “pre-refund wage verification program” and “non-IDT refund program.”

11 In 1994, the IRS installed the Electronic Fraud Detection System (EFDS) system to identify questionable and potentially fraudulent returns. See Treasury Inspector General for Tax Administration (TIGTA) Report Ref. No. 2017-20-080, *The Return Review Program Increases Fraud Detection; However, Full Retirement of the Electronic Fraud Detection System Will Be Delayed* 7 (Sept. 25, 2017).

12 *Id.*

13 There are 11 EFDS components that remain in effect and will likely not be retired in the near future. See TIGTA Report Ref. No. 2017-20-080, *The Return Review Program Increases Fraud Detection; However, Full Retirement of the Electronic Fraud Detection System Will Be Delayed* 7 (Sept. 25, 2017).

14 IRM 25.25.6.1.7(1), *Taxpayer Protection Program Overview* (Aug. 28, 2018); IRM 25.25.3.1(1), *Program Scope and Objectives* (May 10, 2018).

15 IRS response to TAS information request (Aug. 3, 2018). RRP models were activated in 2016 for IDT fraud, and in 2017 for non-IDT fraud. RRP models had to be built from the ground up because EFDS and RRP run on two separate, incompatible platforms. Beginning in Filing Season 2019, nearly all of the models that were in EFDS will now be in RRP.

16 GAO Report, Ref. No. GAO-18-544, *Tax Fraud and Noncompliance: IRS Could Further Leverage the Return Review Program to Strengthen Tax Enforcement* 12 (July 2018).

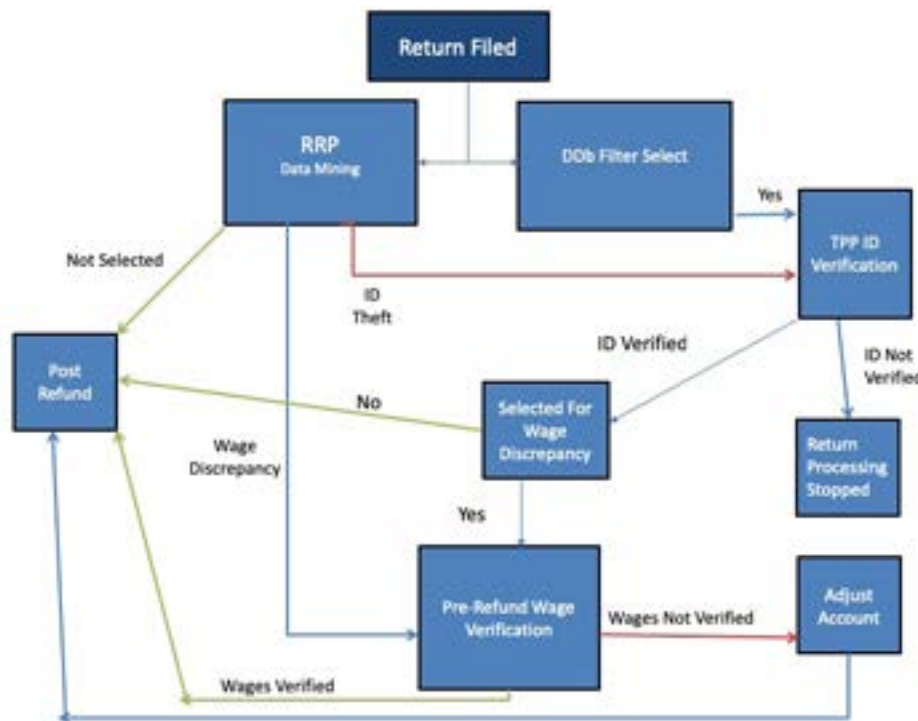
17 *Id.*

- Clustering.** RRP uses a tool that reveals patterns and relationships in masses of data, which allows the system to identify clusters of returns that share traits predictive of deceitful schemes and refund fraud. For example, the IRS could potentially use clustering to identify groups of returns that share the same geographic location, among other traits.¹⁸

Once the models complete their analysis using the techniques listed above, each return is given a score. The risk score is then fed into RRP filters, which will select returns based on whether the score exceeds a specified threshold, while considering other information in the system. If the score exceeds the threshold and other conditions are met, the return will be routed to either the TPP or WVP, whichever is most appropriate.

Figure 1.5.1 provides a simplified flow chart of the complicated processes the IRS uses to screen returns where a refund has been claimed and IDT or non-IDT refund fraud is suspected.

FIGURE 1.5.1, Flow Chart of Refund Return Screening for Identity Theft and Non-Identity Theft Refund Fraud



When a taxpayer’s return is sent to the TPP process, the IRS will ask the taxpayer to authenticate his or her identity either over the phone, online, or by visiting a Taxpayer Assistance Center (TAC).¹⁹ When taxpayers are sent to the pre-refund wage verification process, the information on their returns will be matched with third-party information provided by their employer(s) and payer(s). Beginning in Filing Season (FS) 2017, employers and most other payers were required to submit third-party reporting

18 GAO Report, Ref. No. GAO-18-544, *Tax Fraud and Noncompliance: IRS Could Further Leverage the Return Review Program to Strengthen Tax Enforcement* 12 (July 2018).

19 IRM 25.25.6.1.7, *Taxpayer Protection Program Overview* (Aug. 28, 2018). International taxpayers can mail in documentation to authenticate their identity. Letter 5447C, *Potential Identity Theft during Original Processing; Foreign Address* (Sept. 2018).

information (*Forms W-2 and Forms 1099-MISC-Nonemployee Compensation*) before or on January 31, thus providing the IRS more time to match the wage and tax information reported on the taxpayer's return against information submitted by third parties.²⁰

Selecting Returns as Potentially Fraudulent Significantly Delays Refunds for Many Legitimate Taxpayers, Increasing Taxpayer Anxiety and Causing Financial Hardship

If a return is assigned to TPP, it will generally take about 40 days from the filing of the return for the refund to be issued.²¹ From January 1 through June 30, 2018, more than 1.7 million returns were selected into TPP.²² The timeframe for returns selected into TPP is as follows:

- Submission to selection: 2 days
- Notification to Resolution: 24 days
(includes selection to notification: 5 days)
- Resolution to Refund: 14 days
 - **Total days = 40**²³

If a return is assigned to the pre-refund wage verification process, it also takes about 38 days for a refund to be issued from the time the return was submitted.²⁴ From January 1 through June 30, 2018, approximately 1.2 million returns were selected into the pre-refund wage verification program.²⁵ The timeframe for returns selected into the pre-refund wage verification program is as follows:

- Submission to Refund Fraud Start: 14 days
- Notification to Resolution: 17 days
(includes selection to notification: 7 days)
- Resolution to Refund: 7 days
 - **Total Days = 38**²⁶

Returns can also be subject to both the TPP and the pre-refund wage verification processes. When returns display characteristics of both IDT and non-IDT fraud, a return will be processed through TPP first. Then, if the taxpayer authenticates his or her identity, the return will then be processed through the pre-refund wage verification process. From January 1 through June 30, 2018, 211,076 returns were selected into both the TPP and the WVPs.²⁷ On average, taxpayers' refunds were issued 46 days after

20 Section 201 of the Protecting Americans From Tax Hikes (PATH) Act of 2015 amended IRC § 6071 to require that certain information returns be filed by January 31, generally the same date as the due date for employee and payee statements and are no longer eligible for the extended filing date for electronically filed returns under IRC § 6071(b). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 201 (2015).

21 IRS response to TAS information request (Aug. 3, 2018).

22 *Id.*

23 *Id.*

24 *Id.*

25 *Id.*

26 *Id.*

27 Compliance Data Warehouse (CDW) Individual Master File (IMF) Transaction Code 150 History file and CDW IMF Transaction History file (Nov. 20, 2018). About 10 percent of these accounts were manually selected into the TPP and may never have gone to the pre-refund wage program.

the return was submitted.²⁸ The timeframe for returns selected into both the TPP and pre-refund wage verification programs is as follows:

- Submission to IDT Selection: 2 days
- Notification to IDT Resolution: 24 days
(includes selection to notification: 5 days)
- IDT Resolution to Refund Fraud Start: 7 days
- Start to Refund Fraud Resolution: 6 days
- Resolution to Refund: 7 days
 - **Total Days = 46**²⁹

The IRS Does Not Capture All the Information Necessary to Evaluate the Accuracy and Efficiency of Its Non-IDT and IDT Refund Fraud Programs, and the Information That It Does Track Reveals Significant Delays in Refunds Due a Large Number of Legitimate Taxpayers

To evaluate the accuracy and efficiency of the non-IDT refund fraud program, the IRS tracks two data points to evaluate how accurate its filters are working in selecting fraudulent returns, and whether legitimate returns selected by the filters are being quickly resolved. These data points are the FPR and the operational performance rate.

False Positive Rate: This data point is the percentage of legitimate returns selected by the IRS as potentially fraudulent, divided by the total number of returns selected by the IRS as potentially fraudulent.

Example: The IRS selected 100 returns as potentially fraudulent. Eighty of these returns turned out to be legitimate. Therefore, to determine the false positive rate, divide 80 by 100, which equals 80 percent.

Operational Performance Rate: The IRS's current formula for this rate is the false positive rate discounting those returns the IRS confirmed as legitimate within two weeks of selection (*i.e.*, no more than four weeks from filing, including the two weeks the IRS has to decide if the return should be selected as potentially fraudulent). Specifically, the OPR retains the same denominator as the FPR (the total number of returns selected by the IRS), but the numerator is decreased by the number of returns that the IRS clears as legitimate within two weeks of selection.

Example: The IRS selected one hundred returns, with 80 returns determined to be legitimate (FPR). Twenty of these 80 legitimate returns were resolved within two weeks of selection (four weeks total). Thus, the OPR is 60 percent [(80 minus 20)/100 = 60 percent].

These data points are very useful in determining how this program impacts taxpayers but in order to fully capture that impact, one other data point should be added. This is a variation on the OPR. For purposes of this discussion, it will be referred to as the "Operational FPR".

²⁸ CDW IMF Transaction Code 150 History file and CDW IMF Transaction History file (Nov. 20, 2018).

²⁹ *Id.*

Operational FPR: This data point is the ratio of the legitimate returns resolved after the four-week period (the numerator) and *the number of returns left after the four-week period* (the denominator).

Example: The IRS selected 100 returns, and it determined 80 were legitimate. Twenty of the 80 legitimate returns were resolved within two weeks of selection. That means the “Operational FPR” would be 75 percent [(80 minus 20)/(100 minus 20) = 75 percent].

This formula is a more accurate depiction of the number of legitimate returns that took more than two weeks to be resolved from the time of selection than the OPR, because the numerator and denominator mirror one another. Specifically, both numbers exclude the number of returns resolved within two weeks of selection. On the other hand, the OPR does not exclude the number of returns resolved within two weeks of selection from the formula’s denominator, which distorts the percentage and gives an inaccurate appearance of improved performance. In fact, when TAS Research applied the above-discussed formula for Operational FPR and excluded the number of returns resolved within two weeks of selection from both the numerator and the denominator, it found that the Operational FPR is 77 percent.³⁰

These three data points (FPR, OPR, and Operational FPR) will assist the IRS in identifying problems and finding solutions (*i.e.*, do the fraud detection filters need to be refined, or is there a need for additional staffing to resolve the selected cases faster?). More specifically, it will tell the IRS the following:

- (1) Whether the IRS is quickly resolving the legitimate returns on the front end; or
- (2) Whether the IRS is *not* quickly resolving the legitimate returns on the front end but rather has a very high number of legitimate returns that have slipped through the four-week period and thus are creating both taxpayer and IRS burden.

Therefore, these data points will assist the IRS in determining whether it is quickly resolving these issues so they don’t create taxpayer burden, generate phone calls to the IRS, or create TAS cases. When analyzing the FPR and OPR for the non-IDT refund fraud program during FY 2018, it is clear that the program affected a large number of taxpayers who filed legitimate returns and whose refunds were delayed more than four weeks beyond the date of filing. As mentioned earlier, the FPR for non-IDT refund fraud was 81 percent from January 1 through October 3, 2018.³¹ For the same time period, the non-IDT refund fraud program had an OPR of 64 percent of returns selected into the program that were legitimate even though more than two weeks elapsed from the time of selection until the refund was released. As discussed, this figure understates the number of legitimate returns that were delayed beyond two weeks from the time of selection.³² In 2018, many more taxpayers were impacted by these delays than in past years as non-IDT refund fraud filters selected in excess of one million returns from January 1 through October 3, 2018, a roughly 400 percent increase when compared to the same time period last year.³³

30 TAS used the following formula to reach the 77 percent figure: Selections: 1,312,439. FPR = 63 percent (calculated (826,837/1,312,439)). Fraud Detection rate (refile rate): 81 percent (calculated (1,063,076/1,312,439)). The numerator of the “Operational FPR” would be 826,837. The denominator of the “Operational FPR” calculation = 1,312,439 minus 236,239 (the number of returns cleared within two weeks) = 1,076,200. Therefore, the “Operational FPR” then equals 826,837/1,076,200 = 77 percent.

31 IDT & IVO Selections Performance Report 32 (Oct. 10, 2018).

32 *Id.*

33 *Id.*

When TAS Research excluded the number of returns resolved within two weeks of selection from both the numerator and the denominator, it found that the “Operational False Positive Rate” is 77 percent.

The IDT refund fraud program’s FPR was lower than that of the non-IDT refund fraud program but was still well above 50 percent at 63 percent.³⁴ Unlike the non-IDT refund fraud program, the IDT refund fraud program does not track an OPR. This is because IDT processing is quite different than non-IDT processing. When the return is selected for possible IDT, processing is suspended, and a letter is sent to the taxpayer asking him or her to authenticate his or her identity. Thus, time must be allowed for the letter to be received by the taxpayer, and the taxpayer must take action to authenticate his or her identity for return processing to continue so that the refund can be released.

Conversely, the release of selected non-IDT refunds does not rely on the taxpayer to take any action. Despite these differences, it is imperative that the IDT refund fraud program track the number of cases that take more than a specified period of time to be resolved. It is reasonable that the IDT program would use different criteria to establish this data point. Although the criteria might vary from that of the non-IDT refund fraud program, the formula applied should be similar to the Operational FPR described above. Further, the IRS should consider conducting a study to identify why taxpayers do not authenticate more quickly.

These figures, the non-IDT and IDT refund fraud FPRs, and the OPR for non-IDT refund fraud, albeit limited in the information they provide, illustrate that these programs select too many legitimate returns, and take too long to release the refunds. A false positive rate of around 50 percent is generally accepted among those in the private sector.³⁵ With current FPRs of 81 and 63 percent, there is plenty of opportunity for the IRS to improve its refund fraud filters, without jeopardizing revenue protection.³⁶

Factors Contributing to High False Positive Rates and Refund Processing Delays Include the Fraud Detection Systems’ Weekly Check for Third-Party Information, the IRS’s Failure to Consider If Revenue Lost Is Truly at Risk for a Selected Return, and the Barriers Taxpayers Face in Authenticating Their Identity

For non-IDT refund fraud, refunds associated with returns selected by a filter are generally frozen until the taxpayer’s employer or payer provides third-party data to the IRS or Social Security Administration (SSA), which forwards the information to the IRS. Once the taxpayer’s third-party information is posted, it can be matched with information on the taxpayer’s return, and the refund will be released. However, this process is dependent upon employers’ timely submission of the required information to the SSA or payers’ timely submission to the IRS. For FY 2018, the IRS received 42 percent of expected employer/employee documentation on or by February 5, representing 43 percent of employee information documents.³⁷

34 IDT & IVO Selections Performance Report 32 (Oct. 10, 2018).

35 *Fraud and False Declines: Fighting the Downward Spiral with Collaboration*, (April 28, 2017), <https://www.thepayers.com/expert-opinion/fraud-and-false-declines-fighting-the-downward-spiral-with-collaboration/768755>.

36 *Id.*

37 *Id.* at 40.

Although employers' late submissions of employee information delay the process, the IRS can take additional steps to verify returns even without an employer's submission. For example, the IRS could review the employer's history and determine if there is a pattern of submitting employee information late. If so, and the information on the return is largely consistent with prior year returns, the IRS could presume the return is legitimate and release the refund.

Another issue regarding missing wage information is the frequency at which IRS systems check for the posting of this information, which was checked weekly during FS 2018, instead of daily. Thus, a fraud detection filter may select the return because there is no third-party information available to verify the return. However, the IRS may receive the employer information within a day or two of selecting the return, but the IRS would not be aware that it received that third-party information for at least a week due to IRS systems weekly check for third-party information. For the 2019 filing season, the IRS has made adjustments to several of its filters to systemically check for the posting of third-party information daily instead of weekly.

Other examples where enhancements can be made include releasing returns, particularly if the third-party information is either inconsequential to the refund or would result in a larger refund to the taxpayer. For instance, TAS has handled cases where the return was held because third-party information did not match the information on the return, yet the third-party information would only have served to increase the refund amount.³⁸ When the return is being selected due to a mismatch between the information on the return and the third-party information, refund fraud systems should be developed to conduct a refund analysis and, if the third-party information would either have no impact on the amount of the refund or would increase the amount of the refund, the refund should be released immediately. Simple adjustments to the selection process 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 they are selected. This would allow the IRS to better utilize its resources to verify returns where there is a substantial potential for fraud.

For IDT, the taxpayer is required to authenticate his or her identity either over the phone, online, or in person at a TAC.³⁹ Since taxpayers' refunds are being delayed, the expectation is that taxpayers would authenticate their identity as quickly as possible. However, the process on average still takes about 40 days.⁴⁰ The IRS would be well-advised to follow up with taxpayers who take longer than average to authenticate by inquiring into their reasons for delaying their identity authentication. This information is critical to determine if taxpayers experienced any difficulties authenticating that may be alleviated through changes to IRS procedures. Some possible barriers taxpayers may face when trying to authenticate include difficulty in reaching a customer service representative (CSR) to authenticate their identity over the phone.

Additionally, taxpayers may have difficulty obtaining assistance at a TAC, since generally, TACs will only see taxpayers by appointment.⁴¹ During FS 2018, TACs were overwhelmed with appointments. TAS received complaints that taxpayers were waiting for up to three months to obtain an appointment

38 TAS Systemic Advocacy Management System (SAMS) issues 37230 and 37347.

39 IRM 25.25.6.1.7, *Taxpayer Protection Program Overview* (Aug. 28, 2018).

40 IRS response to TAS information request (Aug. 3, 2018).

41 IRS News Release IR-2016-172, *Tax Preparedness Series: IRS Face-To-Face Help Now by Appointment* (Dec. 20, 2016). IRS response to TAS fact check (Dec. 20, 2016); IRS, Fact Sheet: *Internal Revenue Service Appointment Service Test* (Feb. 26, 2015). The IRS began a pilot during filing season (FS) 2015 whereby taxpayers needed to call for an appointment at 44 sites. The IRS expanded the pilot to more locations during FS 2016, and in November 2016, it completed a transition to appointment-only service at all Taxpayer Assistance Centers (TACs).

in some TACs.⁴² Initially, taxpayers selected for possible IDT, who were trying to authenticate their identities at a TAC, could not get appointments until May, after the filing season had concluded.⁴³ To address this issue, the IRS solicited volunteers from other IRS business units to work at TACs so taxpayers could get appointments to authenticate their identities before the conclusion of the filing season.⁴⁴

The IRS's Outdated Electronic Fraud Detection System (EFDS) Contributes to Long Processing Times Because It Lacks Systemic Verification Capabilities

One of the new non-IDT filters for FS 2018 selected about 303,000 Earned Income Tax Credit (EITC) and Additional Child Tax Credit (ACTC) returns as potentially fraudulent because no third-party income information had been posted as of February 15, 2018, about two weeks after the January 31 deadline established by law.⁴⁵ Once these accounts were selected as potentially fraudulent, the IRS anticipated that the EFDS would be able to release refunds in bulk when income on the return could be verified with third-party information. However, because EFDS does not interact with the IRS system that maintains third-party income information, employees must enter the third-party information into EFDS one document at a time, and then manually release the refunds. What makes this so exasperating is that the IRS has been claiming for more than a decade that it will retire its EFDS in favor of a more modern, sophisticated system.⁴⁶ This is just the latest example of how old systems harm taxpayers and create more work for the IRS.⁴⁷ The frustration of this delay is compounded by the fact that taxpayers cannot receive information about their refunds that are being held when they call the IRS because IRS

Because Electronic Fraud Detection System (EFDS) does not interact with the IRS system that maintains third-party income information, employees must enter the third-party information into EFDS one document at a time, and then manually release the refunds.

42 TAS Systemic Advocacy Management System Issue 37305.

43 Memorandum from Director of IRS Field Assistance (Apr. 2, 2018).

44 *Id.* See also Wage & Investment, Business Performance Review 3 (Aug. 2018).

45 IDT and IVO Selection Performance Report (Feb. 28, 2018); *Continued Oversight Over the Internal Revenue Service: Joint Hearing Before the H. Subcomm. on Health Care, Benefits, and Administrative Rules and H. Subcomm. on Government Operations*, 115th Cong. (2018) (statement of Nina E. Olson, National Taxpayer Advocate).

46 See TIGTA Report Ref. No. 2017-20-080, *The Return Review Program Increases Fraud Detection; However, Full Retirement of the Electronic Fraud Detection System Will Be Delayed* 7 (Sept. 25, 2017); see also National Taxpayer Advocate 2016 Annual Report to Congress 109-120 (Most Serious Problem: *Enterprise Case Management (ECM): The IRS's ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Integrated System (TASIS) As a Quick Deliverable and Building Block for the Larger ECM Project*).

47 See Legislative Recommendation: *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*, *infra*; National Taxpayer Advocate 2016 Annual Report to Congress 109-120 (Most Serious Problem: *Enterprise Case Management (ECM): The IRS's ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Integrated System (TASIS) As a Quick Deliverable and Building Block for the Larger ECM Project*).

CSRs do not have access to the EFDS case management system for the WVP.⁴⁸ The IRS could give CSRs the ability to view information about why the return was flagged, which in turn, would help taxpayers resolve issues more quickly.⁴⁹

The High FPR and Long Delays Resulted in a 287 Percent Increase in Taxpayer Advocate Service Pre-Refund Wage Verification Cases From January 1 through September 30, 2018, When Compared to the Same Time Period in the Prior Year, and in Nearly Half of the TAS Cases Closed Between January 15 and June 30, 2018, Taxpayers Ultimately Received the Refunds Originally Claimed on Their Returns

The increase in returns being selected as potentially fraudulent, the high FPRs, and the large number of selected returns being delayed beyond two weeks, have all contributed to a significant increase in TAS's case receipts.

FIGURE 1.5.2, TAS Pre-Refund Wage Verification Hold Receipts

TAS Pre-Refund Wage Verification Hold Monthly Receipts for 2017 and 2018 (January through September)										
Year	January	February	March	April	May	June	July	August	September	Total
2017	692	1,989	4,169	2,070	2,017	1,768	1,487	1,358	882	16,432
2018	712	3,628	13,361	10,056	9,223	5,811	7,797	7,786	5,263	63,637

As shown in Figure 1.5.5, TAS pre-refund wage verification refund hold case receipts from January 1 through September 30, 2018, increased from 16,432 to 63,637 cases, or 287 percent, when compared to the same period last year.⁵⁰ To evaluate this significant increase, TAS research analyzed all the non-IDT refund fraud cases that were closed in TAS inventory between January 15 and June 30, 2018, that were related to issues arising out of taxpayer's tax year 2017 returns. During this time period, TAS closed 42,120 cases, and out of this number, 18,816 or 45 percent of the taxpayers received the refund that was originally shown on their return.⁵¹ Fifty-five percent of the 18,816 cases that were identified by the RRP system were selected solely by one filter.⁵² These findings are consistent with the high 81 percent FPR and the 77 percent for Operational FPR for non-IDT refund fraud. It further illustrates how a problem with one single filter can affect thousands of taxpayers who file legitimate returns. The National Taxpayer Advocate urges the IRS to work with her and her staff to review the findings of TAS's research to prevent a similar situation from occurring in future filing seasons.

48 IRM 21.5.6.4.35.3.1, -R Freeze Phone Procedures for Accounts with Integrity and Verification Operations (IVO) Involvement (Jun. 15, 2018); *Continued Oversight Over the Internal Revenue Service: Joint Hearing Before the H. Subcomm. on Health Care, Benefits, and Administrative Rules and H. Subcomm. on Government Operations*, 115th Cong. (2018) (statement of Nina E. Olson, National Taxpayer Advocate).

49 Notes from National Taxpayer Advocate Meeting with SAS (Apr. 25, 2018).

50 Data obtained from TAMIS (Feb. 1, 2017; Oct. 1, 2017; Feb. 1, 2018; Oct. 1, 2018).

51 CDW IMF Transaction Code 150 History file and CDW IMF Transaction History file (Nov. 20, 2018). The 18,816 included cases where the refund issued was the same amount as the refund shown on the return, less a math error adjustment.

52 Match of TAMIS data to RRP selection file, 2018 IWW Selection, provided by the IRS.

CONCLUSION

The National Taxpayer Advocate acknowledges the importance of reducing tax fraud and recognizes that robust fraud detection systems are required to meet this objective. However, when these systems routinely have FPRs above 60 percent, they harm legitimate taxpayers and create unnecessary work for the IRS. Equally important is the IRS's efforts in designing a process that can quickly analyze returns and release refunds to legitimate taxpayers.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Calculate an "Operational FPR" in addition to the FPR and OPR for non-IDT accounts.
2. Develop criteria to be used in measuring OPR for IDT accounts.
3. Conduct a study to determine why it takes some taxpayers longer to authenticate their identities and what barriers they may encounter when attempting to do so.
4. 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 between third-party information and the information on a taxpayer's return.
5. Request from outside vendors information on ways to improve the FPR, along with proposals to determine the factors that are contributing to high FPRs.
6. 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**

RESPONSIBLE OFFICIALS

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 Jeffrey J. Tribiano, Deputy Commissioner, Operations Support

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

When the IRS allows a taxpayer's erroneous claim of the earned income tax credit (EITC), it makes an "improper payment."² The IRS estimates that 25 percent of the claimed EITC credits it allowed in fiscal year (FY) 2018 were improper payments.³ The IRS's attempts to reduce the EITC improper payment rate have met with limited success.⁴ While she recognizes the importance of tracking and minimizing improper payments, the National Taxpayer Advocate is concerned that the focus on "a number" masks both the successes and challenges in improving EITC compliance. Specifically:

- The effect of any statutory measures intended to reduce the EITC improper payment rate are not reflected in the IRS's estimate for years;⁵
- The IRS lost an exemption that allowed it to reduce the improper payment estimate by improper payments it recovered;⁶

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 See Improper Payments Information Act of 2002 (IPIA), Pub. L. No. 107-300 § 2(d)(A), 116 Stat. 2350, 2351 (2002), defining an improper payment as "any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments)."

3 Department of Treasury, Agency Financial Report (AFR) Fiscal Year (FY) 2018 194 (Nov. 2018), estimating an earned income tax credit (EITC) improper payment rate of 25.06 percent.

4 As discussed below, since FY 2010 the improper payment rate has fluctuated but has never been estimated as less than 22.8 percent.

5 See, e.g., Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title II, § 201 (a) and (b), 129 Stat. 2242, 3076 (2015) (hereinafter PATH Act), codified at IRC §§ 6071(c) and 6402 (m), discussed below.

6 See Government Accountability Office (GAO), GAO 18-377, *Improper Payments, Actions and Guidance Could Help Address Issues and Inconsistencies in Estimation Processes*, App'x IV, Comments from the Internal Revenue Service (May 2018). When recovered payments are taken into account, the FY 2018 improper payment rate is 23.41 percent rather than 25.06 percent. AFR, FY 2018, 194 n. 4 (Nov. 2018).

- The improper payment rate does not take into account that for every dollar of EITC improper payments, 40 cents of EITC went unclaimed by taxpayers who appear to be eligible for the credit;⁷
- 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;⁸
- EITC improper payments are a relatively small portion of the tax gap;⁹ and
- The EITC program costs less to administer than other non-tax benefit programs and has higher participation rates.¹⁰

In attempting to address improper payments, the IRS may unnecessarily burden taxpayers.¹¹ The IRS could gain insight from TAS research study results and the proactive approaches other tax administrations have adopted in their interactions with taxpayers.¹²

ANALYSIS OF PROBLEM

Background

The current statutory framework pertaining to improper payments originated in 2002, when Congress required the heads of executive agencies, pursuant to guidance from the Office of Management and Budget (OMB), to identify programs and activities susceptible to significant improper payments and report to Congress the estimated amount of improper payments.¹³

7 Treasury Inspector for Tax Administration (TIGTA), Ref. No. 2018-IE-R004, *The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers* at 2 (Apr. 2, 2018).

8 The rules for claiming the child tax credit (CTC) are similarly complex. See IRC § 24. The importance of the CTC was magnified by legislation that increased the amount of the credit from \$1,000 to \$2,000, for tax years 2018-2025. See Pub. L. No. 115-97, § 1022(a), 131 Stat. 2054, 2073 (2017). The National Taxpayer Advocate has recommended that Congress consolidate numerous family status provisions into a new Family Credit and require the IRS to establish a dedicated, year-round toll-free help line staffed by IRS personnel to respond to questions about the credit. National Taxpayer Advocate 2016 Annual Report to Congress 329 (Legislative Recommendation: *Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*).

9 As discussed below, EITC misreporting constitutes six percent of the gross tax gap and ten percent of the tax gap attributable to income misreporting by individuals.

10 As discussed below, the cost of administering the EITC program is around one percent of benefits delivered, with a participation rate of 79 percent.

11 See below for a discussion of the IRS's pursuit of extended math error authority and its imposition of two-year bans on claiming EITC.

12 See, e.g., Organisation for Economic Co-operation and Development (OECD), *The Changing Tax Compliance Environment and the Role of Audit* 19, 23-26 (2017), https://www.oecd-ilibrary.org/taxation/the-changing-tax-compliance-environment-and-the-role-of-audit_9789264282186-en (last visited Nov. 26, 2018).

13 IPIA, Pub. L. No. 107-300, 116 Stat. 2350 (2002), as amended. Current Office of Management and Budget (OMB) guidance consists of OMB M-15-02, Appendix C to Circular No. A-123, *Requirements for Effective Estimation and Remediation of Improper Payments* (2014), as modified by OMB M-18-20 Transmittal of Appendix C to OMB Circular A-123, *Requirements for Payment Integrity Improvement* 25 (June 26, 2018). This guidance implements requirements from the following: (1) IPIA; (2) the Improper Payments Elimination and Recovery Act of 2010 (IPERA), Pub. L. No. 111-204, 116 Stat. 2350 (2010); (3) the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA), Pub. L. No. 112-248, 126 Stat. 2390 (2012); and (4) Executive Order 13520 *Reducing Improper Payments* (Nov. 20, 2009). The 2014 OMB guidance defined "significant improper payments" as gross annual improper payments (*i.e.*, the total amount of overpayments and underpayments) in the program exceeding (1) both 1.5 percent of program outlays and \$10,000,000 of all program or activity payments made during the fiscal year reported or (2) \$100 million (regardless of the improper payment percentage of total program outlays). EITC underpayments are defined as the amount of EITC disallowed by the IRS in processing that should have been allowed, as determined by the National Research Program (NRP) examination. AFR, FY 2013 at 206. Thus, unclaimed EITC amounts are not underpayments and are not included in the calculation of improper payments.

A 2009 Executive Order and 2012 legislation required OMB, among other things, to designate and exercise additional oversight with respect to “high priority” programs.¹⁴ Because EITC has been so designated, the IRS must provide, for inclusion in the Department of the Treasury’s annual Agency Financial Report (AFR), not only the rate and amount of improper EITC payments, but additional information such as the root causes of the improper payments. Pursuant to OMB guidance issued in June 2018, the IRS will be required, among other things, to estimate improper payments attributable to other refundable tax credit programs, such as the Affordable Care Act Premium Tax Credit, the Child Tax Credit, and, potentially, the American Opportunity Tax Credit.¹⁵

In addition to reporting EITC improper payment rates over the years, the IRS has conducted an array of studies relating to erroneous EITC claims, particularly when funds were appropriated for such research.¹⁶ Recent IRS initiatives include studies on the effectiveness of “soft” notices, discussed below.

EITC Improper Payments Estimates, Based on Audits of Tax Years Four Years in the Past, Do Not Reflect the Most Recent Remedial Measures or Take Into Account Unclaimed EITC

As part of its National Research Program (NRP), each year the IRS audits a sample of EITC returns and uses data from the audits to estimate the rate of improper EITC payments for that audit year.¹⁷ The *rate* derived from the NRP data is then used to estimate the *amount* of improper payments for the current year. The most recent year for which NRP data is available is 2014. The total amount of EITC claimed on 2014 returns was divided into the amount which, according to NRP audits, were improper payments to arrive at an improper payment *rate* of 25.06 percent.¹⁸ The FY 2018 EITC improper payment *amount* was estimated by multiplying the NRP *rate* (25.06 percent, based on audits of a tax year four years in the past) times the amount of EITC claimed in 2018 (\$73.6 billion) to arrive at \$18.4 billion.¹⁹ This four-year lag between audit outcomes for the tax year that generated the estimated *rate* and the estimated *amount* of improper payments for a given year is a feature of the improper payment estimating process.

14 Executive Order 13520, *Reducing Improper Payments* § 2 (Nov. 20, 2009); IPERIA, § 3. OMB M-18-20 *Transmittal of Appendix C to OMB Circular A-123, Requirements for Payment Integrity Improvement 25* (June 26, 2018) defines high priority programs as those with more than \$2 billion in improper payments in a given year, an increase from the prior threshold of \$750 million.

15 OMB M-18-20 *Transmittal of Appendix C to OMB Circular A-123, Requirements for Payment Integrity Improvement 25* (June 26, 2018). The guidance institutes this requirement with respect to all programs with outlays in excess of \$5 billion, starting in fiscal year 2020. Thus, programs that meet that threshold will also qualify as “high priority” programs. Affordable Care Act (ACA), Premium Tax Credit, and CTC outlays already exceed that threshold, and the American Opportunity Tax Credit outlays, while currently below the threshold, may grow to the threshold amount in the future. IRS response to TAS information request (Aug. 30, 2018).

16 For example, in 1997, Congress authorized a \$716 million appropriation over five years (from FY 1998 to 2002) “for improved application” of the EITC. Balanced Budget Act of 1997, Pub. L. No. 105–33, § 5702, 111 Stat. 251, 648 (1997). Among the studies the IRS conducted was *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns* 13 (Feb. 28, 2002), reporting, e.g., that among known errors, the largest *amount of overclaims* was caused by taxpayers claiming children who were not their qualifying children, most commonly because the residency requirement was not met. The most *frequent* known error was income misreporting.

17 IRS, *Improper Payments Estimates for the Earned Income Tax Credit: Methodology for the Fiscal Years 2010-2013 Update 2* (May 2010) (on file with TAS). EITC overclaims, defined as the difference between the amount of EITC claimed by the taxpayer on his or her return and the amount the taxpayer should have claimed, as determined by the NRP audit, are reported in the Treasury’s AFR as “actual monetary loss to the government.” See, e.g., AFR, FY 2017 at 176 (Nov. 2017).

18 See AFR, FY 2017 at 174 (Nov. 2017), for a description of this methodology (which does not appear in the FY 2018 AFR).

19 AFR, FY 2018 at 194 (Nov. 2018).

Thus, the estimated EITC improper payment rate does not reflect the most recent measures taken by Congress and the IRS to reduce EITC improper payments.²⁰

The IRS Lost Its Exemption From a Reporting Requirement That Allowed It to Reduce Improper Payment Estimates by Recovered Amounts

In the past, the IRS estimated the improper payment rate by first estimating the gross amount of improper payments, and reducing that amount by the amount of erroneous EITC payments “prevented or recovered.”²¹

This method of computing the EITC improper payment rate was permitted because the IRS had obtained an exemption from the statutory requirement, introduced in 2012, that agencies “include all identified improper payments in the reported estimate, regardless of whether the improper payment in question has been or is being recovered.”²² The IRS’s temporary exemption was allowed “because the tax system differs from spending programs in that much of the verification and compliance activity for potentially erroneous tax returns takes place after refunds have been issued.”²³ In other words, unlike other benefit programs, EITC does not have a separate application process—the tax return is the application. By design, significant compliance activity occurs after issuance of refunds.

However, the IRS’s exemption was not permanent, and the inconsistency was never resolved by the IRS and OMB.²⁴ In 2018, the IRS acquiesced to the Government Accountability Office’s recommendation that it change its method of computing improper payments to disregard recovered amounts.²⁵

Thus, the improper payment rate used to estimate the amount of improper payments in FY 2018, 25.06 percent, was not reduced by recovered improper payments.²⁶ The change in the calculation does not reflect a change in taxpayer compliance, but yields a higher improper payment estimate. When recovered improper payments are taken into account, the *rate* used to calculate the amount of improper payments for FY 2018 becomes 23.41 percent.²⁷ The estimated *amount* of improper payments would thus be 23.41 percent times the amount of EITC claimed on 2018 returns (\$73.6 billion) to arrive at \$17.2 billion (rather than \$18.4 billion).

20 For example, beginning with 2017, the PATH Act imposed a Jan. 31 due date for filing Forms W-2, *Wage and Tax Statement*, Forms W-3, *Transmittal of Wage and Tax Statements*, and any returns or statements required to report nonemployee compensation (such as Forms 1099-MISC, *Miscellaneous Income*), with the Social Security Administration, and required the IRS to delay payment of any refund that includes the EITC or the refundable portion of the CTC until Feb. 15 of each filing year.

21 “Prevented” EITC improper payments are EITC claims that are determined to be erroneous before a refund is paid (these amounts are sometimes referred to as the amount of revenue protected), while “recovered” improper payments are erroneous EITC claims that are paid but later recuperated.

22 IPERIA § 3(b)(2)(D), implemented with OMB M-15-02, Appendix C to Circular No. A-123, *Requirements for Effective Estimation and Remediation of Improper Payments* 18 (2014).

23 GAO, GAO 18-377, *Improper Payments, Actions and Guidance Could Help Address Issues and Inconsistencies in Estimation Processes*, App’x IV, Comments from the Internal Revenue Service (May 2018).

24 *Id.*, noting that “[t]he exemption was intended to be temporary until the IRS and OMB could address outstanding questions related to the appropriate representation of EITC and other refundable tax credit overclaims. However, since none of the discussions with OMB have resulted in any decisions to date, the IRS will update its reporting so that recoveries are no longer included in our estimates.”

25 *Id.*

26 The IRS will continue to take into account “prevented” erroneous payments and will also provide a computation of the EITC improper payments that takes into account recovered erroneous payments for comparison purposes. IRS response to TAS information request (Aug. 30, 2018).

27 AFR, FY 2018 at 194 n. 4 (Nov. 2018).

The estimated amount of improper payments also does not take into account that many taxpayers who appear to be eligible do not claim Earned Income Tax Credit (EITC). The Treasury Inspector General for Tax Administration estimated that ... for every dollar of EITC improper payments, there were 40 cents of unclaimed EITC.

For Every Dollar of EITC Improper Payments, There Were 40 Cents of Unclaimed EITC

The estimated amount of improper payments also does not take into account that many taxpayers who appear to be eligible do not claim EITC. The Treasury Inspector General for Tax Administration (TIGTA) estimated that in 2014, when the EITC improper payments were estimated to be \$17.7 billion, \$7.3 billion in EITC refunds went unclaimed.²⁸ In other words, TIGTA estimated that for every dollar of EITC improper payments, there were 40 cents of unclaimed EITC.

Additionally, the improper payment rate does not take into account that EITC, although claimed by the “wrong” taxpayer, may have reached the intended beneficiary, a qualifying child. For example, suppose a taxpayer claims EITC with respect to a qualifying child, A, who is not the taxpayer’s qualifying child. However, the taxpayer’s former spouse could have claimed EITC with respect to A but did not. Thus, allowing EITC claimed by a parent who turns out to be the “wrong” taxpayer could be an improper payment, even though the benefit was only paid once, and was paid with respect to a qualifying child.²⁹

Since 2010, EITC estimated improper payment rates have fluctuated between a low of 22.8 percent in 2012 and a high of 27.2 percent in 2014, as shown in Figure 1.6.1.³⁰

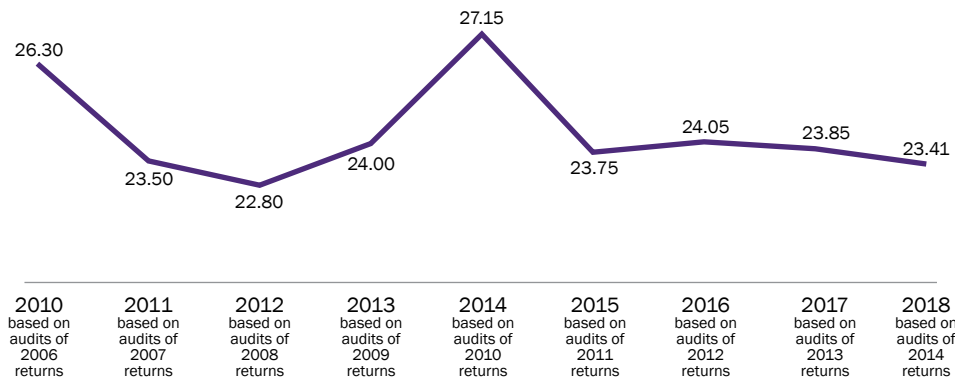
28 AFR, FY 2014 at 201 (Nov. 2014), estimating improper EITC payments of \$17.7 billion; TIGTA, Ref. No. 2018-IE-R004, *The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers* at 2 (Apr. 2, 2018), estimating that five million potentially eligible taxpayers did not claim approximately \$7.3 billion in EITC refunds on their 2014 returns.

29 The extent to which improper payments occur under these circumstances is not known, but could be developed from NRP data. IRS response to TAS information request (Aug. 31, 2018).

30 See U.S. Dept. of the Treas., AFRs, FYs 2010-2018, <https://home.treasury.gov/about/budget-financial-reporting-planning-and-performance/agency-financial-report>. Until FY 2010, the improper payment rate was expressed as a midpoint between upper and lower bounds. The upper and lower bounds reflected assumptions about whether taxpayers who did not participate in the NRP audits were actually entitled to EITC. Beginning with FY 2010, the rate was expressed as a single rate with confidence intervals, with nonparticipating taxpayers treated as being entitled to EITC at the same rate as those who participated in the NRP audit. However, the AFR continued to report upper and lower bounds through 2014. Figure 1.6.1 depicts the midpoint value for the 2010-2014 and the single point estimate thereafter. For purposes of consistency the FY 2018 value, 23.41 percent, is the one that takes into account recovered amounts.

FIGURE 1.6.1

Estimated EITC Improper Payment Rates, 2010-2018



EITC Improper Payments Arise From Complexity of the Rules and Are Not Usually Due to Fraud

The IRS is required to categorize improper payments using one or more of the following root causes: Program Design or Structural Issues; Inability to Authenticate Eligibility; Failure to Verify; Administrative or Process Errors; Medical Necessity; Insufficient Documentation to Determine; and Other.³¹ According to the IRS, almost all EITC improper payments (94 percent) are caused by Inability to Authenticate Eligibility: Data Needed Does Not Exist.³² This category includes cases in which the taxpayer could not substantiate, and the IRS could not confirm:

- That a claimed “qualifying child” met the requirements for that status (49.5 percent of the payments);³³
- That the taxpayer correctly reported income, mainly self-employment income, not reported to the IRS by third parties (26 percent of the payments);
- That the taxpayer’s return reflected the correct filing status (15 percent of the payments);³⁴ or

31 See OMB M-15-02 Appendix C to Circular No. A-123, *Requirements for Effective Estimation and Remediation of Improper Payments* 25 (2014). The “inability to authenticate eligibility” root cause is further divided into two sub-categories: (1) inability to access data; and (2) data needed does not exist.

32 AFR, FY 2018 at 196 (Nov. 2017). NRP auditors record the nature of the errors taxpayers made when they erroneously claimed EITC, and the IRS then groups the error according to the “root cause” classification required by OMB. IRS response to TAS information request (Aug. 30, 2018). OMB provides as examples of this type of “root cause:” “the inability to establish that a child lived with a family for a certain amount of time-for the purpose of determining that a family is eligible for a tax credit-because no database exists to do so” and “failing to provide an agency with information on earnings, and the agency does not have access to databases containing the earnings information.” OMB M-15-02, Appendix C to Circular No. A-123, *Requirements for Effective Estimation and Remediation of Improper Payments* 26-27 (2014).

33 Specifically, they do not exist, or the IRS does not have access to, third-party databases that would confirm, at the time of filing: residency; relationship (when a non-parent claims the qualifying child); age (where the claimed child is a full-time student or is disabled); marital status of children claimed; or whether a valid Social Security number (SSN) is also valid for EITC and not issued solely to receive federal benefits. IRS, *Derivation of Improper Payment Root Cause Percentages* 3 (Aug. 2015).

34 Specifically, the IRS cannot confirm when taxpayers who file as heads of household are actually married. IRS, *Derivation of Improper Payment Root Cause Percentages* 3 (Aug. 2015).

- That the taxpayer met other EITC eligibility requirements (three percent of the payments).³⁵

However, as Treasury and the IRS acknowledge, a central cause of EITC improper payments is the complexity of the rules and the errors, a cause not captured by the OMB categories.³⁶ Experience has shown that simplifying the rules can reduce noncompliance.³⁷

Moreover, TAS studies demonstrate that taxpayers may not be able to document the claim to the examiner's satisfaction, but the taxpayer may actually be entitled to the claimed EITC (*i.e.*, denial of EITC proves only that the IRS did not accept the claim, not necessarily that the taxpayer was not eligible for the EITC).³⁸ In addition, taxpayers may be able to demonstrate eligibility for the credit once they receive adequate explanations of what substantiation the IRS requires.³⁹ To its credit, the IRS has worked with TAS to foster auditors' acceptance of a broader range of substantiating documentation.⁴⁰

As noted above, according to IRS data, when taxpayers erroneously claim EITC with respect to children who were not their qualifying children, the most common error is that the residency requirement was not met.⁴¹ At the urging of the National Taxpayer Advocate, the IRS agreed to allow some audited taxpayers to use affidavits to establish that they met the residency requirement.⁴² Tax Year (TY) 2018 returns will be selected for the initiative in 2019, with the audit results known in 2020.⁴³

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- 35 Specifically, the IRS cannot independently verify when a valid SSN is not valid for EITC and not issued solely to receive federal benefits. IRS, *Derivation of Improper Payment Root Cause Percentages* 3 (Aug. 2015). Additionally, the IRS attributes 0.5 percent of improper payments to cases in which a taxpayer without qualifying children claimed EITC and the taxpayer could have been claimed as the dependent of another taxpayer, or the taxpayer lived outside the U.S. (the IRS cannot verify whether a taxpayer could have been claimed as a dependent by another taxpayer or the length of time a taxpayer lived abroad).
- 36 AFR, FY 2014 at 140, noting that "Treasury and IRS analyses, as well as audits by the GAO and TIGTA, have consistently found that payment errors for EITC and other tax credit programs are largely attributable to the statutory design and complexity of the credits within the tax system, and not rooted in internal control weaknesses, financial management or financial reporting deficiencies." See also Robert Greenstein, John Wancheck, and Chuck Marr, Center on Budget and Policy Priorities, *Reducing Overpayments in the Earned Income Tax Credit*, updated Feb. 20, 2018, noting that "What the Internal Revenue Service (IRS) refers to as the EITC's 'improper payment rate' is not a 'fraud' rate and shouldn't be characterized as such."
- 37 See, e.g., Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. 107-16, § 303, 115 Stat. 38 (2001), modifying and clarifying tiebreaker rules (*i.e.*, rules for determining, when an individual is the qualifying child of more than one taxpayer, which taxpayer is entitled to the credit), and IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 20 (Aug. 2014) comparing the "negligible" incidence of tie-breaker errors, comprising one to two percent of all overclaims, and the 17 percent rate found in the 1999 Compliance Study, and noting "this difference reflects the change in tiebreaker rules that were part of EGTRRA and took effect in 2002."
- 38 See, e.g., National Taxpayer Advocate 2004 Annual Report to Congress, vol. 2 i, *EITC Audit Reconsideration Study*, demonstrating that 43 percent of taxpayers who sought reconsideration of audits that disallowed the EITC in whole or in part received additional EITC as a result of the audit reconsideration.
- 39 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 74, (Research Study: *Study of Tax Court Cases In Which the IRS Conceded the Taxpayer was Entitled to Earned Income Tax Credit (EITC)*), discussing a TAS study of a random sample of cases in which the IRS denied a claim for EITC but conceded the issue after the taxpayer petitioned the Tax Court for review. In most cases, taxpayers repeatedly seek information from the IRS before they file their Tax Court petitions. They evidently do not receive from examiners adequate explanations of what documents are needed, but they do receive adequate explanations once they have exited the examination phase of the case.
- 40 See Internal Revenue Manual (IRM) 4.19.14-1, *Examples of Acceptable Documentation for EITC claims (not all-inclusive)* (July 29, 2016) listing various "new" documents for auditors to consider, such as paternity test results, eviction notices, and statements from homeless shelters. However, anecdotal evidence, such as comments from low income taxpayer clinicians, indicates that some auditors still request unreasonable amounts of documents from taxpayers in support of their EITC claims.
- 41 IRS, *Compliance Estimates for Earned Income Tax Credit Claimed on 2006-2008 Returns* 22 (2014).
- 42 National Taxpayer Advocate 2017 Annual Report to Congress 141, 149 (Most Serious Problem: *The IRS Continues to Make Progress to Improve Its Administration of the EITC, But It Has Not Adequately Incorporated Research Findings that Show Positive Impacts of Taxpayer Education on Compliance*).
- 43 IRS response to TAS information request (Sept. 26, 2018), noting that the IRS will compare prior audit results to audits of taxpayers who received the affidavits.

EITC Improper Payments Are a Relatively Small Portion of the Tax Gap, While the EITC Program Costs Less to Administer Than Other Non-Tax Benefit Programs and Has Higher Participation Rates

The overall amount of true tax liability that is not paid voluntarily and timely is referred to as the gross tax gap.⁴⁴ The most recent estimate of the gross tax gap, based on data for tax years 2008-2010, is \$458 billion. A portion of the gross tax gap, \$264 billion, or 58 percent, is attributable to income misreporting by individual taxpayers.⁴⁵ The three largest components of this \$264 billion consist of:

- \$125 billion, or 47 percent, attributable to business income misreporting;⁴⁶
- \$64 billion, or 24 percent, attributable to misreporting of non-business income;⁴⁷ and
- \$40 billion, or 15 percent, attributable to misreporting of credits.⁴⁸

Of the \$40 billion in misreported credits, \$26 billion is attributable to EITC misreporting.⁴⁹

Thus, EITC misreporting is a relatively small portion of the tax gap—six percent of the gross tax gap and ten percent of the tax gap attributable to income misreporting by individuals—as shown in Figure 1.6.2.

44 IRS, Research, Analysis & Statistics, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2008-2010*, Publication 1415, 1 (May 2016), noting that “the word ‘tax’ in the phrase ‘tax gap’ is used broadly to encompass both tax and refundable and non-refundable tax credits.”

45 *Id.* at 9, reporting annual average estimates for 2008-2010.

46 Business income includes income reported on Schedules C, E, and F, *i.e.*, nonfarm proprietor income (29 percent), flow-through income (from partnerships, S corporations, and estates and trusts) (eight percent), rent and royalty income (eight percent), and farm income (two percent). *Id.* at 19.

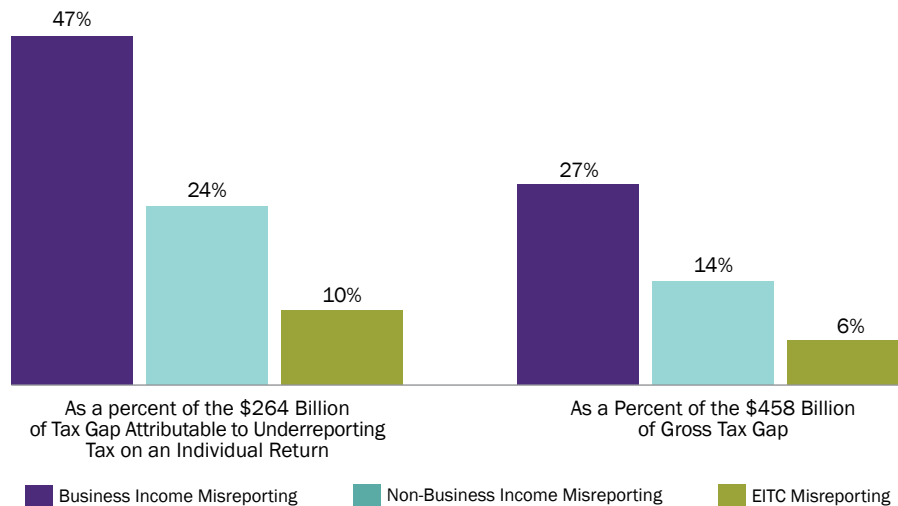
47 Non-business income includes all other individual taxpayer income that is not business income (e.g., wages, salaries, tips, unemployment compensation, pensions and annuities, alimony, interest, dividends, and capital gains). *Id.* at 18.

48 *Id.* at 10.

49 *Id.* at 19, noting that EITC accounts for ten percent of the individual income tax underreporting tax gap; ten percent of \$264 billion is \$26 billion. There are some differences in the methodology for calculating tax gap estimates and calculating improper EITC payments. For example, as noted above, the EITC improper payment rate is expressed as a single rate with confidence intervals, with taxpayers who did not participate in the audit being treated as entitled to EITC at the same rate as those who participated in the NRP audit. For purposes of estimating the tax gap, the EITC audit outcome is used; in most cases, EITC claimed by taxpayers who do not participate in the audit is disallowed. Because of this and other differences in methodology, the amount of estimated EITC misreporting (\$26 billion) for purposes of estimating the tax gap exceeds the estimated improper payment amount (\$18 billion for FY 2013, based on audits of 2010 returns).

FIGURE 1.6.2

Three Largest Components of the Tax Gap, Tax Years 2008-2010



Unlike other anti-poverty programs, taxpayers are not required to meet with caseworkers or submit documentation to establish their eligibility before claiming EITC. Thus, the cost of administering the EITC program (around one percent of benefits delivered) is significantly lower than non-tax payment or benefit programs, and the EITC participation rate (79 percent) is relatively high.⁵⁰ IRS auditors, including NRP auditors, who disallow EITC claimed with respect to a qualifying child are reminded that the taxpayer may still be eligible for the childless worker credit.⁵¹ However, as discussed above, a significant amount of EITC goes unclaimed by taxpayers who appear to be eligible for the credit. IRS notices reminding taxpayers of EITC have not been particularly effective in increasing participation rates.⁵² The IRS could explore the possibility of increasing the EITC participation rate by automatically

50 For a comparison of the costs and benefits of federal payment programs (e.g., Supplemental Nutrition Assistance Program (SNAP), Women, Infants, and Children (WIC), Supplemental Security Income (SSI), Temporary Assistance to Needy Families (TANF), Department of Housing and Urban Development (HUD), Children's Health Insurance Program (CHIP), Medicaid, and school lunch programs), see National Taxpayer Advocate 2016 Annual Report to Congress 341 (Legislative Recommendation: *Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*). See also IRS, *EITC Participation Rate by States*, n.1, <https://www.eitc.irs.gov/eitc-central/participation-rate/eitc-participation-rate-by-states> (last visited Nov. 26, 2018), for tax year 2014.

51 See, e.g., IRM 4.19.14.5.5, *EITC - No Qualifying Children* (Nov. 2, 2017); IRM 4.22.8.6.3.3, *Completing the EIC Eligibility Rules Section of the EIC Lead Sheet Tab* (Jan. 10, 2014).

52 See Office of Evaluation Service, *Tax Filing and EITC Take-up: Reminders promote tax filing compliance and increase EITC payments*, <https://oes.gsa.gov/projects/eitc-filing/> (last visited Nov. 26, 2018), evaluating the effect of sending "combinations of behaviorally informed postcards and brochures, highlighting the recipient's potential eligibility for the EITC" and finding that while the notices increased the number of returns filed, the notices did not increase the rates at which individuals claimed the EITC, although they did increase the amount of EITC dollars paid to treatment individuals by about \$25 on average.

allowing the credit to taxpayers who do not claim EITC but file returns showing they are eligible for it, particularly those eligible for the “childless worker” EITC.⁵³

IRS Measures to Reduce EITC Improper Payments May Unnecessarily Burden Taxpayers

Despite the acknowledged complexity of the rules for claiming EITC as a cause of improper EITC claims, IRS and Treasury legislative proposals to address EITC improper payments have centered on enforcement measures rather than on simplification.⁵⁴ For example, the IRS and Treasury consistently recommend expanding the IRS’s math error authority by conferring “correctible error authority.”⁵⁵ The National Taxpayer Advocate has for many years voiced her concerns about expansions of the IRS’s math error authority and how the IRS exercises that authority and thus does not support this proposal in its current sweeping form.⁵⁶

The IRS also exercises its authority under IRC § 32(k) to impose two-year bans on claiming EITC on taxpayers who claim EITC with “reckless or intentional disregard of rules and regulations.” TAS found that according to IRS data, the IRS improperly imposed the ban 49 percent of the time in 2009, 44 percent of the time in 2010, and 39 percent in 2011.⁵⁷ The IRS imposed 3,442 two-year bans on taxpayers who claimed EITC on their 2017 returns.⁵⁸

53 IRC § 32(c)(1)(A)(ii) defines “eligible individual” to include taxpayers who do not have a “qualifying child.” The maximum amount of EITC for a single worker with no children was \$510 for 2017. IRS, Publication 596, *Earned Income Credit (EIC)* 32 (Jan. 16, 2018). Form 1040 does not capture information about residency, a requirement for claiming childless-worker EITC, but the IRS, through automation and data mining, could use the databases it has access to in order to determine whether the residency requirement was met. See TIGTA, Ref. No. 2018-IE-R004, *The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers* (Apr. 2, 2018) for a similar recommendation, that the IRS, instead of sending reminder notices, consider revising Form 1040 to capture information about taxpayers’ eligibility for EITC, such as ages of children and duration of residency with the taxpayer, and then automatically refund the EITC to eligible taxpayers even if they did not claim it.

54 In contrast, other tax administrations recognize their responsibility to actively seek tax simplification. See, e.g., Australian Tax Office (ATO), Second Commissioner Andrew Mills, *Tax Administration Continuum - ‘The Law was Made for Man, not Man for the Law’* (2017), <https://www.ato.gov.au/Media-centre/Speeches/Other/Tax-Administration-Continuum---The-Law-was-Made-for-Man,-not-Man-for-the-Law/> (last visited Nov. 26, 2018), noting “[t]he final aspect of the Tax Continuum in the ATO’s role as the tax administrator is legislative change. It is an understatement to say that tax law is extremely complex and labyrinthine...the ATO has a duty to advocate when the law is not operating as intended and when there are unintended consequences for the taxpayer.”

55 See, e.g., *General Explanations of the Administration’s Fiscal Year Revenue Proposals* (Treasury Greenbook) FY 2017 at 225, <https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2017.pdf>, proposing to give the Treasury regulatory authority to permit the IRS to “correct errors in cases where (1) the information provided by the taxpayer does not match the information contained in government databases, (2) the taxpayer has exceeded the lifetime limit for claiming a deduction or credit, or (3) the taxpayer has failed to include with his or her return documentation that is required by statute.”

56 See, e.g., National Taxpayer Advocate 2002 Annual Report to Congress 25, 185 (Most Serious Problem: *Math Error Authority*; Key Legislative Recommendation: *Math Error Authority*). See also 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*, *infra*; Most Serious Problem: *The IRS Has Failed to Exercise Self-Restraint in Its Use of Math Error Authority, Thereby Harming Taxpayers*, *infra*.

57 National Taxpayer Advocate 2013 Annual Report to Congress 103, 105 (Most Serious Problem: *The IRS Inappropriately Bans Many Taxpayers from Claiming EITC*).

58 The IRS imposed 9,431; 6,445; 6,296; and 6,106 two-year bans claimed on returns for tax year 2013–2016, respectively. IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File, Aug. 2018.

Tax Administrations Benefit From Shifting to Proactive Compliance Activities

As the Organisation for Economic Co-operation and Development (OECD) notes, tax administrations are benefiting from a shift from reactive compliance activities (*e.g.*, audits) to proactive activities (*e.g.*, outreach and education, behavioral nudges) and upstream activities (*e.g.*, early interventions when a potential tax debt arises and pay-as-you-earn systems).⁵⁹

For example, the Australian Taxation Office (ATO) distinguishes between reviews (conducted to assess whether or not there is a risk of noncompliance and to collect information about particular industries and activities) and audits (conducted where there appears to be noncompliance or where a review would be or has been insufficient).⁶⁰ In either situation, the ATO may correct the return and assess additional tax, but this “escalation” approach typically begins with a review, described as “an opportunity to quickly and cooperatively resolve matters in a transparent way” rather than a full-blown audit.⁶¹

ATO also effectively uses behavioral insights by taking measures such as:⁶²

- Sending text message payment reminders to taxpayers who are likely to pay late or not at all. In 2015-2016, sending 540,000 SMS debt prompts resulted in more than \$949 million in debt being paid on time;
- Sending thank-you messages to taxpayers who had paid on time after receiving an SMS reminder in a previous payment quarter;
- Using “nearest neighbor” analysis to advise taxpayers when a claimed deduction is significantly higher than that claimed by their peers, which prompted many to reduce their claimed deductions; and
- Considering sending text messages advising taxpayers of tax benefits they may have overlooked (*e.g.*, taxpayers could be advised that the deductions they had claimed were below the amounts claimed by their peers, and that they should recheck whether they had claimed all the deductions to which they were entitled).

As discussed below, similar proactive approaches to interacting with taxpayers who claim or appear to be eligible to claim EITC may help reduce the EITC improper payment rate.

59 OECD, *The Changing Tax Compliance Environment and the Role of Audit* 19, 23-26 (2017), https://www.oecd-ilibrary.org/taxation/the-changing-tax-compliance-environment-and-the-role-of-audit_9789264282186-en. For a discussion of various pay-as-you-earn (PAYE) systems in other countries and an analysis of the benefits, burdens, and limitations of a broader PAYE system as it might be applied in the U.S., see Research Study: *A Conceptual Analysis of Pay-As-You-Earn (PAYE) Withholding Systems as a Mechanism for Simplifying and Improving U.S. Tax Administration*, vol. 2, *infra*.

60 ATO, *Taxpayers' charter: If you're subject to review or audit* 3 (2013), <https://www.ato.gov.au/assets/0/104/300/362/2cd37d1a-1184-4568-8dd1-98ecbeb1e503.pdf>.

61 ATO, *Reviews*, <https://www.ato.gov.au/business/private-owned-and-wealthy-groups/what-you-should-know/tailored-engagement/reviews/> (last visited Nov. 26, 2018).

62 ATO, Second Commissioner Andrew Mills, *Tax Administration Continuum - 'The Law was Made for Man, not Man for the Law'* (2017), <https://www.ato.gov.au/Media-centre/Speeches/Other/Tax-Administration-Continuum---The-Law-was-Made-for-Man,-not-Man-for-the-Law/> (last visited Nov. 26, 2018).

IRS EITC Notices Should Be More Tailored and Include Additional Telephone Support

The IRS issues “soft” notices to taxpayers who appear to have claimed EITC in error, advising them to check their returns to verify that the information is correct.⁶³ However, IRS studies of the effectiveness of the soft notices indicate that receiving a soft notice had minimal effect on taxpayer behavior.⁶⁴

In contrast to the general instructions provided in the soft notices, the National Taxpayer Advocate in 2016 sent *salient* letters to representative samples of taxpayers who appeared to have claimed EITC in error on their 2014 returns.⁶⁵ The letters were mailed at a time when taxpayers were likely to be thinking about taxes, *i.e.*, in the two weeks before the filing season began. Taxpayers were beginning to receive tax documents, such as W-2s, in the mail, and the envelope with the TAS letter bore the notation, in red letters, that it contained “Important Tax Information.” Thus, taxpayers were more likely to open the mail. The message was tailored to identify the specific error the taxpayer appeared to have made, and educated the taxpayer about the requirements for claiming EITC. TAS Research studied the effect of the letters on taxpayer compliance, and on the basis of those findings, the National Taxpayer Advocate revised the letters and sent them to taxpayers in representative samples the following year.⁶⁶

One revision to the 2017 letter that was sent to a separate sample of 967 taxpayers who appeared to not have met the residency requirements on their 2015 returns offered a dedicated “Extra Help” telephone line.⁶⁷ The help line was staffed by TAS employees trained to answer taxpayer questions about the letter and the EITC eligibility rules. Only 35 taxpayers called the additional phone number and spoke with a TAS employee. Nevertheless, according to TAS projections, sending the TAS letter with the extra help telephone line to all taxpayers whose 2015 returns appeared to be erroneous because the residency requirement was not met would have averted over \$44 million in erroneous EITC claims.⁶⁸ TAS will repeat the study in a future filing season, offering the extra help line for all notices. The study will also

63 See IRM 4.19.14.2, *EITC Soft Notices* (Dec. 7, 2017), describing Letter 5621, *Help Us Confirm Your Relationship to the EIC Qualifying Children* and Letter 5621-A, *Confirm Your Schedule C Income Used to Claim Earned Income Tax Credit*. These letters give taxpayers the general instruction to “make sure your children meet the criteria for claiming the Earned Income Tax Credit (EITC)” or “make sure the income and expenses you reported on your Schedule C or Schedule C-EZ are correct.”

64 IRS Wage & Investment, *FY 2016 DDb Soft Notice Phase III: Notice Effectiveness 3* (Jan. 2017), reporting that the soft notices issued in December of 2015 averted only about \$40 per taxpayer in erroneous EITC claims. Additional analysis conducted with respect to 2016 yielded similar results. IRS response to TAS information request (Sept. 25, 2018).

65 National Taxpayer Advocate 2016 Annual Report to Congress vol. 2 32 (Research Study: *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently in Error and Were Sent an Educational Letter From the National Taxpayer Advocate*), showing that the TAS letter averted noncompliance on tax year (TY) 2015 returns where the TY 2014 return appeared erroneous because the relationship test was not met. Sending the TAS letter to all taxpayers whose TY 2014 returns appeared to be erroneous because the relationship test was not met would have averted about \$47 million of erroneous EITC claims.

66 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2 13 (Research Study: *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently in Error and Were Not Audited But Were Sent an Educational Letter From the Taxpayer Advocate Service, Part 2: Validation of Prior Findings and the Effect of an Extra Help Phone Number and a Reminder of Childless-Worker EITC Income Tax Credits (EITC) Apparently in Error and Were Sent an Educational Letter From the National Taxpayer Advocate*), showing that sending the TAS letter to all taxpayers whose 2015 returns appeared to be erroneous because the relationship test was not met would have averted over \$53 million in erroneous EITC claims.

67 For a recommendation to Congress that the IRS be required to provide year-round telephone support, see National Taxpayer Advocate 2016 Annual Report to Congress 329 (Legislative Recommendation: *Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*).

68 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2 13 (Research Study: *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently in Error and Were Not Audited But Were Sent an Educational Letter From the Taxpayer Advocate Service, Part 2: Validation of Prior Findings and the Effect of an Extra Help Phone Number and a Reminder of Childless-Worker EITC Income Tax Credits (EITC) Apparently in Error and Were Sent an Educational Letter From the National Taxpayer Advocate*).

include focus groups to capture qualitative information on the effectiveness of the content and layout of the messages.

The IRS is planning to send soft notices to taxpayers who appear to have claimed EITC in error on their 2017 returns because they misreported the amount of their earned incomes, and to study the effect of the soft notices on taxpayers' 2018 returns.⁶⁹ The National Taxpayer Advocate encourages the IRS to provide specificity in these soft notices and direct taxpayers to a dedicated telephone help line available year-round they can call with questions about EITC.⁷⁰

A principal cause of the Earned Income Tax Credit (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.

CONCLUSION

A principal cause of the EITC improper payment rate is the complexity of the rules for claiming EITC, and taxpayers encounter difficulty in documenting their eligibility to claim the credit. At the same time, many taxpayers who appear to be eligible to claim EITC do not claim it, a phenomenon not reflected in the improper payment rate. Automatically allowing EITC in some cases, sending tailored communications to those who appear to have claimed the credit in error, and providing dedicated telephone support available year-round may increase participation rates and avert future erroneous claims.

⁶⁹ IRS response to TAS information request (Sept. 25, 2018).

⁷⁰ See Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Seek a permanent exemption from the requirement that the IRS include recovered EITC payments in the EITC improper payment estimate.
2. 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.
3. 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 EITC to taxpayers who are eligible for EITC with respect to a qualifying child but do not claim it on their returns.
4. Collaborate with TAS Research in designing and conducting the planned study to compare prior EITC audit results to audit results of taxpayers who used affidavits to establish that they met the residency requirement.
5. Revise soft notices that are sent to taxpayers advising them they may have claimed EITC in error to explain the error the taxpayer appears to have made (*e.g.*, not meeting the residency requirement or the relationship requirement, misreporting income or deductions).
6. Establish a dedicated, year-round toll-free “help line” staffed by IRS personnel trained to respond to EITC and Child Tax Credit questions.
7. In soft notices to taxpayers advising them that they may have claimed EITC in error, include the dedicated telephone “help line.”

**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****RESPONSIBLE OFFICIALS**

Ken Corbin, Commissioner, Wage and Investment Division
 Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division
 Carol Campbell, Director, Return Preparer Office
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TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The IRS is tasked with collecting taxes and administering the Internal Revenue Code (IRC). In calendar year 2018, the IRS processed over 150 million individual tax returns, with almost 80 million taxpayers relying on paid preparers.² More than half of these returns were submitted by return preparers who are unregulated by the IRS.³ Unenrolled preparers—those generally not subject to IRS regulation—account for over half of all preparers.⁴

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 ensuring tax compliance. The public needs a way to differentiate between professional, competent, and experienced preparers, and their incompetent or unscrupulous counterparts. The National Taxpayer Advocate has written extensively on the need to protect taxpayers from non-compliant return preparers.⁵

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).
- 2 Compliance Data Warehouse (CDW), *Return Preparers and Providers database Preparer Tax Identification Number (PTIN) table and the Individual Return Transaction File (IRTF) Entity file* (data updated Sept. 30, 2018 for both databases).
- 3 *Id.*
- 4 *Id.*
- 5 See National Taxpayer Advocate 2015 Annual Report to Congress 261-283 (Most Serious Problem: *The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*); National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Taxpayers and Tax Administration Remains Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing Its Efforts to Effectively Regulate Unenrolled Preparers*); National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2006 Annual Report to Congress 197-221 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2005 Annual Report to Congress 223-237 (Most Serious Problem: *Regulation of Electronic Return Originators*); National Taxpayer Advocate 2004 Annual Report to Congress 67-88 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216-230 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*).

The case for IRS oversight of the return preparation industry is clear. When an attorney is hired, there is some level of confidence that the attorney is competent. One could verify that the attorney has passed a bar exam and meets the continuing legal education and professional responsibility requirements of his or her state's bar association. When one visits a hair salon, the hair stylist will have a certificate displayed, which attests to the fact that the stylist has undergone the training necessary to obtain the license. In contrast, there is no such guarantee that an unenrolled tax return preparer has passed any exam, continues to engage in ongoing education, or meets any other minimum standard of competency to prepare federal tax returns.

If anyone can hang out a shingle as a “tax return preparer” with no minimum competency requirements or oversight, problems with return accuracy will abound. The Government Accountability Office (GAO) confirmed this by having its auditors pose as taxpayers visiting tax return preparation chains (which had a minimum of ten locations). Only two out of the 19 randomly selected preparers calculated the correct amount of refund in a GAO study.⁶ The National Consumer Law Center has conducted similar “mystery shopper visits” with similar results.⁷

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.⁸ In 2014, the U.S. Court of Appeals for the District of Columbia upheld the decision, meaning that the IRS will need to fulfill its oversight responsibility within the confines of the current law.

Even with the courts enjoining the IRS from testing and certifying tax return preparers, the National Taxpayer Advocate believes that the IRS still has a vital role to play in protecting taxpayers' *rights to quality service* and *to a fair and just tax system*. The court decision does not absolve the IRS of the responsibility to protect taxpayers.

Specifically, the IRS should:

- Establish a truly cross-functional team to develop and communicate a coordinated strategy to effectively provide oversight of return preparers;
- Conduct in-depth analysis of the impact of penalty assessments on preparers' behavior in subsequent years, and publish the findings;
- Assert a more active role in the voluntary certification process, including designing an examination and developing training materials; and
- Ensure that any references to the directory of Federal Tax Return Preparers are not misleading.

6 Government Accountability Office (GAO), GAO-14-467T, *PAID TAX RETURN PREPARERS: In a Limited Study, Preparers Made Significant Errors* (Apr. 8, 2014).

7 See National Consumer Law Center (NCLC), *Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do* (Mar. 2014), www.nclc.org/images/pdf/pr-reports/report-riddled-returns.pdf.

8 *Loving v. Internal Revenue Service*, 917 F. Supp. 2d 67 (D.D.C. 2018), *aff'd*, 742 F.3d 1013 (D.C. Cir. 2014).

ANALYSIS OF PROBLEM

Background

There are several types of tax return preparers. Attorneys, Certified Public Accountants (CPAs), and Enrolled Agents (EAs) have passed examinations to demonstrate their knowledge and proficiency. Furthermore, they must comply with applicable continuing education requirements for their jurisdiction. These tax professionals have unlimited representation rights before the IRS and may represent their clients on any matters including examinations, collection issues, and appeals.

Unenrolled preparers are individuals other than an attorney, CPA, EA, enrolled retirement plan agent, or enrolled actuary who prepares and signs a taxpayer's return as the paid preparer (or who prepares a return but is not required to sign the return). For tax returns filed after December 31, 2015, unenrolled preparers who have completed the IRS's Annual Filing Season Program (AFSP)⁹ for both the year the tax return was filed *and* for the year(s) in which the representation occurs, have limited representation rights.¹⁰ They may represent clients whose returns they have prepared, but only before Revenue Agents, Customer Service Representatives, and similar IRS employees; they may not represent clients before Appeals or Collections officers.¹¹

Unenrolled preparers who have not received the AFSP Record of Completion do not have the right to represent taxpayers. If the unenrolled preparer checked the box as a third party designee on the Form 1040, the preparer may speak to the IRS to provide more information about an item on the tax return, but may not execute closing agreements, extend the statutory period for tax assessments or collection of tax, execute waivers, or sign any document on behalf of a taxpayer.¹²

Anyone who prepares federal tax returns for compensation is required to have a valid preparer tax identification number (PTIN).¹³ Tax preparers are required to include their PTIN on and sign any returns they prepare. However, some "ghost" tax preparers file tax returns on their clients' behalf without any indication that the taxpayer used a paid tax preparer to complete the return.

Figure 1.7.1 shows the number of individual tax returns prepared for tax year (TY) 2017 by type of preparer. Unenrolled preparers (including those who completed the voluntary AFSP) account for more than half of the nearly 77 million individual tax returns prepared by a preparer.

9 The Annual Filing Season Program is a voluntary program designed to encourage non-credentialed tax return preparers to participate in continuing education courses. To obtain an Annual Filing Season Program Record of Completion, a return preparer must obtain 18 hours of continuing education (including a six-credit hour Annual Federal Tax Refresher course that covers filing season issues and tax law updates) from an IRS-approved continuing education provider. In addition to completing the appropriate continuing education courses, the return preparer must also renew his or her preparer tax identification number (PTIN) for the upcoming year. IRS, *Frequently Asked Questions: Annual Filing Season Program*, <https://www.irs.gov/tax-professionals/frequently-asked-questions-annual-filing-season-program> (last visited Dec. 6, 2018).

10 Rev. Proc. 2014-42, *Annual Filing Season Program* § 6, 2014-29 I.R.B. 192 (2014).

11 See Internal Revenue Manual (IRM) 21.3.7.5.6(3), *Unenrolled Return Preparer (Level H) Representative Research, Rejections and Processing* (Sept. 13, 2017).

12 See Instructions to 2018 Form 1040 (Dec. 10, 2018); IRS Pub. 947, *Practice Before the IRS and Power of Attorney 4* (Rev. Feb. 2018).

13 See Treas. Reg. § 1.6109-2.

FIGURE 1.7.1, Volume of Tax Year 2017 Individual Tax Returns by Preparer Type¹⁴

	Number of Returns								
	Form 1040	Form 1040 with Schedule C	Form 1040A	Form 1040EZ	Form 1040 A/EZ with Schedule EIC	Form 1040 with Schedules C & EIC	Form 1040 with Schedule F	Form 1040 with Schedules F & EIC	Total
Unenrolled Preparer (Unenrolled Prep)	16,634,128	4,456,328	4,480,376	3,260,274	6,949,731	3,035,224	391,237	45,492	39,252,790
Attorney (ATTY)	589,182	180,644	44,916	27,869	31,529	20,109	32,312	2,401	928,962
Certified Acceptance Agent (CAA)	202,595	70,389	67,025	45,944	79,889	44,393	1,868	207	512,310
Certified Public Accountant (CPA)	14,784,869	5,010,256	698,486	486,295	671,680	549,718	601,204	35,088	22,837,596
Enrolled Agent (EA)	5,273,359	1,546,780	863,847	547,327	733,998	382,294	149,137	13,257	9,509,999
Enrolled Actuary	5,688	2,210	1,203	1,063	2,320	2,003	82	8	14,577
Enrolled Retirement Plan Agent (ERPA)	357	104	87	31	167	30	-	1	777
State Regulated Tax Preparer (SRTP)	1,736,864	500,310	404,694	244,619	506,970	255,470	9,080	964	3,658,971
Total	39,227,042	11,767,021	6,560,634	4,613,422	8,976,284	4,289,241	1,184,920	97,418	76,715,982

A recent poll conducted by the Consumer Federation of America indicates strong support for reform of the tax preparer industry. Eighty-six percent of respondents support the requirement that paid tax preparers pass a competency test. Sixty-eight percent of respondents believe that either the federal government or their state government should require paid tax preparers to be licensed.¹⁵ Only seven states (California, Connecticut, Illinois, Maryland, Nevada, New York, and Oregon) currently impose minimum competency standards for unenrolled preparers.¹⁶

Legal Framework

On January 18, 2013, the U.S. District Court for D.C. enjoined the IRS from enforcing regulatory requirements for registered tax return preparers.¹⁷ As a result of this decision in *Loving vs. Internal Revenue Service*, the IRS is not able to mandate that unenrolled tax return preparers complete competency testing or secure continuing education. (This holding does not apply to attorneys, CPAs, or EAs, who are already subject to continuing education requirements imposed by their licensing agencies.)

The *Loving* decision was upheld by the U.S. Court of Appeals for the District of Columbia Circuit on February 11, 2014. The IRS has not further appealed the decision to the Supreme Court. Various bills

14 CDW, *Return Preparers and Providers database PTIN table and the IRTF Entity file* (data updated Sept. 30, 2018 for both databases).

15 See Consumer Federation of America, *Second National Poll Indicates Strong Support for Reform of Paid Tax Preparer Industry* (Mar. 22, 2017), <https://www.nclc.org/images/pdf/taxes/pr-paid-tax-preparer-industry.pdf>.

16 Don't Mess with Taxes, *Seven States that Regulate Paid Tax Preparers* (July 11, 2018), <https://www.dontmesswithtaxes.com/2018/07/7-states-that-regulate-paid-tax-preparers.html>.

17 *Loving v. Internal Revenue Service*, 917 F. Supp. 2d 67 (D.D.C. 2018), *aff'd*, 742 F.3d 1013 (D.C. Cir. 2014).

have been proposed that would require tax return preparers to take a competency exam, attend continuing education classes, and submit to a background check.¹⁸ However, Congress has not enacted any.

The IRS Should Establish a Truly Cross-Functional Team to Develop and Communicate a Coordinated Strategy to Effectively Provide Oversight of Return Preparers

Although the IRS unilaterally 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. Taxpayers need to feel confident that they can rely on return preparers. Rather than designating one centralized Commissioner-level office to coordinate oversight of return preparers, the IRS has spread this responsibility over multiple offices across several organizations.

The Return Preparer Office (RPO) oversees preparer registration and renewal programs, is engaged in general outreach and education, and administers the Annual Filing Season Program. The RPO does not engage in disciplinary proceedings related to return preparers.

The Office of Professional Responsibility (OPR) was established as the governing body responsible for interpreting and applying Treasury Department Circular 230, *Regulations Governing Practice before the Internal Revenue Service*. OPR's stated mission is to "interpret and apply the standards of practice for tax professionals in a fair and equitable manner," and its goals include increasing awareness of the Circular 230 standards of practice through outreach activities, as well as investigating cases where practitioners have run afoul of Circular 230. Attorneys, CPAs, and EAs are among the tax professionals subject to Circular 230. OPR lacks the authority to provide oversight of non-Circular 230 practitioners; however, participants in the AFSP must consent to the Circular 230 obligations. The OPR may take disciplinary action (including against unenrolled agents who have obtained limited representation rights by virtue of completing the AFSP) who are involved in "disreputable conduct."¹⁹

The Wage and Investment (W&I) division's Return Integrity and Compliance Services (RICS) function has developed a Refundable Credits Return Preparer Strategy Guide and Procedures. RICS acknowledges that refundable credit noncompliance among return preparers is problematic for the IRS. For example, more than three-quarters of returns allowed in processing the earned income tax credit (EITC) are prepared by unenrolled preparers.²⁰ Accordingly, W&I's strategy to prevent and reduce improper payments of refundable credits includes strengthening relationships with return preparers, educating them about the credits, and enforcing the preparer due diligence requirements.²¹

18 See Protecting Taxpayers Act, S. 3278, 115th Cong. (referred to S. Comm. on Finance July 26, 2018); Tax Return Preparer Competency Act, H.R. 4141, 114th Cong. (referred to the H. Comm. on Ways and Means Dec. 1, 2015).

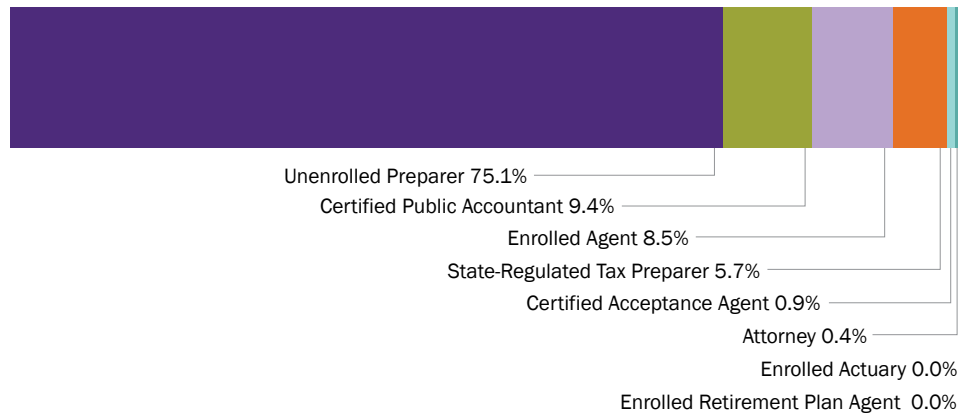
19 IRS Pub. 947, *Practice Before the IRS and Power of Attorney 4*, 7 (Rev. Feb. 2018).

20 CDW, *Return Preparers and Providers database PTIN table and the IRTF Entity file* (data updated Sept. 30, 2018, for both databases).

21 See National Taxpayer Advocate 2015 Annual Report to Congress 261-283 (Most Serious Problem: *The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*). The preparer due diligence requirements are set forth in Treas. Reg. 1.6695-2. A preparer must (1) complete and submit Form 8867, (2) use worksheets or other method to compute credits, (3) have no knowledge that any information used by the preparer is incorrect, and (4) retain records. See below for additional discussion about preparer penalties.

FIGURE 1.7.2²²

Earned Income Tax Credit Returns Filed by Profession (Tax Year 2018)



Small Business and Self-Employed (SB/SE) oversees the Return Preparer Program (RPP). Under the RPP, the IRS can open program action cases (PACs), which are “preparer investigations where clients of questionable preparers are examined to determine whether preparer penalties and/or injunctive actions against the preparers are warranted.”²³

The Criminal Investigation (CI) division administers an Abusive Return Preparer Program. Under this program, CI pursues return preparers for criminal offenses related to the preparation and filing of false income tax returns. Corrupt return preparers who claim inflated personal or business expenses, false deductions, excessive exemptions, or unallowable tax credits may be referred to the Department of Justice for injunctions from preparing taxes, or even criminal sanctions.²⁴

There is a risk that the IRS is not achieving effective oversight with so many different offices and programs in place to oversee return preparers. The IRS’s internal procedures reference a “National Headquarters Return Preparer Strategy,” but no further information about such a strategy is contained in the Internal Revenue Manual (IRM).²⁵ The SB/SE Examination Program Letter for fiscal year 2018 contained a goal to develop a servicewide return preparer strategy.²⁶

22 CDW, *Return Preparers and Providers database PTIN table and the IRTF Entity file* (data updated Sept. 30, 2018, for both databases).

23 IRM 4.1.10.3, *Program Action Cases Overview (PAC)* (Jan. 14, 2011).

24 IRS, *Criminal Investigation 2018 Annual Report* 9. In fiscal year (FY) 2018, there were 224 investigations initiated from the Abusive Return Preparer Program, with 170 indictments (148 of which received sentencing). IRS, *Criminal Investigation 2018 Annual Report* 124.

25 See IRM 4.1.1.6.20.1, *Return Preparer Coordinator (RPC)* (Oct. 25, 2017) (“The area Return Preparer Coordinator (RPC) will be responsible for planning and coordinating the implementation of area and National Headquarters Return Preparer Strategy.”); IRM 4.1.10.1, *Overview of the Return Preparer Program* (Jan. 14, 2011) (“The Area Return Preparer Coordinator (RPC) will be responsible for planning and coordinating the implementation of the Area and the National Headquarters Return Preparer Strategy.”).

26 Small Business/Self-Employed (SB/SE), *FY 2018 SB/SE Examination Program Letter* 7 (“Exam will lead a collaborative effort involving multiple compliance organizations (e.g., Wage & Investment (W&I), CI, Return Preparer Office (RPO)) to develop a comprehensive, Servicewide strategy incorporating the full range of educational, civil and criminal enforcement and judicial actions to ensure we use our limited resources in the most efficient and effective manner to address preparer non-compliance.”).

In May 2018, the IRS convened a cross-functional team tasked with developing a coordinated servicewide return preparer strategy.²⁷ The cross-functional team included representatives from SB/SE (Exam and Collection), Communications, Criminal Investigation, Research, Applied Analytics, and Statistics, W&I, Governmental Liaison, Large Business and International, Return Preparer Office, Office of Professional Responsibility, SB/SE Research, Office of Servicewide Penalties, and Chief Counsel. TAS was not invited to participate on this team. To make this a truly cross-functional team, the National Taxpayer Advocate believes that representatives from TAS, the voice of the taxpayer inside the IRS, must be included.

In developing the return preparer strategy, this team should take on a tiered approach. Rather than immediately resorting to penalties and sanctions, the team should consider the impact of education and soft notices on preparers. The IRS has some efforts with respect to soft notices, but the work is not coordinated or strategically planned.²⁸ If the IRS does not currently have good data on this, the team should work with the Research function to gather the data needed. The team is still conducting analysis; to date, no recommendations have been made.²⁹

Once the IRS has developed a coordinated return preparer strategy, the next challenge is to figure out the best way to spread this message. For populations where taxpayers are especially vulnerable to unscrupulous and opportunistic preparers, the IRS needs to ensure its strategy is communicated. The IRS will need to take a multi-faceted approach, working with partners such as the Volunteer Income Tax Assistance sites and the Low Income Taxpayer Clinics, with consumer rights groups, and with local churches and other community groups. IRS employees need to be on the ground in these communities, partnering with the various groups listed above. In addition, the IRS can explore developing creative public service announcements for TV and radio, as well as tapping into non-traditional social media outlets.³⁰ The Nationwide Tax Forums could be one way to communicate the strategy, but there is much more the IRS may do to reach unenrolled preparers.

The IRS Should Conduct In-Depth Analysis on the Impact of Penalty Assessments on Preparers' Behavior in Subsequent Years, and Publish the Findings

The tax code provides for several different types of preparer penalties. Section 6694 imposes two types of penalties for understatement of taxpayer's liability by tax return preparer:

- Understatement due to **unreasonable position** (IRC § 6694(a)); penalty is the greater of \$1,000 or 50 percent of the income derived by the preparer with respect to the return or claim for refund.
- Understatement due to **willful or reckless conduct** (IRC § 6694(b)); penalty is the greater of \$5,000 or 50 percent of the income derived by the preparer with respect to the return or claim for refund.

27 IRS response to TAS information request (Nov. 29, 2018).

28 For a more detailed discussion, see National Taxpayer Advocate 2016 Annual Report to Congress 261-283 (Most Serious Problem: *The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*).

29 IRS response to TAS information request (Nov. 29, 2018).

30 See National Taxpayer Advocate 2016 Annual Report to Congress 261-283 (Most Serious Problem: *The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*) for some specific recommendations on conducting effective outreach for the IRS's EITC return preparer strategy.

Section 6695 imposes a host of other assessable penalties with respect to the preparation of tax returns, including:

- Failure to furnish copy to taxpayer (IRC § 6695(a));
- Failure to sign return (IRC § 6695(b));
- Failure to furnish identification number (IRC § 6695(c));
- Failure to retain copy or list (IRC § 6695(d)); and
- Failure to comply with due diligence requirements with respect to eligibility for the EITC (IRC § 6695(g)).

FIGURE 1.7.3, IRC §§ 6694 and 6695 Penalties Assessed (FYs 2015–2018)³¹

	FY 2015	FY 2016	FY 2017	FY 2018
Number of IRC §§ 6694 and 6695 Penalties Assessed	3,624	2,582	2,107	2,292

As Figure 1.7.3 shows, the IRS has assessed penalties for preparer misconduct very sparingly, considering that the GAO found errors in returns filed by 17 of 19 paid preparers in its limited sample, and estimated that tax returns filed by paid preparers had a 60 percent error rate.³² A recent report issued by the Treasury Inspector General for Tax Administration (TIGTA) found that just 15 percent of referrals to a return preparer coordinator resulted in a PAC investigation, and 41 percent of PAC investigations were closed without penalty assessments.³³ The IRM provides a list of factors that should be considered when determining if a PAC investigation should be opened.³⁴ Even in situations where the IRS determines that a PAC is not warranted, the IRS should consider whether there is value in sending out a letter. An example of using a soft touch to influence behavior is the issuance of a letter notifying a preparer that a complaint has been received.

The goal of W&I's Refundable Credits Return Preparer Strategy is to reduce overclaims of EITC and other refundable credits through education and compliance treatments. One of the treatment streams consists of auditing paid preparers who claim EITC and other credits for compliance with their IRC § 6695(g) due diligence requirements.³⁵

31 CDW, *IMF Transaction History File* (data compiled Dec. 2018). This included assessments from Master File Tax (MFT) 13 and MFT 55.

32 GAO, GAO-14-467T, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors* 9 (Apr. 8, 2014).

33 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2018-30-042, *The Internal Revenue Service Lacks a Coordinated Strategy to Address Unregulated Return Preparer Misconduct* 11 (July 25, 2018).

34 Factors for consideration of Program Action Case (PAC) action include, but are not limited to:

- ◆ The egregious nature of the questionable conduct—*i.e.*, does the preparer engage in a widespread practice of making material errors and/or demonstrate intentional misconduct.
- ◆ The number of client taxpayers affected by the preparer's conduct.
- ◆ The available resources of the examination groups receiving the PAC examinations.
- ◆ The type(s) of returns involved (*i.e.*, 1040) and the tax years available.
- ◆ The dollar amounts and materiality of potential adjustments.
- ◆ Prior compliance activities — *i.e.* preparer penalties previously asserted, Earned Income Tax Credit (EITC)/Electronic Return Originator (ERO) visitations, and/or RPO compliance letters.

IRM 4.1.10.3.2, *PAC Development Factors* (Dec. 13, 2016).

35 IRS response to TAS information request (Aug. 13, 2018).

FIGURE 1.7.4, IRC § 6695(g) Due Diligence Audits³⁶

FY	Audits Assigned	Surveyed	Discontinued	No Change	Penalties Proposed
2014	747	0 (0%)	21 (3%)	130 (17%)	596 (80%)
2015	1,001	0 (0%)	46 (5%)	145 (14%)	810 (81%)
2016	1,180	8 (1%)	47 (4%)	203 (17%)	922 (78%)
2017	787	0 (0%)	24 (3%)	119 (15%)	644 (82%)
2018	803	0 (0%)	27 (3%)	122 (15%)	654 (81%)

SB/SE conducts these due diligence audits (also known as “site visits”) before and during the filing season. During a due diligence audit, the examiner will interview the preparer and review at least 25 returns, looking at the preparer’s due diligence records, checklists, worksheets, copies of client provided documents, etc.³⁷ Preparers can face a penalty of \$500 (indexed for inflation) for failing to meet the due diligence requirements. Interestingly, the IRS reports that 96 percent of its due diligence audits are conducted on unenrolled agents.³⁸

In theory, consistent assessment of such penalties will help encourage accountability and change behavior.³⁹ After the IRS has assessed penalties against a preparer, it should track the impact on subsequent behavior by reviewing tax returns filed by preparers who have been assessed penalties, and publish the findings. TAS research studies have demonstrated no change audits result in *decreased* compliance in future years; the no change rates of preparer due diligence audits shown above raise similar concerns.⁴⁰

The IRS has not had great success in collecting the penalties assessed. Part of the problem is that these liabilities are processed just like any other taxpayer liability within the Collection function. In the past, the Collection Program Letter prioritized the collection of preparer penalties. However, the collection of these penalties is no longer included as a priority.⁴¹ As a result of limited IRS resources and the low prioritization by Collection in actively working preparer penalty assessments, TIGTA noted that the IRS collected just 15 percent of the penalties assessed against individual return preparers from calendar year (CY) 2012 to CY 2015.⁴²

36 EITC Preparer Treatment Delivery Tool (Dec. 12, 2018). The actual audits are conducted by SB/SE.

37 IRS, *Auditing for Due Diligence Compliance*, <https://www.eitc.irs.gov/tax-preparer-toolkit/preparer-compliance-focused-and-tiered/auditing-for-due-diligence-compliance> (last visited Dec. 6, 2018).

38 IRS response to TAS information request (Aug. 2, 2018).

39 Although there is scholarly debate on how much of a deterrent effect penalties actually have on tax compliance. See Michael Doran, *Tax Penalties and Tax Compliance*, 46 HARV. J. ON LEGIS. 111-161 (2009). See also Research Study: *Do Taxpayers Respond to the Substantial Understatement Penalty? Analysis of Bunching Below the Substantial Understatement Penalty Threshold*, *infra*.

40 Erik Hoelzl, Erich Kirchler, and Ingrid Wahl, *Enforced Versus Voluntary Tax Compliance: The “Slippery Slope” Framework*, 29 J. ECON. PSYCHOL. 218-219 (2008).

41 The FY 2013, FY 2014, and FY 2015 Program Letters for Collection included the collection of tax return preparer penalties as a priority. The FY 2016 and FY 2017 Program Letters did not list collection of tax return preparer penalties as a priority.

42 TIGTA, Ref. No. 2018-30-042, *The Internal Revenue Service Lacks a Coordinated Strategy to Address Unregulated Return Preparer Misconduct* 15 (July 25, 2018).

As a result of limited IRS resources and the low prioritization by Collection in actively working preparer penalty assessments, Treasury Inspector General for Tax Administration (TIGTA) noted that the IRS collected just 15 percent of the penalties assessed against individual return preparers from calendar year (CY) 2012 to CY 2015.

In addition to assessing penalties for preparer misconduct, the IRS may apply sanctions against unscrupulous preparers. The Secretary of the Treasury may (after notice and opportunity for a proceeding) suspend, disbar from practice, or censure representatives who are incompetent, are disreputable, violate regulations, or willfully and knowingly mislead or threaten the person being represented (or a prospective person to be represented).⁴³ In the first six months of CY 2018, the IRS reported only one disbarment, 34 suspensions, and zero censures.⁴⁴

FIGURE 1.7.5, OPR Disciplinary Actions, CY 2015 to CY 2018 (through June)⁴⁵

	CY 2015	CY 2016	CY 2017	CY 2018 (through June)
Disbarment	2	2	1	1
Suspension	61	57	46	34
Censure	0	3	1	0
Total OPR Case Receipts	905	894	2,018	2,018

In extreme cases, return preparers (enrolled or unenrolled) may be enjoined from preparing tax returns. Such a process requires coordination between SB/SE Exam, CI, IRS Office of Chief Counsel, and the Department of Justice.⁴⁶ Perhaps because an injunction against a return preparer requires a great deal of coordination, the IRS rarely imposes such sanctions.⁴⁷

The IRS Should Assert a More Active Role in the Voluntary Certification Process, Including Designing an Examination and Developing Training Materials

While it is true that the courts have enjoined the IRS from requiring testing and certification of tax return preparers, the IRS still has the responsibility to protect taxpayers.

As discussed above, the IRS already administers the AFSP, the voluntary certification program for unenrolled preparers. Currently, the IRS does not administer the knowledge-based comprehension test that participants must pass to obtain the AFSP Record of Completion. Rather, participants are referred

43 31 U.S.C. § 330.

44 Note that the Office of Professional Responsibility has oversight responsibility over Circular 230 tax professionals; it does not have jurisdiction over unenrolled preparers.

45 IRS, *OPR's Case Dispositions*, <https://www.irs.gov/tax-professionals/oprs-case-dispositions> (last visited Dec. 21, 2018).

46 IRM 4.32.2.2, *Overview of Abusive Transactions (AT) Program* (June 4, 2018); IRM 4.32.2.3, *Abusive Transactions Defined* (June 4, 2018).

47 In calendar year 2016, only 70 preparers were enjoined from preparing returns. TIGTA, Ref. No. 2018-30-042, *The Internal Revenue Service Lacks a Coordinated Strategy to Address Unregulated Return Preparer Misconduct* 16 (July 25, 2018).

to a list of continuing education providers who are responsible for the development and administration of the comprehension test. However, the National Taxpayer Advocate believes that because it owns this program, the IRS and the IRS alone should design the test that is administered to program participants.⁴⁸ This would ensure that the content covers the issues the IRS finds to be problematic.

One idea the IRS can consider as it develops its overall return preparer strategy is to tie in continuing education training to the abatement of preparer penalties. For example, if an unenrolled preparer is assessed a \$500 penalty at the conclusion of a due diligence audit, the IRS may be able to encourage that preparer to take a voluntary continuing education course by offering to abate all or a portion of the penalty upon passing the test.

The IRS Should Ensure that Any References to the Directory of Federal Tax Return Preparers Are Not Misleading

The IRS maintains a public directory of federal tax return preparers to help taxpayers find return preparers with certain credentials and qualifications. This searchable and sortable database includes the name, city, state, and ZIP Code of preparers with valid PTINs—including attorneys, CPAs, EAs, enrolled retirement plan agents, and enrolled actuaries. The database also includes a list of participants who have completed the AFSP for that year.

While this database can be helpful to taxpayers, the IRS should be cautious in how it references the Directory of Federal Tax Return Preparers in its communication with taxpayers. For example, in the Appeals Letter 3808, *Docketed Acknowledgment and Conference (to Petitioner)*, taxpayers are referred to the Directory of Federal Tax Return Preparers, although (1) many return preparers listed in the directory may not be authorized to represent taxpayers (if they are not attorneys, CPAs, or EAs), and (2) even a registered return preparer (*i.e.*, one who participates in the AFSP) who prepared and signed the taxpayer's return may only be authorized under Circular 230 to provide limited representation with regard to an examination of that return and are specifically prohibited from otherwise representing the taxpayer.⁴⁹ It is misleading and potentially harmful for the IRS to reference the Directory of Federal Tax Return Preparers without adequately explaining the potential limited representation authorities of such preparers.

Although the IRS is prohibited from requiring unregulated preparers to undergo testing, this does not mean that preparers cannot obtain certification voluntarily, as a way of differentiating themselves from their competition. The IRS can lead the effort in the development and review of training material used by third-party certification programs.

48 Continuing education providers could continue to administer the test, and the IRS can partner with these providers in designing the test, but the IRS alone should direct and design the content.

49 IRS, Circular 230, §10.3(f).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Invite representatives from TAS to the cross-functional team that was established to develop a coordinated strategy to provide effective oversight of return preparers.
2. Develop a comprehensive plan to communicate the coordinated return preparer strategy to Circular 230 preparers and unenrolled preparers.
3. 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.
4. Conduct analysis on the impact of penalty assessments and no change audits on preparers' behavior in subsequent years, and publish the findings.
5. Revise letters and notices (including Appeals Letter 3808) that reference the Directory of Federal Tax Return Preparers to ensure that appropriate caveats are clearly articulated.

INTRODUCTION TO THE EXAMINATION PROCESS: Promoting Voluntary Compliance and Minimizing Taxpayer Burden In the Selection and Conduct of Audits

WHY ARE IRS AUDITS IMPORTANT?

The IRS's primary purpose in selecting tax returns for examination or audit is to promote the highest degree of voluntary compliance.¹

IRS audits are intended to detect and correct noncompliance of audited taxpayers as well as create an environment to encourage non-audited taxpayers to comply voluntarily. The IRS is authorized to examine books, papers, records, or other data and take testimony to determine the correctness of any return and the liability of any person for tax under Internal Revenue Code (IRC) § 7602(a).

The IRS conducts audits either via correspondence, office, or field audits.² Generally, correspondence audits are managed by mail for a single tax year and involve no more than a few issues that the IRS believes can be resolved by reviewing simple documents.³ A field exam deals with more complex issues and involves a face-to-face meeting between the taxpayer and an IRS revenue agent at the taxpayer's home or place of business.⁴ Finally, an office audit is conducted at a local IRS office and generally involves issues that are more complex than those found in correspondence exams but less complex than examinations conducted in the field.⁵

Traditional voluntary compliance has focused on deterrence theory. However, social science research indicates that the deterrence theory accounts for only a portion of the actual compliance rates and that social norms, personal values, and attitudes may have a larger impact on taxpayers' compliance decisions.⁶ Studies have shown that to ensure a high level of voluntary tax compliance, taxpayers must have faith and trust in the fairness of the tax system.⁷

This year's Annual Report contains a research study in Volume 2 that explores the influence of tax audits on taxpayers' attitudes and perceptions.⁸ 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.⁹ Taxpayers who experienced correspondence exams experienced a lower level of perceived justice compared to those who underwent office and field exams.¹⁰

1 Internal Revenue Manual (IRM) 1.2.13.1.10, *IRS Policy Statement 4-21* (June 1, 1974).

2 IRS Statement of Procedural Rules, Treas. Reg. § 601.105(b).

3 See National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 71 (discussing the differences between field and correspondence audits). Large Business and International (LB&I) Division's correspondence audits, however, may be more complicated because they involve complex international tax issues.

4 See IRM 4.10.3.3.2, *Where to Conduct Interviews* (Feb. 26, 2016); IRM 4.1.5.3.2.6, *Revenue Agent versus Tax Compliance Officer* (Oct. 20, 2017).

5 *Id.*

6 National Taxpayer Advocate 2014 Annual Report to Congress 122.

7 See Erich Kirchler, Erik Hoelzl, and Ingrid Wahl, *Enforced versus Voluntary Tax Compliance: The "Slippery Slope" Framework*, 29 J. ECON. PSYCHOL. 219 (2008); see also 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*.

8 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*.

9 *Id.*

10 *Id.*

The study results suggest that IRS correspondence exams foster more distrust of the IRS compared to field or office exams.¹¹ The study also found that taxpayers who experienced an audit that resulted in a refund of tax perceived the IRS with less trust after the conclusion of the audit, suggesting that the taxpayers may have been frustrated to be selected for audit when they had overpaid their tax or felt that the IRS was unfair in its selection of their returns.¹² On the basis of these findings, the National Taxpayer Advocate believes that in selecting returns and evaluating audit cases, the IRS should research and consider how the audits build taxpayers' trust and affect future voluntary compliance.

What is the Difference Between “Real” Versus “Unreal” Audits?

In addition to audits, the IRS conducts “compliance checks,” which should be evaluated along with the IRS’s audit program to determine how they affect taxpayers’ attitudes, perceptions, and future voluntary compliance. The IRS’s compliance checks involve a host of programs and procedures that require taxpayers to provide verification of tax return items via correspondence. Unlike the correspondence audit, however, these communications are not considered audits and do not afford the same protections provided to taxpayers undergoing the audit process.

The National Taxpayer Advocate has previously written about this issue of “real” vs. “unreal” audits.¹³ These contacts or “unreal” audits comprise the majority of compliance contacts and eclipse “real” audit figures. In calendar year 2016, the IRS conducted over 8 million of these “unreal audits” while conducting only 1,033,356 “real” audits.¹⁴ Although this introduction will focus on traditional audits, including correspondence, office, and field, many of the same issues and concerns raised in the IRS correspondence audit program apply to these “unreal audits.”

What is the Impact of Traditional IRS Audits on Voluntary Compliance?

The IRS’s current examination program is not sufficiently building trust and promoting future voluntary compliance. Because the IRS’s traditional audit program has been reduced greatly over the last ten years, the IRS needs to focus on increasing voluntary compliance with the audits that it does conduct. During fiscal year (FY) 2007, the IRS audited 1.55 million returns, or 0.9 percent of all returns filed,¹⁵ compared to FY 2017, where the IRS audited almost 1.1 million returns, or 0.5 percent of all returns filed. In FY 2017, approximately 88 percent of the IRS’s audits involved audits of individual income tax returns. The remaining audits consisted of corporate income tax returns (two percent), nontaxable returns (*e.g.*, partnership income tax returns) (three percent) and specialty tax returns (seven percent) as shown in Figure 1.0.1 below.¹⁶

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 *Id.*

13 National Taxpayer Advocate 2017 Annual Report to Congress 49-63 (Most Serious Problem: *Audit Rates: The IRS Is Conducting Significant Types and Amounts of Compliance Activities That It Does Not Deem to Be Traditional Audits, Thereby Underreporting the Extent of Its Compliance Activity and Return on Investment, and Circumventing Taxpayer Protections*); Nina E. Olson, “Real” vs. “Unreal” Audits and Why This Distinction Matters, NATIONAL TAXPAYER ADVOCATE BLOG (July 6, 2018), <https://taxpayeradvocate.irs.gov/news/nta-blog-real-vs-unreal-audits-and-why-this-distinction-matters?category=Tax News>.

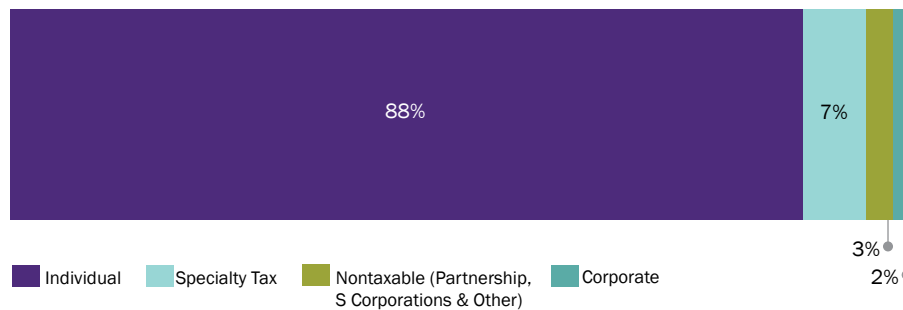
14 *Id.*

15 IRS Data Book, 2007, 23 (Mar. 2008).

16 IRS Data Book, 2017, Publication 55B, 21 (Mar. 2018). Specialty tax returns include employment tax returns, estate returns and gift tax returns. IRM 3.28.2.9 (June 21, 2018).

FIGURE 1.0.1¹⁷

Returns Audited in FY 2017 by Return Type



This introduction will discuss examination programs operated by three IRS business operating divisions—Wage & Investment (W&I), Small Business and Self-Employed (SB/SE), and Large Business and International (LB&I). Each operating division is responsible for a specific segment of the taxpayer population and each creates an Examination or Compliance Plan based on coverage objectives and resources.¹⁸ W&I handles taxpayers who pay taxes through withholding. W&I conducts all its audits via correspondence concerning issues such as refundable credits and some returns containing Schedule C, *Profit and Loss from Business*.¹⁹

SB/SE conducts correspondence audits, office audits, and field examinations of small business taxpayers with assets less than \$10 million, as well as examinations of self-employed and other individuals with income that extends beyond the level of W&I responsibility. LB&I is responsible for the tax compliance of businesses with assets of \$10 million or more, as well as individuals with high wealth or international tax implications. LB&I conducts field, office, and correspondence audits.

As stated above, correspondence exams can be particularly burdensome for many taxpayers, especially low income taxpayers. The IRS makes an already difficult situation, an audit, worse by failing to assign one IRS examiner to each taxpayer case, delaying responses to taxpayers' correspondence by more than 65 days, and frequently closing an exam without any personal contact. The lack of personal contact, in particular, results in a missed opportunity for the IRS to revise its audit selection filters or to update its educational materials to clarify confusing tax issues.²⁰ During FY 2017, the combined correspondence audits of individuals and of businesses comprised approximately 71 percent of all audits, while office audits and field audits comprised 10 and 19 percent, respectively, as depicted on Figure 1.0.2 below.²¹

17 IRS Data Book, 2017, Publication 55B, 21 (Mar. 2018).

18 IRM 4.1.1.2(1), *Exam Plan* (Oct. 25, 2017); IRM 4.1.21.2.2, *LMSB Compliance Plan* (Aug. 1, 2007); IRM 4.1.26.1.3(1), *Responsibilities* (Dec. 13, 2017).

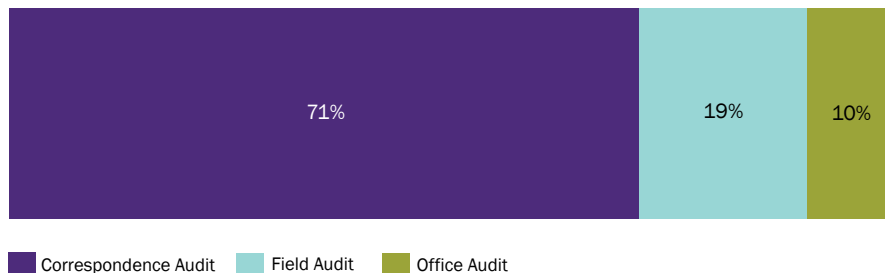
19 IRM 4.19.11.2.1(10), *Procedures for Screening Individual Returns* (June 22, 2016).

20 See 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 Taxpayer Compliance*, *infra*.

21 IRS, Compliance Data Warehouse (CDW), Automated Information Management System (AIMS) fiscal year (FY) 2017 (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.

FIGURE 1.0.2²²

FY 2017 Closed Audits by Type of Audit



Although taxpayers who underwent office and field audits reported higher levels of perceived justice compared to correspondence audits, there is still much room for improvement for office and field exams in terms of earning the taxpayers' trust and perceptions of fair treatment, regardless of the result of the audit. The IRS could improve office audits by making several changes, including tracking results of audits that are appealed by the taxpayer, educating taxpayers on future compliance by adding taxpayer education as a quality attribute, and increasing the number of tax compliance officers (TCOs) in more locations throughout the United States, so that taxpayers feel their particular facts and circumstances are understood.²³

SB/SE's field auditors could improve the taxpayers' audit experience by implementing certain practices, including sharing and discussing the audit plan with taxpayers and affording them the opportunity to propose changes to the plan before it is final, notifying taxpayers during an audit of any consultations with specialists, giving them the opportunity to discuss with the specialist any technical conclusions, and periodically studying taxpayers' filing behavior following field exams to determine the impact of the exam on future compliance.

22 IRS, CDW, AIMS FY 2017 (Dec. 2018). TAS defined Correspondence Audits as audits closed by Tax Examiners in the Wage and Investment Division (W&I) and the Small Business/Self-Employed Division (SB/SE), Office Audits as audits closed by Tax Compliance Officers in SB/SE, and Field Audits as audits closed by Revenue Agents in SB/SE and LB&I. 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.

23 See Most Serious Problem: *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*, *infra*.

How Do the IRS Operating Divisions Select Returns for Audits?

*SB/SE Audit Selection Processes*²⁴

SB/SE selects returns for audit based on referrals, including IRS and external sources and taxpayer-initiated contacts, and selection methods called workstreams. SB/SE uses 33 workstreams to identify and review tax returns that may merit an audit.²⁵ About one-third of the workstreams use some form of automation to identify the returns that should enter the workstream.²⁶ All corporate returns with assets less than \$10 million and all individual returns are computer scored under the Discriminant Function (DIF) system.²⁷

SB/SE identifies a pool of returns from which it selects a smaller group of returns to audit through the process of classification. SB/SE's Campus Classification function is generally responsible for identifying, selecting, and delivering returns to the various examination functions within the IRS.²⁸ During classification, an experienced examiner is expected to use his or her skills, technical expertise, local knowledge, and experience to identify hidden, as well as obvious, issues.²⁹ The classifier further determines whether the return should be examined, identifies the preliminary scope of the audit, and identifies a limited number of items that will be examined.³⁰ The classifier is also responsible for determining the type of examination to be conducted and the grade of the examiner appropriate for conducting the examination.³¹

Because field and office audits are face-to-face, SB/SE selects returns for field and office audit based on the geographic location of Revenue Agents and TCOs. The IRS does not conduct field or office exams in areas where no examiners or TCOs are located. Currently, there are no TCOs located in Alaska, Delaware, Montana, North Dakota, South Dakota, or Wyoming. Therefore, office exams are not conducted in these states.³²

*W&I Audit Selection Processes*³³

W&I relies substantially on the Dependent Database (DDb), an automated computer application to select returns for audit.³⁴ Although W&I uses other sources, such as Integrity and Verification Operations (IVO) referrals, manual classification, referrals from other parts of the IRS, and outside

24 Government Accountability Office (GAO), *IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should be Strengthened*, GAO-16-103 (Dec. 2015). The GAO report discusses in detail SB/SE's process for selecting returns for audit.

25 GAO, *IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should be Strengthened*, GAO-16-103 (Dec. 2015).

26 *Id.*

27 IRM 4.1.2.7.2 (1), *Individual Returns* (Oct. 19, 2017); IRM 4.1.2.7.3(1), *Corporation Returns* (Oct. 19, 2017); IRM 4.1.2.7.4(1), *S Corporation Returns* (Oct. 19, 2017).

28 IRM 4.19.11.1.1, *Background* (Oct. 11, 2017).

29 IRM 4.1.5.3.3.1(3), *Standards for Classification* (Oct. 20, 2017).

30 *Id.*

31 IRM 4.1.5.3.3.1(6), *Standards for Classification* (Oct. 20, 2017).

32 IRS response to TAS information request (Oct. 15, 2018).

33 GAO, *IRS Return Selection: Wage and Investment Should Define Audit Objectives and Refine Other Internal Controls*, GAO-16-102 (Dec. 2015). The GAO report discusses in detail how W&I selects individual returns for audit.

34 *Id.* The IRS may not be using the Dependent Database effectively because it concentrates its Earned Income Tax Credit (EITC) audit resources on taxpayers with a noncompliance issue that is relatively minor (the relationship test), compared to an issue associated with 75 percent of all EITC qualifying child errors (the residency test). See also National Taxpayer Advocate 2015 Annual Report to Congress 248-260 (Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS Is Not Adequately Using the EITC Examination Process as an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance*).

referrals for the selection of cases for correspondence audit, most of W&I's returns are selected from DDb.³⁵ DDb identifies potential non-compliance using data from various sources, including IRS databases, child custody information from the Department of Health and Human Services, the dependent and child birth information from the Social Security Administration, and prisoner information from the National Prisoner File, to determine the validity of the claims for tax credits and refunds.

*LB&I Audit Selection Processes*³⁶

LB&I is in the process of changing the way it addresses compliance, including how it identifies tax returns for audit, and is moving toward implementing issue-based projects it calls “campaigns.”³⁷ According to LB&I, a campaign is a compliance project focused on a specific compliance issue, such as partnerships underreporting income, rather than on using characteristics of the whole tax return for audit consideration.³⁸

Campaigns could consist of an audit, or a less burdensome treatment, such as letters asking taxpayers to consider changing how they report the issue or providing additional guidance to help taxpayers accurately report the issue on their returns. Although the long-term plan is for the campaigns to constitute a significant part of the LB&I compliance program, currently, campaigns only comprise a small minority, only about six percent, of LB&I's audit work.³⁹

LB&I is reportedly working to create metrics for the campaigns, but it is unclear how the IRS currently determines a campaign is not working and should be abandoned, or perhaps should be broadened and expanded. The IRS recently ended some of its campaigns, but has not developed a strategy to communicate the terminations publicly.⁴⁰ While LB&I implements campaigns, officials said that the existing selection methods it uses will continue to operate until LB&I decides whether to replace them.⁴¹ LB&I officials also said that existing selection methods may be repurposed to operate within campaigns as well.⁴²

Like W&I and SB/SE, LB&I identifies returns to audit using computerized scoring models and filters. Additionally, LB&I picks returns with specific issues for compliance initiative projects (CIP) or returns that are mandated for audit, such as refund returns that are subject to Joint Committee on Taxation review.⁴³ LB&I also identifies returns with known abusive tax schemes and gives additional scrutiny to individual tax returns with certain international tax issues.

35 Integrity and Verification Operations filters are not accurate resulting in a high rate of false positives. 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*, *supra*.

36 GAO, *IRS Return Selection: Improved Planning, Internal Controls, and Data Would Enhance Large Business Divisions Efforts to Implement New Compliance Approach*, GAO-17-324 (Mar. 2017).

37 *Id.*

38 *Id.*

39 LB&I Business Performance Review, 3rd Quarter (Oct. 2018).

40 Amanda Athanasiou, *IRS Weighing Termination of LB&I Campaigns*, TAX NOTES TODAY (Nov. 8, 2018).

41 GAO, *IRS Return Selection: Improved Planning, Internal Controls, and Data Would Enhance Large Business Divisions Efforts to Implement New Compliance Approach* 9, GAO-17-324 (Mar. 2017).

42 *Id.*

43 The Joint Committee on Taxation, a Congressional committee, is required to review any proposed refund or credit of income or estate and gift taxes or certain other taxes more than \$2 million (\$5 million in the case of a C corporation) under IRC § 6405.

After returns are scored by computers or pulled for special projects and mandatory work, LB&I conducts another review called classification, in which LB&I staff identifies whether the return merits an audit and identifies specific issues for audit consideration. After the identified returns have been classified or otherwise reviewed for specific tax issues, they are listed in a queue for audit managers to assign to auditors. Auditors in the field assess whether the queued returns have large, unusual, or questionable features.

Once selected, LB&I audits fall into specific categories. Among the most common are Coordinated Industry Cases (CIC), Industry Cases (IC), and International Individual Compliance Cases (IIC). The CIC program puts large enterprises under continual audits. LB&I categorizes tax returns as CIC based on factors that include assets, gross receipts, and operating entities. CIC taxpayers are audited by a team, while IIC returns are usually audited by a single auditor. IIC has responsibility for auditing U.S. taxpayers living or working abroad, or in a U.S. Territory. IIC also identifies tax returns for audit for U.S. taxpayers, who hold income-producing assets in a foreign country or claim the foreign earned income exclusion, or foreign tax credit, and non-resident taxpayers who have a U.S. filing requirement.⁴⁴

What Do the Audit Results Show?

The distribution of audit results by audit type show some of the strengths and weaknesses of the IRS's examination programs in terms of promoting voluntary compliance.

As depicted on Figure 1.0.3⁴⁵ below, the IRS office and field audits show high agreed rates of about 45 percent on average. The IRS should be commended for these high agreed rates because agreement suggests that audit was an effective educational tool. That is, the taxpayer was educated about the issue, understands the mistake, and may be less likely to repeat the mistake in the future.

On the other hand, many of the field audits also concluded with “no change” in the tax adjustment.⁴⁶ This high no change rate suggests that both SB/SE and LB&I are not identifying the correct tax returns or issues for audit. Thus, both the IRS's and taxpayer's resources are being used ineffectively. Additionally, an audit study showed that the taxpayer may become more non-compliant after a no change audit.⁴⁷ The no change rate for corporate returns was 31 percent in FY 2017.⁴⁸ For corporations

44 IRM 4.60.4.5 (Feb. 3, 2015).

45 IRS, CDW AIMS, Individual Master File (IMF), Business Master File (BMF) FY 2017 (Nov. 2018). IRM 4.4.12.5.49.1, *No Change Disposal Codes* (June 1, 2002) defines a no change as case closed by the examiner with no additional tax due (disposal code 1 and 2). In the IRS response to TAS fact check (Dec. 20, 2018), SB/SE notes disposal code 1 as an agreed closure. TAS does not agree with SB/SE's definition because these cases do not require agreement from the taxpayer since there is no additional tax liability (see, e.g., IRM 4.10.8.2.2, *No Change with Adjustments Report Not Impacting Other Tax Year(s)* (Sept. 12, 2014)) and the taxpayers agreement, or disagreement, with the adjustment(s) as it pertains to another's year's liability is not known. Treasury Inspector General for Tax Administration (TIGTA) Report 2018-30-069 concurs with TAS's definition. Additionally, SB/SE includes 'partially agreed' cases (in which a taxpayer executes an agreement to some, but not all, of the proposed adjustments) as agreed cases in their reporting. TAS excludes those cases since the final disposition of the case is unknown (see, e.g., IRM 4.4.12.2.6, *Final Disposition After Input of Partial Assessment* (Sept. 17, 2015), which indicates that cases closed as partial agreements must be updated to reflect either a later agreement or the issuance of a notice of deficiency). 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.

46 IRM 4.4.12.5.49.1, *No Change Disposal Codes* (June 1, 2002) defines a no change as case closed by the examiner with no additional tax due (disposal code 1 and 2).

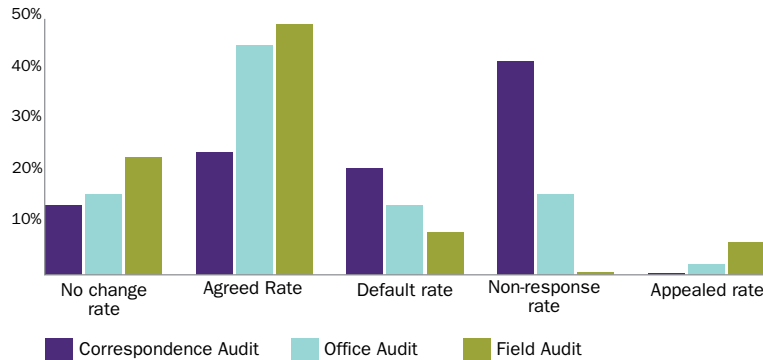
47 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 67-100 (Research Study: Brian Erard, Matthias Kasper, Erich Kirchner, and Jerome Olsen, *Audit Impact Study*); see also Most Serious Problem: *Field Examination: The IRS's Field Examination Program Burdens Taxpayers and Yields High No-Change Rates, Which Waste IRS Resources and May Discourage Voluntary Compliance*, *infra*.

48 IRS Data Book, 2017, Publication 55B, 21 (Mar. 2018).

with total assets between 50 and 100 million, the no change rate was as high as 50 percent in FY 2017.⁴⁹ Similarly, for partnership returns and S corporation returns, the no change rate in FY 2017 was 43 percent and 29 percent, respectively.⁵⁰

FIGURE 1.0.3⁵¹

FY 2017 Closed Audit Results by Type of Audit



49 IRS Data Book, 2017, Publication 55B, 21 (Mar. 2018).

50 *Id.*

51 IRS, CDW AIMS, IMF, BMF FY 2017 (Nov. 2018). IRM 4.4.12.5.49.1, *No Change Disposal Codes* (June 1, 2002) defines a no change as case closed by the examiner with no additional tax due (disposal code 1 and 2). In the IRS response to TAS fact check (Dec. 20, 2018), SB/SE notes disposal code 1 as an agreed closure. TAS does not agree with SB/SE's definition because these cases do not require agreement from the taxpayer since there is no additional tax liability (see, e.g., IRM 4.10.8.2.2, *No Change with Adjustments Report Not Impacting Other Tax Year(s)* (Sept. 12, 2014)) and the taxpayers agreement, or disagreement, with the adjustment(s) as it pertains to another's year's liability is not known. TIGTA Report 2018-30-069 concurs with TAS's definition. Additionally, SB/SE includes 'partially agreed' cases (in which a taxpayer executes an agreement to some, but not all, of the proposed adjustments) as agreed cases in their reporting. TAS excludes those cases since the final disposition of the case is unknown (see, e.g., IRM 4.4.12.2.6, *Final Disposition After Input of Partial Assessment* (Sept. 17, 2015), which indicates that cases closed as partial agreements must be updated to reflect either a later agreement or the issuance of a notice of deficiency). 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 SB/SE and W&I correspondence exams combined, the audit results show a non-response rate of 40 percent and a default rate of 20 percent in FY 2017 as shown on Figure 1.0.3 above.⁵² The 40 percent non-response rate indicates that taxpayers did not respond at all to the IRS's correspondence audit notice. In addition, of those taxpayers who did respond to the correspondence audit notices, 20 percent did not petition the Tax Court or sign an agreement after the issuance of the statutory notice of deficiency.⁵³

Most of these correspondence audits involved audits of individual income tax returns of low income taxpayers with incomes of \$25,000 or less who claimed the Earned Income Tax Credit (EITC).⁵⁴ Approximately 38.6 percent or 361,360 of all individual income tax audits consisted of this group of taxpayers in FY 2017.⁵⁵ The high non-response and default rates suggest that it is especially difficult for taxpayers who claim the EITC to respond to the IRS timely and appropriately for several reasons, including the complexity of EITC eligibility requirements and complicated family living situations.⁵⁶

Most Serious Problems

In the three Most Serious Problems that follow, the National Taxpayer Advocate expresses concerns that IRS examinations fail to increase future voluntary compliance, do not measure voluntary compliance in terms of taxpayers' positive attitudes towards the IRS and educating taxpayers, and place undue burdens on taxpayers. The Most Serious Problems are:

- **CORRESPONDENCE EXAMINATION:** *The IRS's Correspondence Examination Procedures Burden Taxpayers and are Not Effective in Educating the Taxpayer and Promoting Future Voluntary Compliance;*
- **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;* and
- **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.*

52 A default assessment is one made by the IRS subject to its authority under IRC §§ 6212 and 7602, where the taxpayer fails to file a petition with the U.S. Tax Court or sign an agreement after the issuance of a statutory notice of deficiency (SNOD). IRC § 7602 authorizes the IRS to conduct audits and assess all taxes imposed by Title 26. If the auditor determines that a deficiency of tax exists, subject to IRC § 6212, he or she may send the taxpayer a notice of deficiency by certified mail or registered mail; however, as restricted by IRC § 6213 the IRS may not make an assessment "until such notice has been mailed to the taxpayer, or until the expiration of such 90-day or 150-day period," or, if taxpayer has filed a timely petition with the Tax Court, until the decision of the Tax Court has become final. See also IRM 4.8.9.26, *Defaulted Notices* (July 9, 2013).

53 For the 20 percent of taxpayers who did not sign an agreement or petition the Tax Court after the issuance of the notice of deficiency, they are giving up crucial rights including their right to the only prepayment judicial forum where the taxpayer can appeal an IRS decision. See 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*; see also Most Serious Problem: *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*, *infra*.

54 IRS Data Book, 2017, Publication 55B, 21 (Mar. 2018).

55 IRS Data Book, 2017, Publication 55B, 21 (Mar. 2018). This percentage is derived from 361,360 divided by 933,785 which is the business and nonbusiness returns with Earned Income Tax Credit with under \$25,000 of total gross receipts divided by total individual income tax returns audited.

56 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*.

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****RESPONSIBLE OFFICIALS**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division
Ken Corbin, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and be Heard*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

Internal Revenue Code (IRC) § 7602(a) provides the IRS with the authority to conduct examinations for the purposes of determining whether a tax return is correct, creating a return where the taxpayer has not filed, and determining a taxpayer's tax liability. 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.² During FY 2017, the IRS conducted approximately 71 percent of all audits (business and individual) by correspondence.³ Proponents of correspondence examinations argue they are beneficial because they allow the IRS to audit many taxpayers without complex issues and minimize burden for them. However, in many cases, the issues deemed as "not complex" may involve complicated rules and procedures, or complicated fact situations, or both as in the case of the Earned Income Tax Credit (EITC). In addition, taxpayers audited by correspondence 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.

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 IRS Data Book, 2017, Publication 55B, 21 (Mar. 2018). This number does not include certain returns, such as those of tax exempt and government entities, nor does it include other compliance contacts that can be considered "unreal" audits, and which make the number much higher. See National Taxpayer Advocate 2017 Annual Report to Congress 49-63 (Most Serious Problem: *Audit Rates: The IRS Is Conducting Significant Types and Amounts of Compliance Activities that It Does Not Deem to Be Traditional Audits, Thereby Underreporting the Extent of Its Compliance Activity and Return on Investment, and Circumventing Taxpayer Protections*).

3 IRS Data Book, 2017, Publication 55B, 22 (Mar. 2018).

For FY 2018 correspondence audits, the IRS took more than 65 days to respond to the majority of taxpayer replies in both EITC cases and non-EITC refundable credit cases.⁴ During FY 2018, the Small Business/Self-Employed Division (SB/SE) exam employees answered the exam phone line only about 35 percent of the time⁵ and, not surprisingly, SB/SE reported receiving only about 0.87 incoming calls per correspondence exam potentially because taxpayers could not get through.⁶ These problems are exacerbated when the audited taxpayer is low income, has limited English proficiency, or there are other impediments that hinder communication during the audit.

An examination is primarily an education vehicle, so the taxpayer learns the rules, corrects mistakes, and can comply in the future. The tax assessed from the examination is a byproduct of the exam, but it is not the purpose. 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.⁷

The National Taxpayer Advocate is concerned that:

- Audit selection procedures may lead to complex cases being audited by correspondence and a disproportionate burden on low income taxpayers;
- Insufficient training on complex issues for correspondence examiners may prevent them from correctly determining the liability or knowing when to transfer a case to an employee with specific expertise;
- A substantial number of taxpayers audited by correspondence face barriers to understanding and effectively participating in the audit;
- The IRS's correspondence is often confusing and does not provide sufficient time for the taxpayer to respond; and
- The IRS metrics do not consider taxpayer needs and preferences when determining the effectiveness of its correspondence exam program, and the IRS prioritizes measures such as cycle time and closures, which ignore the impact on the taxpayer.

ANALYSIS OF PROBLEM

Background

In the past ten years, the percentage of overall audits (including businesses and individuals) conducted by correspondence has remained steady, around 80 percent. However, overall audits have decreased substantially, as shown in Figure 1.8.1.

4 IRS, *W&I RICS Examination PAC 7F Reports* (Sept. 2018), combining correspondence statuses 55 and 57. See Internal Revenue Manual (IRM) 4.19.13.11, *Monitoring Overaged Replies* (Feb. 9, 2018) instruction to give either a 107 or a 150-day follow up expectation to taxpayers. For a discussion of the IRS's practice of mothballing overaged audit responses from taxpayers, see Case Advocacy section, *infra*.

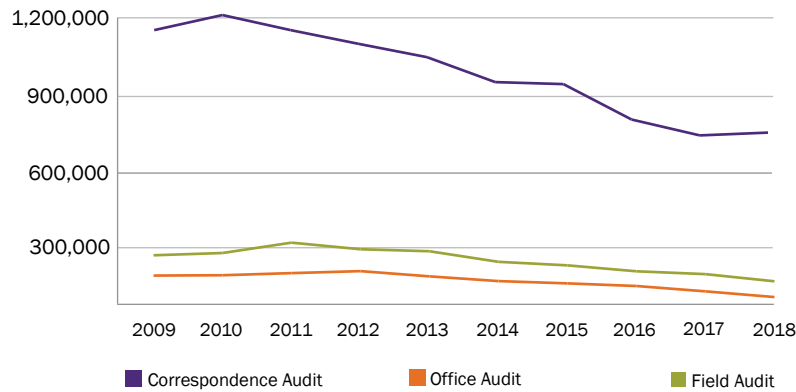
5 IRS, Product Line Detail (Enterprise Performance) Snapshot report (week ending Sept. 30, 2018).

6 IRS response to TAS information request (Oct. 24, 2018).

7 Jason DeBacker, Bradley T. Heim, Anh Tran, and Alexander Yuskavage, *Once Bitten, Twice Shy? The Lasting Impact of IRS Audits on Individual Tax Reporting* (Aug. 25, 2015) (working paper, Indiana University), <https://pdfs.semanticscholar.org/3833/61d62ea27f93deb89bf2c4b926bc5e96e14b.pdf>.

FIGURE 1.8.1⁸

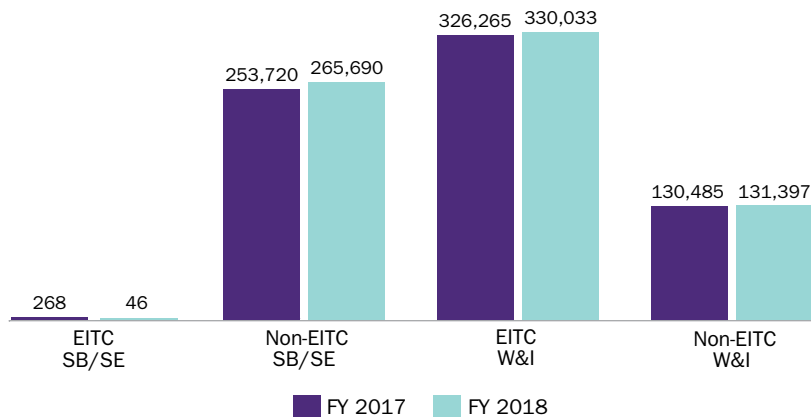
Number of Correspondence Audits, Office Audits, and Field Audits Closed during Fiscal Years 2009 through 2018



As shown in Figure 1.8.2, in FY 2018, SB/SE closed about 266,000 correspondence exams,⁹ and Wage and Investment Division (W&I) closed about 461,000 correspondence exams, with EITC exams comprising about 72 percent of W&I’s exams.¹⁰

FIGURE 1.8.2¹¹

W&I and SB/SE Correspondence Audits Closed by EITC and Non-EITC for FY 2017 to 2018



8 IRS response to TAS Fact Check (Dec. 20, 2018). For the purposes of this chart, correspondence audits include audits closed by campus tax examiners in the Wage and Investment Division (W&I) and Small Business/Self-Employed Division (SB/SE). Field audits include audits closed by revenue agents in SB/SE and Large Business and International (LB&I). Office audits include audits closed by tax compliance officers in SB/SE.

9 IRS response to TAS information request (Oct. 24, 2018).

10 *Id.*

11 IRS response to TAS fact check (Dec. 20, 2018). IRS response to TAS information request (Oct. 24, 2018).

SB/SE handles discretionary correspondence audits, including over 30 individual tax issues, such as nonrefundable credits, Schedule A and Schedule C expenses, and unreported income.¹² Of the nearly 447,000 Schedule C exams closed by SB/SE in the last two fiscal years, about 29 percent were conducted by correspondence. Schedule C correspondence exams represented about 38 percent of all correspondence exams conducted by SB/SE.¹³ The IRS has indicated that it may conduct correspondence exams for some issues related to the new deduction for qualified business income under IRC § 199A, but has not projected the volume.¹⁴

SB/SE uses a variety of sources to determine which cases to audit. To determine the exam work plan, SB/SE reports looking at the staffing/hours to work returns, projections for inventory already started or delivered to the various Exam functions, and the Exam Planning Scenario Tool (EPST), which determines the mix of inventory for Discriminant Index Function returns for Correspondence Exam Discretionary as well as Field Revenue Agents (RAs) and Tax Compliance Officers (TCOs).¹⁵ EPST provides scenarios of optimized mix by activity codes for Field (RA & TCO) and by project codes for Campus, based on historical business results.¹⁶ Activity codes describe the financial scope of the return and its complexity, which help determine the appropriate type of examiner.¹⁷ Project Codes identify a specific feature or item on a tax return that the IRS would like to monitor for compliance purposes, for example, Schedule A – Casualty Loss.¹⁸

Starting in FY 2016, W&I exclusively worked all new EITC correspondence exams.¹⁹ The majority of the inventory in the Refundable Credits Examination Operation (RCEO) is derived from the computer program known as the Dependent Database (DDb).²⁰ In FY 2014, DDb identified more than 77 percent of the closed EITC audits.²¹

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- 12 See IRM 4.19.15.1 through 4.19.15.43 (Dec. 1, 2017). SB/SE does not specifically audit Earned Income Tax Credit (EITC), but they will make automatic adjustments to EITC, the American Opportunity Tax Credit, and the Child Tax Credit when the Adjusted Gross Income changes due to other audit adjustments, including changes to Schedule C income.
- 13 IRS response to TAS fact check (Dec. 20, 2018).
- 14 The IRS anticipates a low volume of IRC § 199A exams during FY 2019 since most examinations efforts during that fiscal year will be tax year 2017 and earlier returns. IRS response to TAS information request (Oct. 24, 2018).
- 15 Discretionary exams are conducted by choice, as opposed to EITC exams that are driven by the Revenue Protection Strategy or the refundable credits exams identified by risk based scoring criteria. See IRM 4.19.15.1.3, *Roles and Responsibilities* (Dec. 1, 2017); IRM 4.19.14.1.1, *Background* (Dec. 7, 2017); IRM 4.19.14.1.4, *Program Management and Review* (Dec. 7, 2017).
- 16 IRS response to TAS information request (Apr. 27, 2018). The activity code identifies the type of return examined, e.g., Form 1040 in a specified income range and the project code identifies the examination issue(s), e.g., EITC. See Document 6036 (October 2017).
- 17 IRM Exhibit 4.4.1-1, *Reference Guide* (Apr. 15, 2016). An activity code would present a brief description of the return such as: Non-Farm Business with Schedule C or F where Total Gross Receipts are between \$XX and \$XX, and Total Positive Income is less than \$XX. IRS, Document 6036, *Examination Division Reporting System Codes Booklet 18-24* (Oct. 2017). The activity codes include the actual dollar range, which TAS redacted here. “In general, total positive income is the sum of all positive amounts shown for the various sources of income reported on the individual income tax return, and thus excludes losses.” IRS 2017 Databook, October 1, 2016 to September 30, 2017, 33, <https://www.irs.gov/pub/irs-soi/17databk.pdf>.
- 18 IRS, Project Code Listing (Oct. 16, 2018).
- 19 IRS response to TAS information request (Oct. 24, 2018).
- 20 IRS response to TAS information request (June 22, 2018).
- 21 Government Accountability Office (GAO), *Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened*, 16-103 (Dec. 2015). The IRS may not be using the Dependent Database (DDb) effectively because it concentrates its EITC audit resources on taxpayers with a noncompliance issue that is relatively minor (the relationship test), compared to an issue associated with 75 percent of all EITC qualifying child errors (the residency test). National Taxpayer Advocate 2015 Annual Report to Congress 248-260 (Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS Is Not Adequately Using the EITC Examination Process As an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance*).

FIGURE 1.8.3, Top 5 Project Codes Examined by W&I and SB/SE Correspondence Audit Programs in FY 2010 and FY 2018²²

Project Description	FY 2010	Project Description	FY 2018
First Time Homebuyer Credit (Pre-Refund case)	281,446	EITC DDb (Pre-Refund)	105,765
EITC DDb (Pre-Refund)	160,647	Employee Business Expense	71,429
Non-Filer Program	113,612	Schedule C Expenses	57,657
Employee Business Expense	69,106	EITC-DDb Post refund	47,903
EITC-DDb Post Refund	67,841	Non-Filer Program	37,791

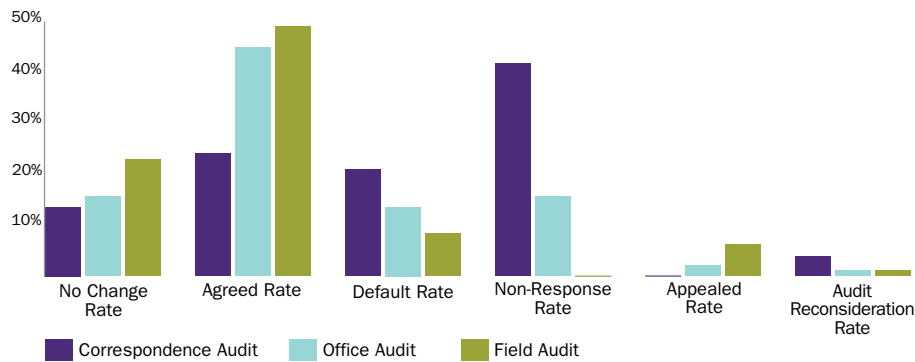
As shown in Figure 1.8.4, correspondence audits generally have lower no change rates, lower agreed rates, and significantly higher non-response rates. Appealed rates are surprisingly low for correspondence audits, given the low agreed rates, and may reflect taxpayers who are not receiving the correspondence or who have simply given up. On the other hand, audit reconsiderations are significantly higher for correspondence exams, which may reflect that taxpayers do not understand their appeal rights or do not realize what has happened until the IRS tries to collect from them.²³

22 IRS, Compliance Data Warehouse (CDW) Audit Information Management System (AIMS) fiscal year (FY) 2010 and FY 2018 (Dec. 2018), and IRS response to TAS fact check (Dec. 20, 2018). TAS chose project codes because they show why a return was selected and reflect the number of EITC adjustments. Issue codes reflect the adjustment line item on the tax return, e.g., the issue code for exemptions means that the exemptions were in question and the examiner classified that issue. However, issue codes do not include EITC in the top five because the EITC is an automatic adjustment, so the examiner does not classify it. For example, changing the number of dependents would automatically calculate an EITC adjustment, but EITC would not be reflected in the issue code.

23 IRS, CDW AIMS, Individual Master File (IMF), Business Master File (BMF) FY 2017 (Nov. 2018). Correspondence Audit includes SB/SE and W&I closures. IRM 4.4.12.5.49.1, *No Change Disposal Codes* (June 1, 2002) defines a no change as case closed by the examiner with no additional tax due (disposal code 1 and 2). In the IRS response to TAS fact check (Dec. 20, 2018), SB/SE notes disposal code 1 as an agreed closure. TAS does not agree with SB/SE's definition because these cases do not require agreement from the taxpayer since there is no additional tax liability (see, e.g., IRM 4.10.8.2.2, *No Change with Adjustments Report Not Impacting Other Tax Year(s)* (Sept. 12, 2014)) and the taxpayers agreement, or disagreement, with the adjustment(s) as it pertains to another's year's liability is not known. Treasury Inspector General for Tax Administration (TIGTA) Report 2018-30-069 concurs with TAS's definition. Additionally, SB/SE includes 'partially agreed' cases (in which a taxpayer executes an agreement to some, but not all, of the proposed adjustments) as agreed cases in their reporting. TAS excludes those cases since the final disposition of the case is unknown (see, e.g., IRM 4.4.12.2.6, *Final Disposition After Input of Partial Assessment* (Sept. 17, 2015), which indicates that cases closed as partial agreements must be updated to reflect either a later agreement or the issuance of a notice of deficiency). IRS response to TAS fact check (Dec. 20, 2018) did not disagree with TAS's definitions for no change or agreed closures.

FIGURE 1.8.4²⁴

Closing Rates, Appealed Rate, and Audit Reconsideration Rate for Correspondence Audit, Office Audit, and Field Audit Closed in FY 2017



Audit Selection Procedures May Lead to Complex Cases Being Audited by Correspondence and a Disproportionate Burden on Low Income Taxpayers

The IRS selects taxpayers for correspondence audit who have legally and factually complex issues, such as taxpayers claiming the EITC or Child Tax Credit (CTC) with differing relationships with the child claimed, complicated living situations where a child may not reside in one residence the entire year, and multiple sources of support for the child.²⁵ Taxpayers claiming the EITC with qualifying children must have a timely issued Social Security number (SSN) for the taxpayer and children; and there are three primary tests for each qualifying child:

- Age test: the child must be younger than the taxpayer and under 19 at the end of the calendar year (or under 24 if a full-time student, or any age if permanently and totally disabled).²⁶
- Relationship test: the child must be the taxpayer's son or daughter, stepchild, foster or adopted child, or a descendant of any of them (*e.g.*, a grandchild), or a child who is a sibling, stepsibling, or half-sibling of the taxpayer, or a descendant of any of them (*e.g.*, a nephew or grandnephew).²⁷
- Residence test: the child must live with the taxpayer for more than half the calendar year.²⁸

Taxpayers entering correspondence exams may be unfamiliar with these rules because they may have had little involvement in filing their returns due to using a paid preparer. For EITC returns filed for tax year 2017, over half were prepared by paid preparers.²⁹

24 IRS, CDW AIMS, IMF, BMF FY 2017 (Nov. 2018). FY 2017 will have a low audit reconsideration compared to older years due to the lack of time since the audit closing date. Correspondence Audit includes SB/SE and W&I closures. Field Audit includes SB/SE and LB&I closures.

25 GAO explains: "Verifying eligibility with residency and relationship requirements can be complicated and subject to interpretation," and the IRS itself acknowledges on its website: "EITC is complex and many special rules apply." GAO, *Comprehensive Compliance Strategy and Expanded Use of Data Could Strengthen IRS's Efforts to Address Noncompliance* 16-475 (May 2016); IRS, *Do I Qualify for the Earned Income Tax Credit?* (Jan. 2017), <https://www.irs.gov/newsroom/do-i-qualify-for-the-earned-income-tax-credit>.

26 IRC § 152(c)(3).

27 IRC § 152(c)(2).

28 IRC § 152(c)(1)(B).

29 IRS, CDW, IRTF tax year 2017. (Dec. 2018).

In addition to using correspondence exams for complex family status issues, the IRS is increasingly using them to audit Schedule C taxpayers. SB/SE increased its percentage of Schedule C exams conducted by correspondence from 18 percent in FY 2017 to 24 percent in FY 2018.³⁰ The National Taxpayer Advocate is concerned about the IRS's potential use of correspondence exams for the IRC § 199A qualified business deduction, which involves highly complex issues as evidenced by the almost 47-page proposed regulations.³¹

Insufficient Training on Complex Issues for Correspondence Examiners May Prevent Examiners From Correctly Determining the Liability or Knowing When to Transfer a Case to an Employee With Specific Expertise

Currently, tax examiners (who conduct correspondence audits for W&I and SB/SE) receive approximately 85 hours of basic income tax law training when they are hired. This training covers primarily items on the Form 1040, *U.S. Individual Income Tax Return*, but may be supplemented by training on additional deductions or specific issues.³² For example, a correspondence examiner may subsequently complete the six-hour course #17877, *Schedule C Travel, Meals & Entertainment*, the 18-hour course #17874, *Mortgage Interest*, or the 1.5 hour course, #17872, *Schedule C Exams: Legal and Professional Fees*.

However, unlike TCOs and RAs conducting office and field examinations, tax examiners do not receive the full spectrum of training on Form 1040 and related forms and schedules in one comprehensive training session. This presents difficulties for the IRS and the taxpayer if an exam item expands or evolves into an issue for which the correspondence examiner has not yet been trained. For example, a review of a taxpayer's travel, meals, and entertainment expenses may reveal that the claimed deduction is actually a car and truck expense. If the tax examiner has not yet completed the two-hour course #17876, *Car and Truck*, the taxpayer's *right to pay no more than the correct amount of tax* may be impaired.³³

A Substantial Number of Taxpayers Audited by Correspondence Face Barriers to Understanding and Effectively Participating in the Audit

Challenges for Low Income Taxpayers

Almost half of all correspondence exams conducted by W&I and SB/SE for individual taxpayers are EITC exams, which necessarily involve low income taxpayers.³⁴ Taxpayers with lower incomes and

30 IRS response to TAS fact check (Dec. 20, 2018).

31 Qualified Business Income Deduction, 83 Fed. Reg. 40884 (proposed Aug. 16, 2018) (to be codified at Treas. Reg. §§ 1.199A-1 through 1.199A-6).

32 IRS response to TAS information request (May 21, 2018); IRS response to TAS information request (June 6, 2018); IRS response to TAS fact check (Dec. 20, 2018).

33 IRS response to TAS information request (May 21, 2018). Examiners have the option to transfer a correspondence exam to an area office if the issue is deemed too complex for correspondence and they receive managerial approval. However, without adequate technical training, an examiner might not recognize the issue should be reassigned to an employee with more or different expertise. IRM 4.19.13.15.1, *Transfers to Area Office* (Jan. 1, 2016).

34 Approximately 46 percent of correspondence examinations (excluding partnership audits conducted under the partnership audit rules of the Tax Equity and Fiscal Responsibility Act (TEFRA)) closed by W&I or SB/SE during FYs 2017 and 2018 were EITC exams. IRS response to TAS information request (Oct. 24, 2018). IRS response to TAS information request (Oct. 25, 2018). Almost three quarters of W&I correspondence exams closed during FY 2018 were EITC exams. IRS response to TAS fact check (Dec. 20, 2018).

education levels may have more difficulty understanding the tax laws and may rely on incompetent or unscrupulous return preparers.³⁵

FIGURE 1.8.5, Individual Returns Closed by Correspondence Audit in FY 2010 and FY 2018 by Activity Code.³⁶

	FY 2010	FY 2018
Form 1040PR/1040SS	382	157
Form 1040, EITC present & TPI <\$200,000 and Schedule C/F TGR <\$25,000 or EITC with No Schedule C/F	539,318	350,820
Form 1040, EITC present & TPI <\$200,000 and Schedule C/F TGR >\$24,999	12,495	7,728
Form 1040, No EITC present – TPI <\$200,000 and No Schedule C, E, F, or Form 2106	327,621	119,450
Form 1040, No EITC present – TPI <\$200,000 and Schedule E or Form 2106 but No Schedule C or F	128,243	97,133
Form 1040, No EITC present - Non-farm Business with Schedule C/F TGR <\$25,000 and TPI <\$200,000	84,937	74,485
Form 1040, No EITC present - Non-farm Business with Schedule C/F TGR \$25,000 - \$99,999 and TPI <\$200,000	31,442	17,736
Form 1040, No EITC present - Non-farm Business with Schedule C/F TGR \$100,000 - \$199,999 and TPI <\$200,000	11,999	10,076
Form 1040, No EITC present - Non-farm Business with Schedule C/F TGR >\$199,999 and TPI <\$200,000	1,885	3,333
Form 1040, No EITC present - Farm Business Not Classified Elsewhere and TPI <\$200,000	2,752	2,218
Form 1040, No EITC present - No Schedule C or F and TPI >\$199,999 and <\$1,000,000	53,931	16,783
Form 1040, No EITC present - Schedule C or F present and TPI >\$199,999 and <\$1,000,000	19,079	13,871
Form 1040, No EITC present - TPI >\$999,999	9,369	3,210

Correspondence examinations may be especially challenging for taxpayers with a language barrier, who may benefit from a face-to-face conversation. A 2014 TAS survey found that 70 percent of Hispanic consumers who are representative of the general Hispanic population age 18 and older were below 250 percent of the federal poverty level, making them more likely to claim refundable credits designed for low income taxpayers, which are generally audited by correspondence.³⁷ Furthermore, despite the high number of low income taxpayers who use paid preparers, low income taxpayers audited by correspondence may not be represented during the actual audit. A 2007 TAS study found the vast majority of EITC taxpayers audited were unrepresented.³⁸ Unrepresented taxpayers may not understand

35 In 2014, 80 percent of students leaving high school (including those who graduated and those who did not) from families with income in the top quartile enrolled in college, compared with only 45 percent from families in the bottom quartile. The Pell Institute, *Indicators of Higher Education Equity in the United States: 2016 Historical Trend Report* 20, http://www.pellinstitute.org/downloads/publications-Indicators_of_Higher_Education_Equity_in_the_US_2016_Historical_Trend_Report.pdf.

36 IRS response to TAS fact check (Dec. 20, 2018).

37 Forrester Research, Inc., *The Taxpayer Advocate Service: Hispanic Underserved Analysis*, Q4 2014, 10 (Dec. 2014). See National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 101-110 (Research Study: *Understanding the Hispanic Underserved Population*).

38 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2 94-116 (Study: *IRS Earned Income Credit Audits — A Challenge to Taxpayers*).

the correspondence or how to respond correctly without being able to ask questions face-to-face.³⁹ In the 2007 TAS study, TAS found that represented taxpayers were twice as likely to retain EITC after the audit, and they retained almost twice as much EITC, as unrepresented taxpayers.⁴⁰

Difficulty in Receiving Mail and Having Correspondence Timely Reviewed

Compounding other issues is the fact that taxpayers do not always receive correspondence from the IRS. During the last two fiscal years, approximately eight percent of statutory notices of deficiency (SNODs) in EITC correspondence exams and four percent of SNODs in non-EITC exams conducted by W&I were undeliverable.⁴¹ Undeliverable mail rates for the SNODs in SB/SE correspondence exams were higher than W&I correspondence exams during FYs 2017 and 2018, indicating that small businesses and self-employed taxpayers may have more problems with receiving SNODs.⁴²

Even when mail is received and responded to, it may not be worked in time. Although SB/SE and W&I report associating exam correspondence to the taxpayer's file within one or two days, examiners may not review the correspondence until much later.⁴³ As shown in Figures 1.8.6 and 1.8.7, W&I was delinquent in reviewing and responding to responses for the majority of correspondence audits.⁴⁴

FIGURE 1.8.6, W&I Response Time for FY 2018 EITC Audits⁴⁵

	Cases	Percentage
Responses 65 days old or greater	55,318	83%
Responses less than 65 days old	11,508	17%

FIGURE 1.8.7, W&I Response Time for FY 2018 Non-EITC Refundable Credit Audits⁴⁶

	Cases	Percentage
Responses 65 days old or greater	22,487	79%
Responses less than 65 days old	5,881	21%

39 See 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*.

40 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2 94-116 (Study: *IRS Earned Income Credit Audits — A Challenge to Taxpayers*).

41 TAS response to TAS information request (Oct. 25, 2018). See 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*.

42 IRS response to TAS fact check (Dec. 20, 2018).

43 IRS response to TAS information request (Oct. 25, 2018). IRS response to TAS information request (Oct. 24, 2018).

44 IRS responses are considered delinquent when the case is in status 55 or 57, which requires at least 65 days to have elapsed since receiving the taxpayer's reply. IRM 4.19.13.11, *Monitoring Overaged Replies* (Feb. 9, 2018); IRS, *W&I RICS Examination PAC 7F Reports* (Sept. 2018) (combining correspondence statuses 55 and 57). For a discussion of the IRS's inadequate handling of overaged audit responses from taxpayers, see Case Advocacy section, *infra*.

45 IRS, *W&I RICS Examination PAC 7F Reports* (Sept. 2018).

46 *Id.*

During 2018, taxpayers received an IRS “Interim Letter” informing them of delays of four, five, or, in many cases, six months just for the IRS to review the taxpayer’s correspondence.⁴⁷ Because the IRS only provides taxpayers with 30 days to provide documentation in a correspondence exam, these delays may appear patently unfair to the taxpayer, harming trust in the tax system and negatively affecting voluntary compliance.⁴⁸

Since many correspondence exams are conducted pre-refund, taxpayers may not receive their refunds until the filing season of the next year.⁴⁹ TAS elevated the concern to W&I management, who attributed the long wait times to attrition losses and a heavy volume of mail receipts. The IRS waits at least 105 days after issuing the SNOD to allow for a taxpayer response before proceeding to assess the tax by default.⁵⁰ However, the SNOD may go out before the IRS considers the taxpayer’s examination response (including substantiating documents) because the system has advanced the case to the next stage and will not permit the employee to stop it.⁵¹

Inability To Reach the Employee Who Evaluates the Taxpayer’s Response

Even where the IRS receives the taxpayer’s correspondence and reviews it, taxpayers in correspondence exams may not be able to speak to an employee familiar with the case because the IRS does not assign a single employee to each taxpayer’s case, as directed by the IRS Restructuring and Reform Act of 1998 (RRA 98).⁵² The IRS will assign the case to a tax examiner if it determines a reply “needs technical assistance or evaluation of records sent by the taxpayer.”⁵³

Furthermore, because IRS correspondence does not include the contact information of the employee who reviewed the taxpayer’s reply, the taxpayer cannot ask questions of the person who made the decision.⁵⁴ Once a tax examiner reviews a taxpayer’s documentation, makes an evaluation, and creates a letter to the taxpayer explaining why the documentation is not sufficient, such a letter should include the employee’s name and contact information. RRA 98 states: “...any manually generated correspondence received by a taxpayer from the Internal Revenue Service shall include in a prominent manner the name, telephone number, and unique identifying number of an Internal Revenue Service employee the taxpayer may contact with respect to the correspondence.”⁵⁵ By not including this information, the IRS may be violating the law and is impairing the taxpayer’s *right to challenge the IRS’s position and be heard*.

47 Letter 3500, *Interim Letter to Correspondence from Taxpayer*. See Systemic Advocacy Management System (SAMS) issues 39961, 39948, 39794, 39786, 39779, 36457, 36121, 35726, and 34740 documenting use of Letter 3500 and chronic delays in responding to taxpayer correspondence.

48 For a discussion of how perceived fairness affects voluntary compliance, see Erich Kirchler, Erik Hoelzl, and Ingrid Wahl, *Enforced versus Voluntary Tax Compliance: The “Slippery Slope” Framework*, 29 J. ECON. PSYCHOL. 218-219 (2008).

49 During 2018 through the end of October, the IRS sent out approximately 176,000 CP 75 *Exam Initial Contact Letter – EIC – Refund Frozen* to taxpayers, indicating that it was holding their refunds pending a correspondence examination. The average cycle time for a correspondence audit in W&I during the last two fiscal years was about 190 days and 229 for SB/SE. IRS response to TAS information request (Oct. 25, 2018); IRS response to TAS information request (Oct. 24, 2018).

50 IRM 4.19.10.1.5.2, *Standard Suspense Periods for Correspondence Examination* (Dec. 8, 2017).

51 See IRM 4.19.13.10.6, *Taxpayer Requests Additional Time to Respond*, 7-8 (Mar. 30, 2018).

52 Pub. L. No. 105-206 § 3705(b), 112 Stat. 685, 777 (1998). See National Taxpayer Advocate 2014 Annual Report to Congress 134-144 (Most Serious Problem: *Correspondence Examination: The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*).

53 IRM 4.19.13.10, *Taxpayer Replies* (Feb. 20, 2018).

54 See, e.g., Letter 525, *General 30 Day Letter* (Sept. 2014).

55 Pub. L. No. 105-206, § 3705(a) (1998).

The IRS may not know how many taxpayers are trying to reach the IRS about a correspondence exam because taxpayers cannot reach an employee at all. During FY 2018, the SB/SE exam phone line only had a 61 percent level of service, with only 35 percent of calls being answered by an exam employee, and about 17 percent routed to an automated message.⁵⁶ W&I reports receiving an average of only about 1.6 incoming calls per correspondence exam during the last two fiscal years, and SB/SE reports only about 0.8 incoming calls per correspondence exam.⁵⁷ A 2010 IRS analysis found that 62 percent of correspondence exam callers were repeat callers.⁵⁸

In many cases, there is no personal contact before closing a case. In FY 2018, about 42 percent of W&I and SB/SE correspondence audits were closed with no personal contact.⁵⁹ During FYs 2017 and 2018, W&I reported an average of 0.09 outgoing calls per correspondence exam—approximately one call for every 11 cases.⁶⁰ The IRM touts: “Because the ACE [Automated Correspondence Exam] system will automatically process the case through creation, statutory notice and closing, tax examiner (TE) involvement is eliminated entirely on no-reply cases. Once a taxpayer reply has been considered, the case can be reintroduced into ACE for automated Aging and Closing in most instances.”⁶¹ Because examinations are an opportunity for the taxpayer to show the IRS that it is wrong (or why the taxpayer believes the IRS is wrong), closing an exam with no personal contact means the IRS misses an opportunity to fix its filters or update its educational materials to clarify confusing issues. Further, TAS has found that outgoing contacts can increase the response rate for taxpayers, reduce the average cycle time of the exam, and increase the taxpayer agreed rate—which not only saves the IRS resources, but may mean the taxpayer better understood the exam and why the return was incorrect.⁶²

TAS has found that outgoing contacts can increase the response rate for taxpayers, reduce the average cycle time of the exam, and increase the taxpayer agreed rate—which not only saves the IRS resources, but may mean the taxpayer better understood the exam and why the return was incorrect.

56 IRS, Product Line Detail (Enterprise Performance) Snapshot report (week ending Sept. 30, 2018).

57 IRS response to TAS information request (Oct. 24, 2018); IRS response to TAS information request (Oct. 25, 2018).

58 Thirteen percent of correspondence exam callers called more than eight times. POP Team Recommendations, Solutions to Improve Taxpayer Satisfaction in Correspondence Examination Briefing Document (June 21, 2010).

59 IRS response to TAS fact check (Dec. 20, 2018).

60 *Id.*

61 IRM 4.19.20.2, *Automated Correspondence Exam Overview (ACE)* (Jan. 8, 2015).

62 The IRS selected 900 correspondence exam cases for a test group in which Exam telephoned the taxpayers ten days after the initial contact letter and again just prior to issuing the statutory notice of deficiency (cases were randomly selected from Project Codes 0261 and 0289 inventory via the DDb starting in cycle 2011-04 and continuing through cycle 2011-18). For those taxpayers successfully contacted, the response rate was 61 percent compared to 43 for the control group, the average cycle time was 21 days less than the control group, and the agreed rate was 30 percent compared to just 20 percent for the control group. TAS, *Earned Income Tax Credit (EITC) Enhanced Communication Test (CEECT)* White Paper (Nov. 2012).

The IRS's Correspondence Is Often Confusing and Does Not Provide Sufficient Time to Respond

A past TAS survey of taxpayers who were audited on the EITC found that more than 25 percent of them did not understand the IRS audit notice was telling them they were under audit, and about half didn't understand what they needed to do in response to the audit letter.⁶³ This lack of awareness is not limited to low income taxpayers claiming refundable credits. A study of self-employed taxpayers audited by correspondence between 2010 and 2015 found 39 percent of taxpayers did not recall they had been audited.⁶⁴

In a TAS study of enhanced communication during EITC correspondence audits, Exam forwarded almost 700 cases to TAS that were closed other than as “no change” or “agreed” and TAS was able to contact 37 percent of these taxpayers. In 44 percent of the cases, the taxpayers acknowledged they were ineligible for the EITC, but only two percent of these 44 percent said they understood they were ineligible prior to TAS's contact.⁶⁵ Taxpayers who understand what they did wrong may avoid making the same mistakes in the future. Further, this taxpayer education may promote voluntary compliance because multiple studies show that increasing knowledge of tax law results in a higher willingness of those taxpayers to comply.⁶⁶ However, when asked about procedures for educating audited taxpayers to avoid repeat mistakes, W&I stated: “The document request and publications included in the notices inform taxpayers of the tax law requirements and examples of documentation that can be provided to support the audit issues.”⁶⁷

The IRS correspondence and forms are clearly inadequate to inform and educate taxpayers. The CP 75, *Exam Initial Contact Letter – EIC – Refund Frozen*, one of the most common initial contact letters in correspondence exams, demonstrates why taxpayers may not understand what documentation is requested.⁶⁸ The CP 75 states at the top that the IRS is auditing the taxpayer's return, which may help alleviate confusion over whether the taxpayer is being audited. However, the CP 75 refers the taxpayer to Form 886-H-EIC to understand which documents a taxpayer must send in to prove EITC eligibility. As shown in Figure 1.8.8, this form is particularly confusing because it asks taxpayers to submit information to prove different residency requirements without clearly telling the taxpayer which documents may be submitted and which may fulfill some of or all of the different requirements.

63 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 103 (Study: *IRS Earned Income Credit Audits — A Challenge to Taxpayers*).

64 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, 163 (Matthias Kasper, Sebastian Beer, Erich Kirchler & Brian Erard, Research Study: *Audits, Identity Theft Investigations, and Taxpayer Attitudes: Evidence from a National Survey*).

65 TAS, *Earned Income Tax Credit (EITC) Enhanced Communication Test (CEEET) White Paper* (Nov. 2012).

66 *Id.*

67 IRS response to TAS information request (June 22, 2018).

68 In FY 2018 the volume of CP75 notices were: CP75, 181,342; CP75A, 48,573; CP75C, 107; and CP75D, 17,949. IRS, CDW, *Notice Delivery System (NDS) FY 2018* (Dec. 2018).

FIGURE 1.8.8, Excerpt of Question 1 from Form 886-H-EIC

Form 886-H-EIC (October 2018)			Department of the Treasury—Internal Revenue Service Documents You Need to Send to Claim the Earned Income Credit on the Basis of a Qualifying Child or Children for Tax Year 2018		
Taxpayer name		Taxpayer Identification Number		Tax year	
<p>To get Earned Income Credit (EIC), the child must have lived with you, be related to you and be a certain age. Para recibir el Crédito por Ingreso del Trabajo (EIC, por sus siglas en inglés), el niño tiene que haber convivido con usted, ser su pariente, y tener una edad específica. Visite IRS.gov/eitc para buscar la versión en español del Formulario 886-H-EIC (SP) (May. 18-2018) o llame al 1-800-829-3675. Visit IRS.gov/eitc to find out more about who qualifies for EIC.</p>					
<p>1. Each child that you claim must have lived with you for more than half of 2018* in the United States. The United States includes the 50 states and the District of Columbia. It doesn't include Puerto Rico or U.S. possessions such as Guam.</p> <p><small>*Certain times that you, or the child, is temporarily away from home due to special circumstances as long as the child lived with you. Examples include illness, college, business, vacation, military service or detention in a juvenile facility.</small></p>					
<p>To prove the child lived with you in the United States, the document(s) must have:</p> <ul style="list-style-type: none"> your U.S. address, your name, and the child's name. If you use a P.O. Box as your mailing address, you must send it registered mail, first-class, or by Air Application stamped by the Post Office. the dates in 2018 the child lived at the same address as you must cover more than half of 2018. if the document has the child's name and your address but not your name, you need to send in another document with your name showing the same address. 		<p>If you can send one or more of the following documents to prove the child lived with you for more than half of 2018:</p> <ul style="list-style-type: none"> school records (you may need to send one or more school records) medical records from doctors, hospital or medical clinic (communication records may not include all the necessary information) adoption or child placement documents court records 		<p>Or, send dated statements on letterhead from:</p> <ul style="list-style-type: none"> the child's school the child's childcare provider (not a relative) the child's health care provider, doctor, nurse or clinic a social service agency a placement agency official your employer an Indian tribal official your landlord or property manager a piece of mailing others. 	

A taxpayer reading this form may wonder: What kind of document is sufficient to prove residency in the United States? Can only the documents in the second column related to proving the child lived with the taxpayer be used to show residency in the United States? Are the documents in the third column alternatives for both the first and the second column? What information must be included on a dated statement? Would a school record issued at the end of the year demonstrate residency for more than half the year, or would two be required? These questions could go on and on but, unfortunately, a taxpayer has only 30 days to seek clarification from the IRS and provide the records. Although taxpayers can request an extension of time to provide information, it appears either not many EITC taxpayers take advantage of this or not many of these requests are granted. During the last two fiscal years, W&I granted approximately 2,100 of these requests for additional time to respond, compared to SB/SE, which granted approximately 27,000.⁶⁹

Furthermore, without an IRS employee being able to view the record a taxpayer is proposing to submit, the examiner may not know that such a record would be inadequate until after the taxpayer already mails it in.⁷⁰ Then, assuming the documentation is not accepted, instead of a conversation about how to remedy the problem, the taxpayer would receive a “30-day letter,” indicating how the IRS proposes to adjust the return and providing the taxpayer a 30-day window to provide further documentation before the IRS issues the SNOD.⁷¹ In some cases, the taxpayer may receive the 30-day letter at the initiation of the audit, where the IRS combines the initial contact letter and the preliminary report into

69 Approximately 72 percent of W&I correspondence exams are EITC exams. Starting in 2016, SB/SE started no new EITC correspondence audits. IRS response to TAS information request (Oct. 24, 2018); IRS response to TAS information request (Oct. 25, 2018). Neither operating division could provide the number of denied requests for additional time to provide documentation.

70 Virtual service delivery and other videoconferencing technology could mitigate this problem by allowing a taxpayer to show records to an IRS employee in real time. See National Taxpayer Advocate 2014 Annual Report to Congress 154-162 (Most Serious Problem: *Virtual Service Delivery: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services*).

71 IRC § 6213(a). Once a taxpayer receives the Statutory Notice of Deficiency (SNOD), the taxpayer may still provide documentation to the IRS, but the 90-day period for petitioning the U.S. Tax Court to challenge the liability before paying has begun.

a “combo-letter.” This letter confuses the taxpayer and sends a message that the IRS has already made a preliminary decision about the taxpayer’s case without even reviewing the taxpayer’s documentation.

The IRS Metrics Do Not Consider Taxpayer Needs and Preferences When Determining the Effectiveness of Its Correspondence Exam Program, and the IRS Prioritizes Measures Such as Cycle Time and Closures, Which Ignore the Impact on the Taxpayer

SB/SE points to the following metrics for measuring its examination program:

1. Full time employees
2. Closures and new starts by types of return
3. Inventory
4. Cycle time
5. Employee engagement index
6. Customer satisfaction
7. Reconsiderations
8. Quality score⁷²

W&I provided an even shorter list in response to TAS, highlighting only three metrics included in its FY 2017 final Business Performance Review:

1. Cycle time
2. No change rate
3. Accuracy rate⁷³

Although customer satisfaction may affect voluntary compliance, this measure fails to capture taxpayers who did not participate in the audit by not responding.⁷⁴ The IRS should measure response rates to determine how many taxpayers participated and use this information to tailor its correspondence or contacts for certain issues that resulted in low participation rates. Further, the metrics overall are inadequate to determine the effectiveness of the correspondence examination program in terms of choosing the best cases to audit, educating the taxpayer, and increasing voluntary compliance. In addition to customer satisfaction surveys, the IRS could use surveys to gauge how well taxpayers understand the audit. As discussed above, a 2007 TAS study found that more than 25 percent of EITC taxpayers audited were not even aware they were being audited.⁷⁵ A metric that captured an agreement rate would be more meaningful in determining effectiveness of compliance education than the summary “change” rate by which IRS computes its return on investment because it would suggest the taxpayer understands the error and will avoid making it again.

The IRS could also capture data regarding whether taxpayers understand the information they need to provide by surveying or conducting focus groups with taxpayers and looking at what types of documentation taxpayers frequently sent that were deemed insufficient. This could help the IRS better

72 IRS response to TAS information request (Apr. 27, 2018).

73 IRS response to TAS information request (June 22, 2018).

74 SB/SE Campus Exam Mail Customer Satisfaction Report, SB/SE Research TM20349 (Aug. 2018).

75 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2 103 (Study: *IRS Earned Income Credit Audits — A Challenge to Taxpayers*).

inform taxpayers about exactly what documentation is acceptable and may even provide an impetus for the IRS accepting additional forms of documentation as a result of what the surveys show.

Although SB/SE reports audit reconsideration numbers,⁷⁶ it does not do so in a meaningful way because it compares only the sheer number of audit reconsiderations for field audits and correspondence audits without looking at the percentage. Further, the IRS should measure how many correspondence audits result in in appeals conferences and the result of those conferences. Additionally, the IRS should track the number of appeals to the U.S. Tax Court, including what percentage resulted in a lower liability or a full concession by the IRS, to understand where greater communication or better employee training is needed.⁷⁷

Finally, neither W&I nor SB/SE measure how taxpayers perceive the IRS and how they feel about paying taxes after a correspondence audit.⁷⁸ A recent TAS study found that taxpayers audited by correspondence report a lower sense of fairness in the examination and are more likely to hold negative views towards the IRS than individuals audited in-person.⁷⁹

Analyzing how correspondence audits affect taxpayer attitudes towards the IRS, including filing and paying taxes, would go beyond just looking at whether a taxpayer was satisfied with the customer service received during the audit. The IRS could gather data to analyze filing and payment compliance in the years following an audit to determine the effect on future behavior.

CONCLUSION

The IRS's correspondence examination program burdens taxpayers and misses opportunities to educate the taxpayer. The IRS is ignoring important measures such as the resulting impact on voluntary compliance and taxpayer attitudes. Focusing on metrics like closures and cycle time has allowed the IRS to ignore the taxpayer perspective. Failing to assign an employee to a taxpayer's case, not allowing the taxpayer to speak with the examiner making decisions about the taxpayer's case, closing cases with little or no personal contact, and asking taxpayers to wait six months or more for the IRS to consider documentation directly undermine the taxpayer's *right to challenge the IRS's position and be heard*, and impair *the rights to be informed, to quality service, to pay no more than the correct amount of tax, and to a fair and just tax system*.

76 IRS response to TAS information request (Oct. 24, 2018).

77 A 2012 TAS study found taxpayers in EITC cases that were fully conceded by the IRS called the IRS on average five times after petitioning the U.S. Tax Court; yet, only one fifth of the cases were conceded due to the hazards of litigation. National Taxpayer Advocate 2012 Annual Report to Congress vol. 2 87.

78 SB/SE Campus Exam Mail Customer Satisfaction Report, SB/SE Research TM20349 (Aug. 2018). The taxpayer may add open-ended comments to the customer satisfaction survey, but the survey does not measure the taxpayer's perception of fairness.

79 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*.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Require at least one personal contact between an IRS employee and the taxpayer (this can be satisfied by an outgoing or incoming phone call) before closing a correspondence examination.
2. Measure taxpayers' filing compliance (including filing a return, making an error on a return, and underreporting taxes on a return) following correspondence examinations and apply this data to guide audit selection based on the resulting impact on compliance.
3. Continue to assign a single employee for a correspondence examination when the IRS receives a response from the taxpayer either by phone or correspondence, and expand on this right by retaining this employee as the single point of contact throughout the remainder of the exam.
4. Per RRA 98 § 3705(a), 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.
5. Conduct surveys of taxpayers following correspondence examinations to gauge their understanding of the examination process and their resulting attitudes towards the IRS and towards filing and paying taxes.
6. Collect data regarding which forms of documentation taxpayers sent in a correspondence examination that were deemed insufficient and revise existing correspondence examination letters to better explain documentation requirements.
7. 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****RESPONSIBLE OFFICIALS**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

Douglas O'Donnell, Commissioner, Large Business and International Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

Internal Revenue Code (IRC) § 7602(a) provides the IRS with the authority to conduct examinations to determine whether a tax return is correct, to create a return where the taxpayer has not filed, and to determine a taxpayer's tax liability. In fiscal year (FY) 2017, the IRS conducted only 29 percent of all audits and 23 percent of individual income tax return audits in the field or in an office, with the remaining conducted by correspondence.² Both IRS operating divisions conducting field audits, Small Business/Self-Employed (SB/SE) and Large Business and International (LB&I), have conducted fewer field exams in recent years, with approximately 272,000 field exams in FY 2010 and only about 156,000 field exams in FY 2018.³

The primary objective in identifying tax returns for examination is to promote the highest degree of voluntary compliance.⁴ However, the IRS may not be driving voluntary compliance and further, may have no way of knowing whether it is doing so as a result of its field exams. Between FY 2010 and FY 2018, an average of about 23 percent of SB/SE field audits and about 32 percent of LB&I field audits

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 IRS Data Book, 2017, Publication 55B, 22-23 (Mar. 2018).

3 IRS, Compliance Data Warehouse (CDW), Automated Information Management System (AIMS) fiscal year (FY) 2010 and 2018 (Dec. 2018). Due to the lapse in appropriations, the Large Business and International Division (LB&I) did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

4 Internal Revenue Manual (IRM) 1.2.13.1.10, *Policy Statement 4-21* (June 1, 1974).

resulted in no change.⁵ Research shows that no change audits result in greater future noncompliance.⁶ When measuring results, the IRS appears to look primarily at the bottom line from specific audits per resources expended—measuring closures, cycle time, employee satisfaction, and quality scores—and not the indirect effects. Moreover, neither SB/SE nor LB&I have a measure to track whether future filing or payment compliance increases after an audit. Although both divisions track the number of requests for audit reconsideration, they do not track how many of these audit reconsiderations are eventually appealed by the taxpayer.⁷

From a taxpayer's perspective, field audits provide an opportunity to interact with IRS employees face-to-face and work directly with a single employee or team. However, some taxpayers may not have access to all IRS employees making decisions about their issues, such as technical specialists. Others experience difficulty in understanding the scope of the audit due to a lack of transparency or overly broad document requests. The IRS has no formal centralized system to track taxpayer complaints and requests to speak to a manager in field exams. As a result, the IRS reduces the opportunities for two-way communication to learn why a particular issue should not be examined and what taxpayers are doing wrong, intentionally or unintentionally.

The National Taxpayer Advocate is concerned that:

- The IRS may be wasting resources and failing to drive future voluntary compliance due to the high no change rates for its field audits;
- The primary purpose of audits is to improve voluntary compliance, yet the IRS does not measure how field audits affect taxpayers' future filing behavior and attitudes towards tax administration;
- With declining numbers of field audits, the IRS must ensure that it selects the best cases to drive future compliance;
- A lack of transparency during field exams, including SB/SE's declining to share an individual exam plan with the taxpayer, infringes on the taxpayer's *right to be informed*; and
- The IRS does not provide a clear path for taxpayers to elevate issues nor does it track taxpayer complaints about field exams.

These shortcomings in the field examination process impair taxpayers' rights *to be informed, to quality service, to pay no more than the correct amount of tax, to challenge the IRS's position and be heard, and to a fair and just tax system.*

5 IRS, CDW, AIMS FY 2010 to FY 2018 (Dec. 2018). IRM 4.4.12.5.49.1, *No Change Disposal Codes* (June 1, 2002) defines a no change as a case closed by the examiner with no additional tax due (disposal code 1 and 2). In the Small Business/Self-Employed Division (SB/SE) response to TAS fact check (Dec. 20, 2018), SB/SE notes disposal code 1 as an agreed closure. TAS does not agree with the SB/SE definition because these cases do not require agreement from the taxpayer since there is no additional tax liability (see, e.g., IRM 4.10.8.2.2, *No Change with Adjustments Report Not Impacting Other Tax Year(s)* (Sept. 12, 2014)) and the taxpayer's agreement, or disagreement, with the adjustment(s) as it pertains to another's year's liability is not known. Treasury Inspector General for Tax Administration (TIGTA) Report 2018-30-069 concurs with TAS's definition. 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.

6 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2 67-100 (Sebastian Beer, Matthias Kasper, Erich Kirchlner, Brian Erard, *Audit Impact Study*).

7 IRS responses to TAS information request (Nov. 1, 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.

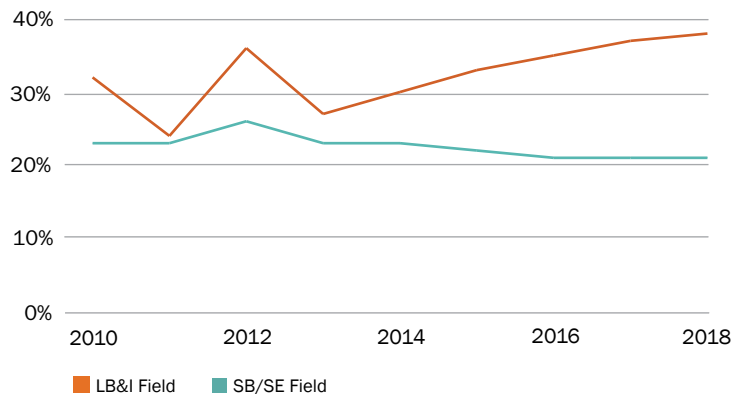
ANALYSIS OF PROBLEM

The IRS May Be Wasting Resources and Failing to Drive Voluntary Compliance Due to the High No Change Rates For Its Field Audits

There are direct and indirect effects from audits that propose no additional tax to be assessed (“no change” audits). First, a no change audit means the IRS has expended time and resources without assessing any additional dollars that can be collected from the taxpayer. Second, the IRS may have prompted the taxpayer to choose to report less tax in the future. A 2015 study conducted for TAS found that self-employed taxpayers filing Schedule C who received a no change audit reduced their reported income by 37 percent three years after the audit.⁸ This is in contrast to taxpayers with audits recommending an additional tax assessment, who instead increased the amount of tax they reported after the audit by an average of 250 percent.⁹ A recent study also found that taxpayers with audits recommending additional tax report a higher perceived risk of future audits, which may explain why they increased the amount of tax they reported in subsequent years.¹⁰ Despite the direct and indirect effects of audits, the IRS maintains a high no change rate for its field exams, as shown in Figure 1.9.1.

FIGURE 1.9.1¹¹

No Change Rate for Field Exams Closed During FY 2010-2018



⁸ National Taxpayer Advocate 2015 Annual Report to Congress vol. 2 88 (Research Study: *Audit Impact Study*).

⁹ *Id.*

¹⁰ 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*.

¹¹ IRS, CDW, AIMS FY 2010 to FY 2018 (Dec. 2018). IRM 4.4.12.5.49.1, *No Change Disposal Codes* (June 1, 2002) defines a no change as a case closed by the examiner with no additional tax due (disposal code 1 and 2). In the SB/SE response to TAS fact check (Dec. 20, 2018), SB/SE notes disposal code 1 as an agreed closure. TAS does not agree with the SB/SE definition because these cases do not require agreement from the taxpayer since there is no additional tax liability (see, e.g., IRM 4.10.8.2.2, *No Change with Adjustments Report Not Impacting Other Tax Year(s)* (Sept. 12, 2014)) and the taxpayer’s agreement, or disagreement, with the adjustment(s) as it pertains to another liability is not known. TIGTA Report 2018-30-069 concurs with TAS’s definition. 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.

The no change rate for SB/SE field exams has remained steady over recent years at close to a quarter of exams, meaning almost a quarter of the SB/SE field audits may actually be encouraging taxpayers to become less compliant.¹² LB&I, on the other hand, had higher no change rates in its field audits, about 32 percent on average from FY 2010 to FY 2018, demonstrating that LB&I may not be achieving its stated goal of targeting noncompliance.¹³ For corporate taxpayers, over 100 of whom are under continuous audit, this no change rate is particularly concerning.¹⁴

The Primary Purpose of Audits Is to Improve Voluntary Compliance, yet the IRS Does Not Measure How Field Audits Affect Taxpayers' Future Filing Behavior and Attitudes Towards Tax Administration

Although audits do have a direct effect in terms of recommending additional tax dollars to be assessed, the overarching goal should be improving voluntary compliance. 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 when one compares additional reported taxable income in years following the audit with the additional dollars assessed as a direct result of the audit.¹⁵ IRS Policy Statement 4-21 identifies promoting voluntary compliance as the primary driver of selecting returns for audits.¹⁶ One scholar explains what it means for the U.S. tax system to be based on voluntary compliance:

It means that the tax authority does not have adequate resources, and never did, to assess taxes against each taxpayer directly or audit every return. Since the IRS cannot execute either of these practices, it instead relies on individual taxpayers to accurately assess their own tax liability on annual returns and timely pay the correct amount due.¹⁷

Key to increasing voluntary compliance is building trust in taxpayers. To encourage this trust the IRS must focus on perceived fairness, which includes distributive justice, procedural justice, and retributive justice.¹⁸ In terms of procedural justice, “taxpayers consider the treatment by the tax authorities, information provided, costs regarding compliance and administration, and the dynamics of allocation of revenues.”¹⁹ Transparency also plays a role as “increased information related to tax law and explanations

12 When excluding SB/SE field exams conducted as part of the National Research Program (NRP), the no change rate is similar—an average of approximately 22 percent for SB/SE non-NRP exams for FY 2010-2018. IRS, CDW, AIMS FY 2010 through FY 2018 (Dec. 2018). “NRP audits are selected through stratified random sampling and therefore the no change rate would be expected to be higher than returns that are being selected for examination due to indications of a high risk of noncompliance.” IRS response to TAS fact check (Dec. 21, 2018).

13 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.

14 IRS, CDW, AIMS FY 2010 through FY 2017 (Dec. 2018). LB&I is transitioning its former continuous audit program for large corporations, the Coordinated Industry Case program, to the new Large Corporate Compliance program, which aims to develop better risk profiles for large corporations. Nonetheless, the group of high risk taxpayers under continuous audit is currently over 100 taxpayers, down only slightly from 2016. LB&I Business Performance Review, FY 2018 4th Quarter (Nov. 16, 2018).

15 Jason DeBacker, Bradley T. Heim, Anh Tran, and Alexander Yuskavage, *Once Bitten, Twice Shy? The Lasting Impact of IRS Audits on Individual Tax Reporting* (Aug. 25, 2015) (working paper, Indiana University), <https://pdfs.semanticscholar.org/3833/61d62ea27f93deb89bf2c4b926bc5e96e14b.pdf>.

16 IRM 1.2.13.1.10, *Policy Statement 4-21* (June 1, 1974).

17 J.T. Manhire, *What Does Voluntary Tax Compliance Mean?: A Government Perspective*, 164 U. Pa. L. Rev. Online 11 (2015), <http://www.pennlawreview.com/online/164-U-Pa-L-Rev-Online-11.pdf>.

18 Erich Kirchler, Erik Hoelzl, and Ingrid Wahl, *Enforced versus Voluntary Tax Compliance: The “Slippery Slope” Framework*, 29 J. Econ. Psychol. 218-219 (2008).

19 Distributive justice concerns the exchange of resources, both benefits and cost, and retributive justice applies when the sanctions for breaking rules are perceived as appropriate. *Id.*

for changes can increase fairness perceptions.”²⁰ Also important are a culture of interaction, perceived neutrality regarding the treatment of different groups, and equal and respectful treatment of taxpayers.²¹ Finally, metrics used to evaluate examinations should look at three types of indirect effects: (1) induced effects, which are behavior changes due to a change in the enforcement level or audit rate; (2) subsequent period effects, which are changes in an individual taxpayer’s behavior post-audit; and (3) group effects, which are changes in compliance by members of the taxpayer’s social network.²²

In measuring the effectiveness of the field audit program, the IRS appears to look primarily at the bottom line from specific audits per resources expended, without measuring the indirect effects, including social network effects. SB/SE’s Business Performance Review (BPR) reflects that the IRS measures closures, cycle time, employee satisfaction, and quality scores.²³ LB&I’s BPR includes similar performance measures.²⁴ In 2014, the National Taxpayer Advocate recommended that the IRS “[a]dopt ‘increasing voluntary compliance’ as the primary measure for evaluating both enforcement and taxpayer service initiatives.”²⁵ However, neither SB/SE nor LB&I have added a measure to track whether future filing or payment compliance increases after an audit.²⁶ Further, neither operating division has a system in place to track if audited taxpayers are compliant in future years.

The current measures may not be useful if the IRS does not choose the correct cases for an audit. Cycle time may be quick if the IRS is auditing taxpayers who are relatively compliant. Closing cases may not be a positive outcome if the taxpayer does not feel the issues are resolved. Although both SB/SE and LB&I track audit reconsiderations, neither tracks how many of these reconsiderations go to the IRS Office of Appeals, meaning the IRS does not know when it gets the answer wrong or when there are hazards of litigation, both of which should inform audit selection.²⁷

In addition to subsequent compliance, the IRS should also track taxpayers’ attitudes towards the IRS, tax administration, and paying their taxes after an audit. A study commissioned by TAS found that in terms of taxpayers’ attitudes towards the IRS and paying taxes, no change audits resulted in the most positive taxpayer attitudes, greater than taxpayers receiving a refund.²⁸ Taxpayers with additional taxes proposed had the most negative attitudes after an audit.²⁹ Likewise, taxpayers with additional taxes proposed reported a weaker sense of procedural and distributive justice, lower levels of trust in the IRS, a greater sense of coercion, and more feelings of anger.³⁰ Although reducing the number of taxpayers with additional tax proposed is not desirable, the IRS could still use metrics such as these to drive changes to

20 Erich Kirchler, Erik Hoelzl, and Ingrid Wahl, *Enforced versus Voluntary Tax Compliance: The “Slippery Slope” Framework*, 29 J. ECON. PSYCHOL. 219 (2008).

21 *Id.*

22 Kim Bloomquist, *Incorporating Indirect Effects in Audit Case Selection: An Agent-Based Approach*, IRS Research Bulletin 103 (2012), <https://www.irs.gov/pub/irs-soi/12resconincorporating.pdf>.

23 SB/SE FY 2018 1st Quarter Business Performance Review (BPR). BPRs review the operating divisions’ progress on meeting their performance goals and report on new or emerging issues that may affect programs and performance. IRM 1.5.1.15, *Proposing, Reviewing, and Updating Performance Budget Measures* (Sept. 24, 2014).

24 IRS response to TAS information request (May 4, 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.

25 National Taxpayer Advocate 2014 Annual Report to Congress 122.

26 IRS response to TAS information request (Nov. 1, 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.

27 *Id.*

28 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*.

29 *Id.*

30 *Id.*

the way the IRS conducts audits. For example, the IRS could test whether a greater focus on educating the taxpayer during the audit might reduce feelings of coercion because a taxpayer would understand the mistake made. Greater transparency at the beginning of the exam (discussed below) could reduce feelings of mistrust.

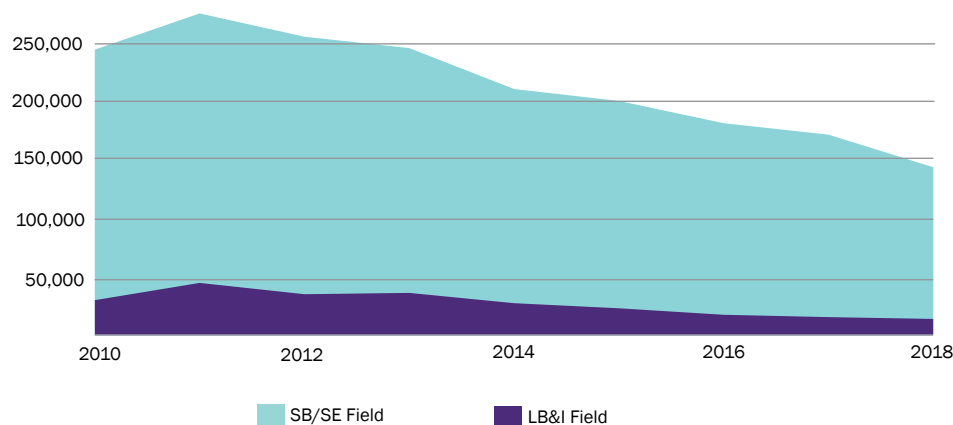
The field exam customer satisfaction surveys do not capture this information because they are more focused on how the taxpayer feels about a specific encounter and not how the taxpayer might alter their behavior in the future. LB&I reports that it has been collaborating with Research, Applied Analytics and Statistics (RAAS) to conduct behavioral research related to the LB&I campaigns to determine their impact on taxpayer behavior.³¹ The National Taxpayer Advocate encourages the IRS to continue with this research and conduct behavioral research regarding all audit treatments to better understand how they may affect voluntary compliance.

With Declining Numbers of Field Exams and Revenue Agents, the IRS Must Ensure That It Selects the Best Cases to Drive Future Compliance

As shown in Figure 1.9.2, both SB/SE and LB&I field audits have been declining in recent years, reflecting that both operating divisions may need to be more discriminating as managers must choose to survey more cases and audit less.

FIGURE 1.9.2³²

Volume of Field Audit Closures by Operating Division FY 2010-2018



Both LB&I and SB/SE focus largely on the current compliance risk—choosing returns based primarily on anticipated noncompliance found on that specific return. SB/SE selects over 22 percent of audits

31 IRS response to TAS information request (May 4, 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.

32 IRS, CDW, AIMS FY 2010 to FY 2018 (Nov. 2018) for LB&I. IRS response to TAS fact check (Dec. 20, 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.

based on the computer program Discriminant Function (DIF),³³ and over half of its 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.³⁴ As a result, there is only a limited number of audits to be selected from other criteria such as information matching and compliance projects. Although the Treasury Inspector General for Tax Administration (TIGTA) recently criticized SB/SE for not auditing enough related-year returns,³⁵ this criticism considered only the bottom line in terms of direct revenue from the examination. When one considers the indirect effects of an examination, including how the audited taxpayer and the taxpayer's peers in the community or industry might change their behavior, it is clear that audit selection must go beyond just the dollars assessed on a return.

LB&I uses the computerized scoring system, known as the Discriminant Analysis System (DAS), to score returns for corporations with assets over \$10 million to be delivered to the field.³⁶ Recent Government Accountability Office (GAO) audits of both SB/SE and LB&I show weaknesses for both operating divisions in how they document and justify managers' final decisions about whether to audit or survey a case that is included in the queue of potential cases.³⁷ Thus, even if computer systems such as the DIF or the DAS are effective in weeding out and not selecting taxpayers who are likely compliant, the IRS may not be making the best decisions in the end regarding which taxpayers in the queue to audit.

To be more nimble in identifying emerging trends and creating an enforcement presence, LB&I initiated the "campaign" program, in which it will conduct issue-based examinations and apply one or multiple treatment streams based on compliance risk.³⁸ There are currently 45 campaigns, and examples include: Foreign Earned Income Exclusion, Swiss Bank Program, IRC 48C Energy Credit, and Deferral of Cancellation of Indebtedness Income.³⁹ Although the long-term plan is for the campaigns to constitute a significant part of the LB&I compliance program, currently they only comprise a small minority—only about six percent—of LB&I's audit work.⁴⁰ LB&I is reportedly working to create metrics for the campaigns, but it is unclear how the IRS currently determines a campaign is not working and should

33 "The Discriminant Function (DIF) is a risk-based method of scoring tax returns for examination potential. The models are based on the mathematical technique called discriminant analysis and are developed using data from the National Research Program or the prior Taxpayer Compliance Measurement Program (TCMP) data." IRS response to TAS fact check (Dec. 21, 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.

34 These prior or subsequent year returns were mostly related to methods for trying to shelter income and DIF-identified returns. Government Accountability Office (GAO), *IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened*, GAO 16-103 (Dec. 2015).

35 TIGTA, *Improvements Are Needed to Ensure Adequate Consideration of the Pickup of Prior and/or Subsequent Returns During Field Examinations*, 2018-30-073 (Sept. 17, 2018).

36 IRS response to TAS information request (May 4, 2018). IRS, *2016 Internal Revenue Service Advisory Council (IRSAC) Large Business and International Report* (Sept. 30, 2017), <https://www.irs.gov/tax-professionals/2016-irsac-lbi-report>. 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.

37 GAO, *IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened*, GAO 16-103 (Dec. 2015); GAO, *IRS Return Selection: Improved Planning, Internal Controls, and Data Would Enhance Large Business Division Efforts to Implement New Compliance Approach*, GAO 17-324 (Mar. 2017).

38 IRS, *IRS Announces Initial Rollout of Campaigns* (June 28, 2018), <https://www.irs.gov/businesses/large-business-and-international-launches-compliance-campaigns>.

39 IRS response to TAS information request (Nov. 1, 2018). IRS, *Full List of LB Large Business and International Campaigns* (Oct. 30, 2018), <https://www.irs.gov/businesses/full-list-of-lb-large-business-and-international-campaigns>. 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.

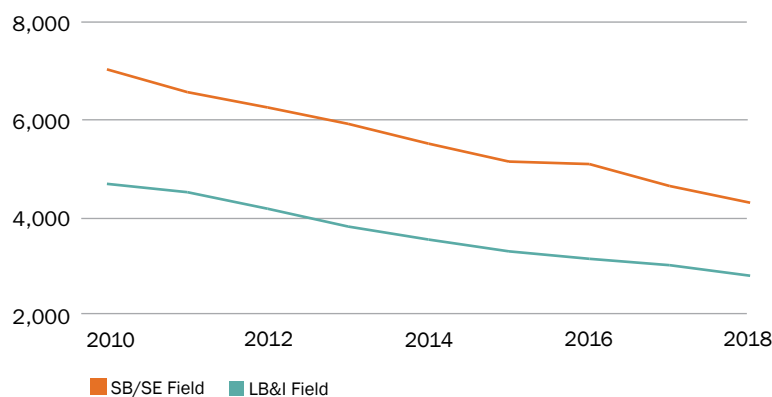
40 LB&I FY 2018 3rd Quarter BPR. Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

be abandoned, or perhaps should be broadened and expanded. The IRS recently ended some of its campaigns, but has not developed a strategy to communicate the terminations publicly.⁴¹ Without a system in place to provide updates on the exams conducted as part of the campaigns in real time—for example, when an issue is closed or an exam is agreed to—the IRS will not be able to adjust its exam strategy at the earliest point in time.

Not surprisingly, a reduction in Revenue Agents corresponds with the reduction in field exams over recent years. Both IRS operating divisions conducting field exams in FY 2018 employed only about 60 percent of the Revenue Agents they had in FY 2010.

FIGURE 1.9.3⁴²

Nonsupervisory Revenue Agents Last Pay Period of FY 2010 to FY 2018



This reduction makes it more critical for the IRS to ensure it has exam employees in the right locations. LB&I states that organizational components generally have discretion to decide at which locations to hire based on workload.⁴³ However, looking at past or current workload may not allow the IRS to have staffing in place in the right locations as it identifies emerging trends. Similarly, SB/SE may be taking a myopic view in selecting locations to hire examiners. For non-specialty examiners, SB/SE uses workload studies to distribute workload based on the geographic locations with the highest DIF scores.⁴⁴ However, only about a fifth of SB/SE field audits are based on DIF scores.⁴⁵ SB/SE was planning a new partnership audit selection process known as Flow-through Initiatives, partnering Field Case Selection with RAAS to improve workload selection for flow-through returns with emphasis on using data to

41 Amanda Athanasiou, *IRS Weighing Termination of LB&I Campaigns*, TAX NOTES TODAY (Nov. 8, 2018).

42 IRS Human Resources Reporting Center, *Workforce Information by Organization Report* for the ending pay period FY 2010 to FY 2018 for non-supervisory Revenue Agent jobs series 512. SB/SE counts do not include SB/SE campuses. 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.

43 IRS response to TAS information request (Nov. 1, 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.

44 IRS response to TAS information request (Nov. 1, 2018).

45 GAO, *IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened*, GAO 16-103 (Dec. 2015).

Both IRS operating divisions conducting field exams in Fiscal Year (FY) 2018 employed only about 60 percent of the Revenue Agents they had in FY 2010.

create business rules, statistical models, and select returns using an enterprise case approach. However, the IRS abruptly ended this initiative due to “resources.”⁴⁶

A Lack of Transparency During Field Exams, Including SB/SE’s Declining to Share an Individual Exam Plan With the Taxpayer, Infringes on the Taxpayer’s Right to Be Informed

The IRS misses opportunities by not learning from taxpayers during exams what the taxpayers are doing wrong, either intentionally or unintentionally. Although the focus of examinations can change as the audit unfolds, providing greater transparency at the beginning of an exam would allow the taxpayer to raise concerns that might show why an issue should not be examined or where taxpayers could use additional guidance. This transparency might also allow taxpayers to change their filing behavior for later years or correct errors via amended returns. Instead, taxpayers may not understand the focus of the examination until midway through.

When LB&I initiates an audit, it shares with the taxpayer an examination plan for that particular audit that includes the issues to be examined, timeframes, personnel required, processes to be followed, and respective responsibilities.⁴⁷ Both members of the exam team and the taxpayer sign the plan, committing to achieving the timeline set out.⁴⁸ When asked why SB/SE does not share a similar audit plan with the taxpayer, it stated: “SB/SE audits are more focused, with smaller scope, less complex and faster cycle time which does not warrant a full in-depth audit plan like LB&I’s process,” and “[g]enerally SB/SE examiners share/discuss the issues that will be audited and provide the taxpayers with an Information Document Request (IDR) prior to the initial appointment.”⁴⁹ However, the IDR may not provide the same level of detail as the LB&I exam plan nor is it a substitute for it.⁵⁰

Before the LB&I exam plan is final, it must be shared and discussed with the taxpayer in an interactive way that “contributes to their understanding of the examination plan and also affords them the opportunity to propose changes before the plan is final.”⁵¹ SB/SE’s IDR does not perform the same function as an exam plan. The IDR is a “request” for documents that, if the IRS determines is not responded to fully, can be the precursor to a summons—that is, an adversarial act in which there is no room for discussion. Moreover, the IRM allows SB/SE to use *pro-forma* type IDRs with a list of commonly requested items in exams; however, it warns examiners not to use a “shot-gun” approach by requesting everything on the list.⁵² However, practitioners at a 2016 Congressional hearing on small

46 IRS response to TAS information request (Nov. 1, 2018).

47 IRS, Publication 4837, *Achieving Quality Examinations through Effective Planning, Execution and Resolution* (Oct. 2010).

48 *Id.*

49 IRS responses to TAS information requests (May 4, 2018, Nov. 1, 2018).

50 IRM 4.46.3.8, *Examination Plan* (Mar. 14, 2016). Among other items, the LB&I Exam Plan must include: detailed steps for each issue; case and issue timeline(s) with milestone dates; issue team members, including each team member’s estimated days; established dates and decision points that are used to periodically risk-assess issues being examined; and agreements made during the opening meeting. IRM 4.46.3.8.1, *Elements of an Examination Plan* (Mar. 14, 2016).

51 IRM 4.46.3.8.2, *Taxpayer Review of the Examination Plan* (Mar. 14, 2016).

52 IRM 4.10.2.10.2, *Requesting Information or Documents from the Taxpayer* (Jan. 17, 2017).

business burdens stated “we are finding requests for things outside the scope of the audit”⁵³ and “while these requests [IDRs] are often customized, they also contain boilerplate items that agents are required to seek regardless of the issues that the agent has identified and regardless of the type of business that the taxpayer is operating.”⁵⁴

This lack of transparency impairs the taxpayer’s *right to be informed*. It not only creates burden for the taxpayer, who does not know what is being audited, but it also prevents the IRS from weeding out issues that do not need to be part of the audit or using information from the taxpayer to better understand why the taxpayer made a mistake and how the IRS can adjust its public guidance in real time to prevent further problems. Sharing the audit plan could allow for earlier resolution of issues. Taxpayers could also adjust prior or later year returns to avoid related audits. Further, with this increased communication with the taxpayer, the IRS may discover that the audit of the particular type of taxpayer or issue is not the best use of its resources and adjust its audit strategy.

The IRS Does Not Provide a Clear Path For Taxpayers to Elevate Issues Nor Does It Track Taxpayer Complaints About Field Exams

Another item that prevents the IRS from identifying, in real time, problems with its audit selection tools and examination procedures is the lack of a clear path for taxpayers to elevate issues and make complaints. Although the use of a “team” exam approach is necessary for large or complex cases, taxpayers may be cut off from the decision-makers in their cases. One practitioner explained to Congress:

While this [specialist] assistance is necessary, the process is often mysterious and the taxpayer is left in the dark regarding who is making decisions. Our experience includes situations where a revenue agent who lacks expertise may rely on a technical specialist to make the decision in an examination, and due to staffing levels, the specialist may not have adequate time to fully assist, so revenue agents have only consultations with them. In some cases, the taxpayer is not aware that this has occurred or has not had an opportunity to discuss the specialist’s technical conclusions.⁵⁵

Furthermore, when taxpayers have complaints, they may not have a reasonable path to raise them. The Tax Executive Institute notes the IRS’s public statement that there will be no single member of the exam team with a majority vote, and the first point of contact empowered to make the decision about whether to consider an issue resolved or abandoned is the Deputy Commissioner of LB&I.⁵⁶ With the number of members of an exam team and their breadth across the IRS, taxpayers at an impasse may have few options other than elevating to the Deputy Commissioner of LB&I.

Neither LB&I nor SB/SE Examination has a formal, centralized system to track taxpayer complaints and requests to speak to a manager.⁵⁷ As such, there is no mechanism for the IRS to catalog what it has

53 *IRS Puts Small Businesses Through Audit Wringer: Hearing before the H. Comm. on Small Business*, 114th Cong. (2016) (statement of Warren Hudak, President, Hudak & Company, testifying on behalf of the National Association of Enrolled Agents).

54 *Id.* (statement of Jennifer E. Breen, Partner, Morgan, Lewis & Bockius LLP, testifying on behalf of the American Bar Association Section of Taxation).

55 *Id.* (statement of Kathy Petronchak, Director of IRS Practice and Procedure, Alliantgroup).

56 Tax Executive Institute, *The New LB&I: Recent IRS reorganization raises panoply of significant issues* (Feb. 23, 2016), <http://taxexecutive.org/the-new-lbi/>.

57 IRS response to TAS information request (May 4, 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.

learned in terms of what is or is not working from the taxpayer's perspective and use this to adjust its compliance strategy and ensure its case selection is optimal.

CONCLUSION

The IRS has many opportunities for improving its field examination program. The unacceptably high no change rates across the field exam programs reveal that the IRS is wasting resources by examining taxpayers for whom it will not recommend additional tax assessments. Further, these no change exams may be worse than no exams at all because taxpayers may choose to report less tax in subsequent years as a result of the exam. In order to meet its goal of promoting voluntary compliance, the IRS must reduce the no change rates and create measures that capture how a taxpayer changes his or her filing behavior and attitudes as a result of an audit. Creating better measures may also help the IRS identify areas where it needs to change how it conducts its exams—namely providing greater transparency and a clearer path for taxpayers to raise complaints.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. 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.
2. 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.
3. Require SB/SE to provide an examination plan similar to what LB&I requires for all audited taxpayers for all field examinations.
4. 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.
5. 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****RESPONSIBLE OFFICIAL**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

Under Internal Revenue Code (IRC) § 7602(a) the IRS may conduct examinations to determine whether a tax return is correct, to create a return where the taxpayer has not filed, and to determine a taxpayer's tax liability. The IRS's Office Examinations Program (Office Exam), administered by the Small Business/Self-Employed Division (SB/SE), performs a small fraction of all IRS audits per year. In fiscal year (FY) 2017, the IRS audit coverage rate for all returns was 0.5 percent.² Of those audited, only 102,517 returns were audited through office exams (approximately ten percent).³ Office exams are generally performed in locations where the IRS has the appropriate examination personnel, Tax Compliance Officers (TCOs).⁴ SB/SE currently has 639 TCOs performing office exams, a 49 percent decrease compared with FY 2011, despite office exams having higher agreed-to rates than correspondence exams.⁵

IRS Policy Statement 4-21 states that the primary purpose in selecting tax returns for examination is to promote the highest degree of voluntary compliance.⁶ However, the IRS does not know if Office Exam

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 IRS, *Data Book* 23 (2017). The audit coverage rate is computed from the 1,059,934 returns audited in fiscal year (FY) 2017 across its examination programs divided by the 195,614,161 returns filed in calendar year 2016.

3 IRS response to TAS information request (Oct. 15, 2018).

4 Internal Revenue Manual (IRM) 4.10.2.9.2 (2), *Place and Time of Examination* (Feb. 11, 2016).

5 IRS response to TAS information request (Oct. 15, 2018). IRS, Compliance Data Warehouse (CDW), Automated Information Management System (AIMS) FYs 2011 to 2018 (Dec. 2018).

6 IRM 1.2.13.1.10, *Policy Statement 4-21* (June 1, 1974).

achieves this purpose. The National Taxpayer Advocate's concerns about the overall effectiveness of office exams are two-fold:⁷

- The measures the IRS uses to determine the effectiveness of the exam selection process do not capture data needed to determine the program's impact on increasing voluntary compliance; and
- The scope of the office exam program may limit its impact and introduce bias into the selection process, rendering the program available only to taxpayers who are geographically proximate, have specific issues, or where the IRS has appropriate examination personnel.

In-person face-to-face exams have the potential to provide a real opportunity for the IRS to educate taxpayers on filing compliance for the future and to increase voluntary compliance. Limiting office exams to a small portion of the taxpayer pool, closing the exams cursorily, and failing to approach the exam as an educational experience cannot serve to genuinely further the goal of increasing voluntary compliance and fails to capitalize on the opportunity to put a human face on the IRS.

BACKGROUND

The IRS uses several workstreams to identify returns that may merit additional scrutiny, including assigning all returns a discriminant function (DIF) score, implementing special projects, and receiving referrals.⁸ IRS employees review the pool of returns to determine if the return should be audited and the appropriate audit process. Returns may then be assigned to employees for audit.

Office Exams Offer Advantages to Taxpayers Versus Correspondence Exams

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.

When a return is selected for office examination, the TCO may send the taxpayer a letter with the date, time, and location of the exam.⁹ Research shows that an opt-out system (where a person is sent a letter with a firm date and time for an appointment) versus an opt-in (where a person is sent a letter requesting he or she call and schedule an appointment) may be more effective in ensuring the person shows up for

7 For an in-depth discussion of the National Taxpayer Advocate's concerns about other types of examinations, see 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*, *supra*; 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*, *supra*.

8 For a discussion of the exam selection process, see *Introduction to the Examination Process: Promoting Voluntary Compliance and Minimizing Taxpayer Burden in the Selection and Conduct of Audits*, *supra*.

9 IRM 4.10.2.8.1.1 (Nov. 4, 2016). One letter option is IRS, Letter 2202, *Initial Contact Letter – Firm Set Appointment Letter* (Feb. 2017). This letter sets an appointment date and time for the taxpayer. Two other possible letters request that the taxpayer call the IRS to schedule the appointment. IRS Letter 3572 (Dec. 2016); IRS Letter 3572-A (Dec. 2016).

Office exams offer a unique opportunity to educate a taxpayer in person and to help the taxpayer understand his or her filing obligations going forward. With higher agreed-to rates and lower non-response rates than correspondence exam, the process results in a better outcome for taxpayers and the IRS.

the appointment.¹⁰ Correspondence exams (and the two office exam letters requesting the taxpayer call the IRS for an appointment) require the taxpayer to proactively respond to a letter, the functional equivalent to an opt-in system, and may be less effective in eliciting a response from the taxpayer, resulting in higher non-response rates. A mixed approach, where the letter sets a date for the exam, but permits the taxpayer to call to reschedule would allow for flexibility for the taxpayer, but also prompt the taxpayer to act due to the scheduled appointment.

Office exams offer a unique opportunity to educate a taxpayer in person and to help the taxpayer understand his or her filing obligations going forward. With higher agreed-to rates and lower non-response rates than correspondence exam, the process results in a better outcome for taxpayers and the IRS.¹¹ Many of the same benefits may be available from exams conducted in a virtual face-to-face environment, provided the IRS has the appropriate technology; however, virtual audits would not be an entire substitute for in-person audits due to the limitations of internet and technology access among taxpayers.¹²

The IRS Does Not Know if the Office Exam Program Effectively Promotes Voluntary Compliance

IRS Policy Statement 4-21 clearly articulates the IRS's stated purpose in selecting returns for examination:

The primary objective in selecting returns for examination is *to promote the highest degree of voluntary compliance* on the part of taxpayers. This requires the exercise of professional judgment in selecting sufficient returns of all classes of returns in order to assure all taxpayers of equitable consideration, in utilizing available experience and statistics indicating the probability of substantial error, and in making the most efficient use of examination staffing and other resources.¹³

10 Studies have shown that an opt-out system for flu vaccinations results in higher rates of vaccination for those who receive a notice with a prescheduled appointment compared to those who receive an opt-in notice requesting they make an appointment. See, e.g., Gretchen Chapman, Meng Li, Howard Leventhal, Elaine Leventhal, *Default Clinic Appointments Promote Influenza Vaccination Uptake Without a Displacement Effect*, BEHAVIORAL SCIENCE & POLICY, Vol. 2 Issue 2 2016, at 41-50.

11 IRS, CDW, AIMS FY 2011 to 2018 (Dec. 2018). Combined, SB/SE and Wage and Investment (W&I) correspondence exams for FY 2018 had a non-response rate of over 40 percent, compared to 14 percent for office exam.

12 National Taxpayer Advocate 2017 Annual Report to Congress, vol. 2 61-146 (Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*) (95 percent confidence level). Taxpayers indicated that about 28 percent did not have broadband, which translates to over 41 million taxpayers without this type of access. This is more prevalent within the vulnerable population groups including low income taxpayers (at or below 250 percent of poverty level based on household size, income, and location), seniors (age 65 and older), and taxpayers with disabilities (long term condition self-reported in the survey).

13 IRM 1.2.13.1.10, *Policy Statement 4-21* (June 1, 1974).

Although this statement is decades old, the concept of promoting voluntary compliance is one that should underlie all IRS programs and procedures, including the selection of returns for examination.

As described in a research study in Volume 2 of this report, the type of audit can be important relative to the attitudes and behavior of taxpayers who have been audited. In the sample of taxpayers in the report, only 64 percent of taxpayers remember being audited, with stark differences from those who underwent correspondence audits versus field or office examinations.¹⁴ Eighty percent of those subject to office audit recall being audited, compared to less than 40 percent of those who experienced correspondence exam.

Overall, taxpayers in the study who experienced audits reported higher levels of fear, anger, threat and caution when thinking about the IRS and feel less protected by the IRS.¹⁵ Taxpayers who experienced field or office exams reported higher levels of perceived justice compared to those who underwent correspondence exam.¹⁶ Further, the study results suggest that taxpayers who undergo correspondence exam have a high erosion of trust of the IRS compared to this who experience field or office exam.¹⁷ Surprisingly, the study found that taxpayers who experienced an audit which resulted in a refund of tax perceived the IRS with less trust after the conclusion of the audit, suggesting that perhaps the taxpayers may have been frustrated to be selected for audit when they had overpaid their tax or felt that the IRS was unfair its selection of their returns.¹⁸

The IRS Gets What It Measures

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.¹⁹ 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?²⁰

While the IRS measures field examination customer satisfaction, it does not separately survey office exam customer satisfaction. Further, while the field examination customer satisfaction survey may also capture taxpayers who underwent office examination, a customer satisfaction survey is not effective in achieving a broad picture of taxpayer satisfaction with the field examination process as the response rate is too low to extrapolate to the entire population.²¹ The IRS should not combine field and office exam taxpayer satisfaction into one survey; instead, it should break out taxpayer satisfaction by type of

14 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*.

15 *Id.*

16 *Id.*

17 *Id.*

18 *Id.*

19 SB/SE, *2nd Quarter 2018 Business Performance Review* 13. IRM Exhibit 4.2.8-1, *Quality Attributes Rated by Field and Office Exam National Quality Reviewers* (Mar. 5, 2018).

20 IRS response to TAS information request (Oct. 15, 2018). TAS understands that SB/SE Research will be working with the Campus Correspondence Audit function determining to what extent it is feasible to assess the impact they have on voluntary compliance. SB/SE intends to look at recent audit projects by industry and geographic region, including the extent to which the addition of outreach or education could magnify any impact of those examinations on voluntary compliance—assuming that outreach or education information is available in a timely manner to meet deliverable timeframes. TAS looks forward to the results of this project. IRS response to TAS fact check (Dec. 13, 2018).

21 IRS, *SB/SE Field Exam Mail Customer Satisfaction Report Survey Year 2017* (Aug. 2018). SB/SE did not receive enough responses to this survey to extrapolate the results to the larger population.

The IRS gets what it measures. If it does not measure how the exam process impacts future compliance, and it does not measure the quality of an exam to at a minimum include educating the taxpayer, it cannot hope to achieve these outcomes.

exam to allow the IRS to use the data it obtains to improve and refine the office examination program. However, the IRS also combines office and field exam into one category when it reports on the results of examination in the IRS Data Book.²²

The IRS could benefit from studying the future compliance of taxpayers subject to audit. Tracking future compliance, with an emphasis on type of audit performed, core issues examined, taxpayer type, and other characteristics, including the number and nature of interactions between the IRS auditor and the taxpayer, would help the IRS refine its audit strategy and use its audit resources more effectively to promote future compliance.

The mission of SB/SE Examination is to “provide Small Business and Self-Employed (SB/SE) taxpayers top quality service by helping them understand and meet tax responsibilities and by applying the tax law with integrity and fairness.”²³ Underlying this mission statement is a key element that states the goal of “educating and informing taxpayers so they understand what they must do to comply with the law.” Educating and informing taxpayers about how to achieve compliance and remain compliant in the future should be a primary goal of face-to-face interactions with taxpayers. However, nowhere in the quality review attributes of office exams does the IRS measure whether the employee educated the taxpayer and provided the taxpayer with information the taxpayer needs to be compliant in the future.²⁴

Further, the SB/SE office examination program does not track the results of appealed exams.²⁵ Failing to do so misses an opportunity to understand if the exam process could be improved so that fewer taxpayers feel the need to appeal the results of the initial exam or to offer training if similar issues are consistently being conceded or settled on appeal.

Again, the IRS gets what it measures.²⁶ If it does not measure, as discussed above, how the exam process impacts future compliance, and it does not measure the quality of an exam to at least include educating the taxpayer, it cannot hope to achieve these outcomes.

22 IRS, *2017 Data Book* (Mar. 2018).

23 IRM 1.1.16.3 (Nov. 16, 2018).

24 IRM 4.2.8 Exhibit 4.2.8-1, *Quality Attributes Rated by Field and Office Exam National Quality Reviewers* (Mar. 5, 2018). See also IRM 21.20.1-5, *EQRS/NQRS Attributes* (Oct. 22, 2018).

25 IRS response to TAS information request (Oct. 15, 2018).

26 National Taxpayer Advocate 2017 Annual Report to Congress 93-106.

The Scope of the Office Exam Program May Limit Its Impact and Introduce Bias Into the Selection Process

Office Exams Are Geographically Limited

Office exams are generally scheduled at the office closest to the taxpayer's residence, if the office has the appropriate examination personnel on site.²⁷ This constraint immediately limits which taxpayers may ever be selected for office exam. Currently, taxpayers in Alaska, Delaware, Montana, North Dakota, South Dakota, or Wyoming, where there are no TCOs conducting office exams, will never be audited via office exam.²⁸ Whereas taxpayers who live in Virginia (2 TCOs), North Carolina (7 TCOs), or Michigan (8 TCOs) may have a much lower chance of being audited via office exam versus taxpayers who live in Texas (59 TCOs), New York (62 TCOs), or Florida (50 TCOs).²⁹ Further, within the states that do have TCOs conducting office exams, the number of office exam locations have decreased from 241 to 175 (a 27 percent decrease) between 2011 and 2018.³⁰

27 IRM 4.10.2.9.2(2) (Feb. 11, 2016).

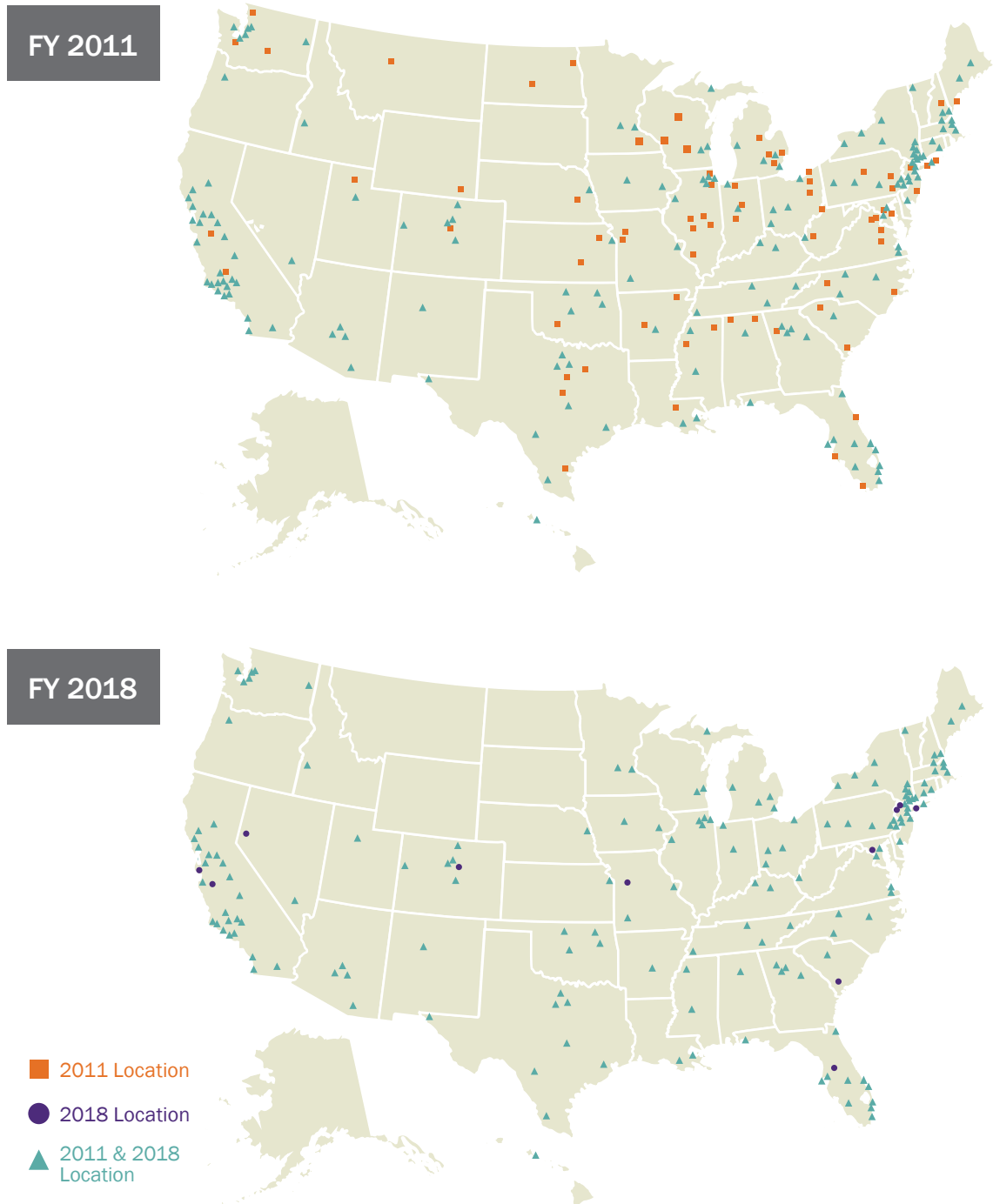
28 IRS response to TAS information request (Oct. 15, 2018).

29 *Id.*

30 *Id.*

FIGURE 1.10.1³¹

Small Business/Self-Employed Tax Compliance Officer Locations
Fiscal Years 2011 and 2018



31 IRS response to TAS information request (Oct. 15, 2018).

Selecting taxpayers for office exam based on where 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*. Such a process will also necessarily impact the type of businesses that are selected for office exam due to lack of TCOs in certain areas or make it more likely that businesses located in an area with a concentration of TCOs will be subject to office exam. Selecting in this manner also cuts the other way—an office exam gives the taxpayer an opportunity to interact in person with the IRS, and office exams have generally better outcomes for taxpayers than correspondence exams, such as lower default rates and higher agreed-to rates, so taxpayers selected for other types of exams due to the lack of nearby TCOs may be worse off than other taxpayers.³²

Office Exams Are Limited by Topic

SB/SE audits business tax returns. Classifiers sort potential returns for audit between Revenue Agents (RAs) (for field exam) and TCOs. The time planned for an audit by TCOs is substantially less than for an RA, so TCOs address less complicated issues.³³ The Internal Revenue Manual lists examples of issues for office exam:

Dependency exemptions; income from tips, pensions, annuities, rents, fellowships, scholarships, royalties, and income not subject to withholding; deductions for business related expenses; deductions for bad debts; determinations of basis of property; deductions for education expenses; capital gain versus ordinary income determinations; complex miscellaneous itemized deductions such as casualty and theft losses where determinations of fair market value are required; Schedule E basis and passive activity issues for flow-through losses; and deductions for employee business expenses such as travel and entertainment.³⁴

However, the IRS notes that is only an illustrative list, provides a checklist guide of additional items to consider, and leaves the classification of the exam up to the judgment of the classifier.³⁵

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. The IRS could test-pilot programs for office exams in areas, such as charitable contributions, and track customer satisfaction, exam results, and future compliance of those taxpayers compared to taxpayers audited via correspondence exams to determine if office exam is more effective.

32 IRS, CDW, AIMS FY 2011 to 2018 (Dec. 2018). For a discussion of the National Taxpayer Advocate's concerns regarding other types of exams see 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*, *supra*; 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*, *supra*.

33 IRM 4.1.5.3.2.6 (Oct. 20, 2017).

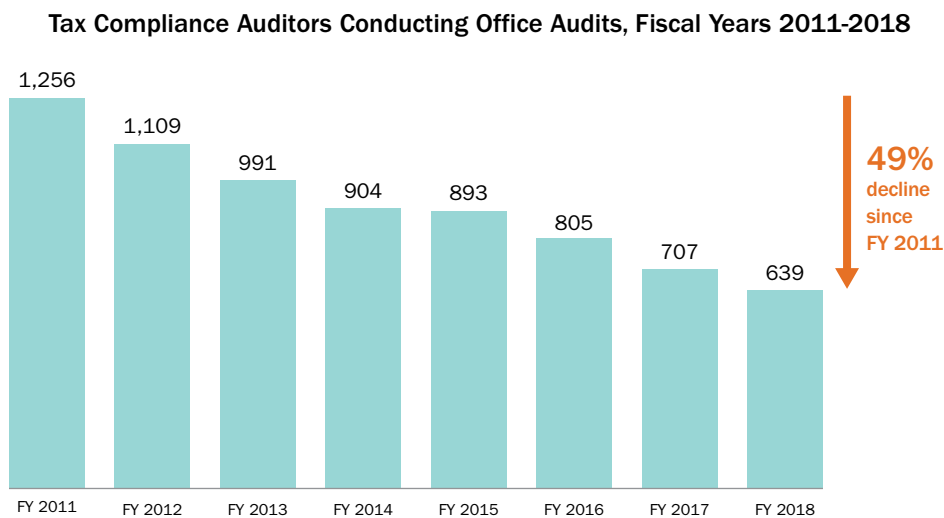
34 *Id.*

35 *Id.* Further indicated in the provided table for consideration are that Forms 1120s with assets under \$250,000 with no balance sheet issues, no priority issues, no acquisitions, mergers, reorganizations, no recapitalizations, liquidations, no stock redemptions, no IRC 351 stock transfer, and no final returns can be assigned to TCOs; Forms 1040s with Schedule C/F gross receipts and/or costs of goods sold between \$200,000 and \$750,000 if the return has multiple Schedule C/Fs and other indicators or less than \$200,000 if other indicators are not present; individuals receiving wages from closely held C corporations and claiming employee business expenses/Schedule C expenses; gross receipts as a classified issue less than \$200,000; Schedule C/F with only non-gross receipts issues classified and total gross receipts less than \$500,000.

Office Exams Are Limited by Number of TCOs

The employees who conduct office exams have declined precipitously. In 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.³⁶

FIGURE 1.10.2, Number of Tax Compliance Auditors Conducting Office Audits, FY 2011 to FY 2018³⁷



As discussed above, office exams are already limited geographically by employee location, an issue further exacerbated by the staggering decline in IRS employees conducting office exams. Of the remaining 175 locations across the country where TCOs conduct office exams, 32 percent of the offices have only one TCO.³⁸ In FY 2018, the IRS closed about 79,000 office exams, or 124 exams per examiner.³⁹

³⁶ IRS response to TAS research request (Oct. 15, 2018).

³⁷ *Id.*

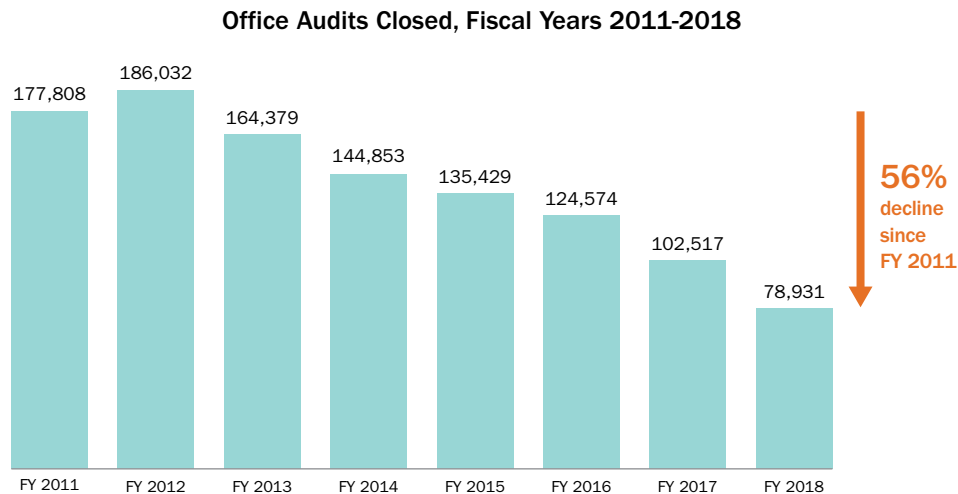
³⁸ *Id.* IRS response to TAS fact check (Dec. 13, 2018).

³⁹ *Id.*

Office Exams Have Significantly Declined

The number of office exams conducted by the IRS has declined since FY 2011 (with the exception of FY 2012). In FY 2011, the IRS closed almost 178,000 office exams, compared to about 79,000 in FY 2018, a nearly 56 percent decrease.⁴⁰

FIGURE 1.10.3, Number of Office Audits Closed, FY 2011 to FY 2018⁴¹



At the same time, dollars assessed from the office exam program have decreased only 28 percent from FY 2011 to FY 2018, suggesting that the IRS is doing a better job selecting returns for office exam.⁴² Dollars per return has actually increased, from \$6,666 in FY 2011 to \$10,815 in FY 2018, an increase of approximately 62 percent, further suggesting the IRS is selecting better returns for examination.⁴³

The constraints on office exam limit the likelihood of selection for an office exam based on many factors. This may impact the *right to a fair and just tax system*. Taxpayers who are not geographically proximate to an IRS office with office exam personnel are unlikely to ever be selected for an office exam versus those taxpayers who live nearby.

⁴⁰ IRS response to TAS information request (Oct. 15, 2018). IRS response to TAS fact check (Dec. 13, 2018).

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

CONCLUSION

Promoting voluntary compliance is an important goal. However, the current IRS office exam program cannot show its progress toward this goal because of the way the program is designed and by SB/SE's failure to determine an actual impact on future voluntary compliance. Not only does the IRS not measure future compliance of taxpayers who undergo an audit, it neglects to track the results of its own audits that are appealed. Operating an examination program without significant analysis of the results of the program beyond closure rates and closure results is a missed opportunity for the IRS to improve the process and promote future voluntary compliance.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Develop measures to track the downstream compliance of audited taxpayers by type of exam.
2. Track results of audits that are appealed by the taxpayer by type of exam.
3. Add educating the taxpayer on future compliance to the quality attributes of an exam for field and office exam.
4. Increase the number of TCOs and put them in more locations throughout the United States.
5. Expand the issues covered by office exam, develop pilot programs for office exams for issues such as charitable contributions, 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

RESPONSIBLE OFFICIALS

Ken Corbin, Commissioner, Wage and Investment Division
William M. Paul, Acting Chief Counsel

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF 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 (*i.e.*, the normal “deficiency procedures”).² Because this “math error authority” (MEA) is not limited to clear-cut errors, it can deprive taxpayers of benefits to which they are entitled, and leave them with no realistic opportunity for judicial review, as discussed in prior reports.³

The taxpayer is best equipped to receive and understand a math error notice and address any discrepancy immediately after filing. On April 10, 2018, however, the IRS concluded it can use MEA after processing the return, just like an audit.⁴ Such delays increase the risk that taxpayers will not be able to respond timely. Yet, the IRS has used this new post-processing MEA to reverse refundable credits for students, children, and the working poor (*i.e.*, the American Opportunity Tax Credit (AOTC), Child

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 See IRC §§ 6213(b), (g)(2) (listing in (A)-(Q), the 17 specific types of errors). If the taxpayer timely responds to a math error notice, then the IRS abates the assessment and must follow deficiency procedures before making another assessment. See IRC §§ 6213(a), (b)(2).

3 See, e.g., National Taxpayer Advocate Fiscal Year (FY) 2019 Objectives Report to Congress 114-118 (Area of Focus: *The IRS Has Expanded Its Math Error Authority, Reducing Due Process for Vulnerable Taxpayers, Without Legislation and Without Seeking Public Comments*); National Taxpayer Advocate 2014 Annual Report to Congress 163; National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 5, 91-92; National Taxpayer Advocate 2011 Annual Report to Congress 74; National Taxpayer Advocate 2006 Annual Report to Congress 311; National Taxpayer Advocate 2003 Annual Report to Congress 113; National Taxpayer Advocate 2002 Annual Report to Congress 25, 186; National Taxpayer Advocate 2001 Annual Report to Congress 33. For a proposal to expand the opportunity for judicial review, see Legislative Recommendation: *Fix the Flora Rule: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*, *infra*.

4 Program Manager Technical Advice (PMTA) 2018-17 (Apr. 10, 2018), https://www.irs.gov/pub/iranoa/pmta_2018_17.pdf.

Tax Credit (CTC), the Additional Child Tax Credit (ACTC), and the Earned Income Tax Credit (EITC), respectively) on 17,691 returns in fiscal year (FY) 2018—often nearly two years after the returns were filed.⁵

The IRS improperly denied credits to 289 of these taxpayers and sent 113 of them the wrong letters to explain why their credits were disallowed, according to the Treasury Inspector General for Tax Administration (TIGTA).⁶ TIGTA also said the IRS wasted over \$400,000 doing manual reviews because it did not address the problem systemically and did not reject e-filed returns immediately—a process that would have allowed taxpayers or their preparers to address the problem right away.⁷

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 unreasonable risks to the taxpayer's *right to pay no more than the correct amount of tax, to challenge the IRS's position and be heard, to privacy (i.e., that enforcement will "be no more intrusive than necessary")*, and *to a fair and just tax system (i.e., to "expect the tax system to consider [their specific] facts and circumstances")*. She is also concerned it will waste resources when the resulting assessments are incorrect.

ANALYSIS OF PROBLEM

Discrepancies in Data Do Not Mean an Assessment Is Needed

Discrepancies can appear on returns even if the taxpayer is entitled to the benefits he or she claimed. For example, the IRS has MEA to assess tax when a taxpayer claims a dependent, but does not include the dependent's correct taxpayer identification number (TIN).⁸ Because a TIN is a long string of numbers, it can contain typographical errors.

A TAS study of math errors on dependent TINs found that:⁹

- The IRS subsequently reversed (at least part of) the math errors on 55 percent of the returns with incorrect TINs.
- The IRS could have resolved 56 percent of them using information already in its possession (*e.g.*, the TIN listed on a prior year return).
- In 41 percent of the cases where the IRS could have corrected the TINs (and in another 11 percent where it could have corrected at least one TIN), the taxpayer was denied a tax benefit that he or she was entitled to receive.
- Such taxpayers were denied \$1,274 on average.

5 IRS response to TAS information request (Nov. 9, 2018).

6 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2018-40-015, *Employer Noncompliance With Wage Reporting Requirements Significantly Reduces the Ability to Verify Refundable Tax Credit Claims Before Refunds Are Paid* 13 (Feb. 26, 2018).

7 TIGTA, Ref. No. 2018-40-015, *Employer Noncompliance With Wage Reporting Requirements Significantly Reduces the Ability to Verify Refundable Tax Credit Claims Before Refunds Are Paid* 11 (Feb. 26, 2018).

8 IRC § 6213(g)(2)(H). In the case of an individual, a taxpayer identification number (TIN) may include a Social Security number (SSN), an Individual TIN (ITIN), or an Adoption TIN (ATIN). IRS, Pub. 1915 (2018). An ITIN is issued to individuals who are required to have a TIN for tax purposes, but are not eligible for a SSN. An ATIN is a temporary number issued to a child who is being adopted in the U.S. before the child can obtain a SSN.

9 National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 114, 117-120 (Research Study: *Math Errors Committed on Individual Tax Returns – A Review of Math Errors Issued on Claimed Dependents*).

The IRS's failure to investigate potential errors before assessing tax is inconsistent with general direction from Congress that the IRS should not use MEA to resolve uncertainty against the taxpayer.¹⁰

As another example, the IRS also has MEA to reverse EITC claimed by a noncustodial parent for a child who is shown on the Federal Case Registry (FCR) of child support orders as being in someone else's custody.¹¹ An IRS study found that 39 percent of the children reported on the returns selected for audit, based solely on FCR data mismatches were claimed correctly.¹² Because FCR data is not sufficiently reliable, the IRS has adopted the National Taxpayer Advocate's recommendation not to assess math errors based on mismatches between returns and FCR data. However, the IRS may not have undertaken this study without direction from Congress.

MEA Procedures Raise Concerns When the Assessments Are Erroneous

Any expansion of MEA raises the following concerns when the resulting assessments could be in error:¹³

- The IRS does not always try to resolve apparent discrepancies before burdening taxpayers with summary assessments.
- IRS communication difficulties—confusing letters, fewer letters (*i.e.*, one math error notice as compared to three or more letters in an audit), and shorter deadlines (*i.e.*, 60 days as compared to more than 120 days in an audit)—make it more difficult for taxpayers to respond timely.¹⁴
- Because it is easier to miss math error deadlines, more taxpayers—particularly low income taxpayers—will have the burden to prove their returns are correct, and lose access to the Tax Court.

10 H.R. REP. No. 94-658, at 290 (1976) (“... care should be taken to be sure that what appears to be an error in addition or subtraction is not in reality an error in transcribing a number from a work sheet, with the final figure being correct even though an intermediate arithmetical step on the return appears to be wrong ... It is expected that the Service will check such possible sources of arithmetical errors before instituting the summary assessment procedures.”). *Id.* at 291 (“... this summary assessment procedure is not to be used where the Service is merely resolving an uncertainty against the taxpayer.”).

11 Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 303(g), 115 Stat. 38, 56-57 (2001) (codified at IRC § 6213(g)(2)(M)). The House Conference Report requested a study of the FCR database by the Department of Treasury, in consultation with the National Taxpayer Advocate, of the accuracy and timeliness of the data in the FCR; the efficacy of using math error authority in this instance in reducing costs due to erroneous or fraudulent claims; and the implications of using math error authority in this instance, given the findings on the accuracy and timeliness of the data. H.R. REP. No. 107-84, at 147 (2001) (Conf. Rep.). See also National Taxpayer Advocate 2002 Annual Report to Congress 189 (Legislative Recommendation: *Math Error Authority*).

12 See IRS, *Federal Case Registry Final Report*, Project 5-02-12-3-005 (CR-39) (July 2003) (“almost 39% of the FCR children were allowed per examination ... With the exclusion of no reply cases ... the rate of FCR children that are allowed per examination increases to 53.5%”).

13 For a more detailed discussion of the differences between the audit and math error procedures, see National Taxpayer Advocate Fiscal Year (FY) 2019 Objectives Report to Congress 114-118. For a detailed discussion of the math error process and math error notices, see 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*.

14 Although it should be easier for taxpayers to understand and respond to audit notices than math error notices, a TAS study found “almost 40 percent [of those receiving an Earned Income Tax Credit (EITC) audit notice] ... did not understand what the IRS was questioning ... [and] only about half of the respondents felt that they knew what they needed to do in response to the audit letter.” National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 100, 103-104. For a discussion of continuing problems with math error notices see, 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*.

- Internal Revenue Code (IRC) § 7605(b) generally prohibits the IRS from examining a return more than once, but the IRS can examine a return after making a math error adjustment.¹⁵

For these reasons, the National Taxpayer Advocate has opposed the Treasury Department's repeated requests for Congress to authorize it to use its regulatory authority to expand the types of issues the IRS could address using MEA (called "correctable error" authority).¹⁶ She recommended that Congress limit MEA to the following situations:¹⁷

1. There is a mismatch between the return and unquestionably reliable data.
2. The IRS's math error notice clearly describes the discrepancy and how taxpayers may contest the assessment.
3. The IRS has researched the information in its possession (*e.g.*, information provided on prior-year returns) that could reconcile the apparent discrepancy.¹⁸
4. The IRS does not have to analyze facts and circumstances or weigh the adequacy of information submitted by the taxpayer to determine if the return contains an error.
5. The abatement rate for a particular issue or type of inconsistency is below a specified threshold for those taxpayers who respond.
6. For any new data or criteria, the Department of Treasury, in conjunction with the National Taxpayer Advocate, has evaluated and publicly reported to Congress on the reliability of the data or criteria for purposes of assessing tax using math error procedures.

The IRS could adopt these common-sense limits without legislation. Doing so would minimize 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*. It would also help prevent the IRS from wasting resources on incorrect assessments.

Post-Processing Math Error Adjustments Are Even More Burdensome

Post-processing math error adjustments are even more burdensome for taxpayers than regular math error adjustments. If the IRS summarily assesses a liability after processing the return, the taxpayer is less likely to be able to:

- Receive and understand the IRS's communication;
- Discuss the issue with a preparer;
- Access underlying documentation;
- Recall and explain facts relevant to the filing;
- Return any refunds (or endure an offset) without experiencing an economic hardship; and

15 For a detailed discussion of how math errors and other "unreal audits" bypass taxpayer protections, see, *e.g.*, National Taxpayer Advocate 2017 Annual Report to Congress 49-63 (Most Serious Problem: *The IRS Is Conducting Significant Types and Amounts of Compliance Activities That It Does Not Deem to Be Traditional Audits, Thereby Underreporting the Extent of Its Compliance Activity and Return on Investment, and Circumventing Taxpayer Protections*).

16 See, *e.g.*, Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals* 168-169 (Feb. 2012); Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals* 225-226 (Feb. 2016). For concerns about the recommendation, see, *e.g.*, National Taxpayer Advocate 2017 Purple Book 44-45; National Taxpayer Advocate 2015 Annual Report to Congress 329-339; Nathan J. Richman, *Expanding Math Error Authority Could Worsen 2 Tax Systems Issues*, 2017 TNT 127-2 (July 5, 2017).

17 See National Taxpayer Advocate 2015 Annual Report to Congress 329-339.

18 It is TAS's understanding that the IRS is legally authorized to correct returns using math error authority so as to benefit the taxpayer (*e.g.*, when it has information sufficient to determine the taxpayer is entitled to a credit).

- Learn how to avoid the problem before the next filing season.

Perhaps for the same reasons, the law limits how long after filing the IRS can make assessments, and the IRS tries to maintain the “currency” of its audits and has a policy statement that generally bars examiners from addressing old delinquencies.¹⁹ Because taxpayers are supposed to have the *right to quality service* and *to privacy* (*i.e.*, the right to expect that enforcement action will be no more intrusive than necessary), the IRS can and should take similar precautions to ensure it detects math errors while processing returns or not at all. If instead, the IRS uses post-processing MEA to recover EITC benefits, it could be sued for violating the taxpayer’s constitutional rights.²⁰

The IRS Is Now Using Post-Processing MEA to Recover Credits

In December 2015, the Protecting Americans From Tax Hikes (PATH) Act barred taxpayers from claiming the AOTC, CTC, ACTC, or EITC using TINs issued after the due date of the return (*e.g.*, using TINs issued in 2015 to file returns for 2014 during 2016, which are called retroactive claims).²¹ TIGTA found the IRS had improperly paid these credits to 15,744 taxpayers who filed 2014 returns during the 2016 filing season.²² TIGTA subsequently found the IRS improperly paid retroactive claims on 2013-2015 returns to 4,509 taxpayers during the 2017 filing season.²³ The IRS used post-processing MEA to recover these credits from 17,691 taxpayers in FY 2018—often nearly two years after they filed the returns.²⁴

Like the TAS study of MEA (discussed above), TIGTA’s review of returns processed during the 2017 filing season found that the IRS sometimes got it wrong—improperly denying credits to 289 taxpayers.²⁵ Moreover, it sent 113 taxpayers the wrong letters to explain why their credits were disallowed, thus giving them the wrong explanations, undermining their ability to correct the IRS’s mistakes or obtain judicial review.²⁶

19 IRC § 6501(a) (assessment limitations period); IRS, *Reducing the Federal Tax Gap, A Report on Improving Voluntary Compliance* 36 (Aug. 2, 2007), https://www.irs.gov/pub/irs-news/tax_gap_report_final_080207_linked.pdf (discussing audit currency); Policy Statement 5-133 (P-5-133), *reprinted as IRM 1.2.14.1.18(5)* (Aug. 4, 2006) (generally limiting the “enforcement of delinquency procedures for not more than six (6) years”).

20 For a discussion of this argument, see National Taxpayer Advocate, *The IRS Might Recover EITC Using Its Newly Discovered Post-Processing Math Error Authority, but Is It Constitutional?* NTA BLOG (Sept. 13, 2018), <https://taxpayeradvocate.irs.gov/news/nta-blog-the-irs-might-recover-eitc-using-its-newly-discovered-post-processing-math-error-authority-but-is-it-constitutional>.

21 See Sections 204-206 of Division Q of the Consolidated Appropriations Act, Pub. L. No. 114-113, 129 Stat. 2242 (2015) (codified at IRC §§ 32(m), 24(e), and 25A(i)(6)).

22 See TIGTA, Ref. No. 2017-40-042, *Processes Do Not Maximize the Use of Third-Party Income Documents to Identify Potentially Improper Refundable Credit Claims* 5 (July 17, 2017). See also TIGTA, Ref. No. 2018-40-032, *The Internal Revenue Service Is Not in Compliance with Improper Payment Requirements* 11-12 (Apr. 9, 2018); TIGTA, Ref. No. 2018-40-015, *Employer Noncompliance With Wage Reporting Requirements Significantly Reduces the Ability to Verify Refundable Tax Credit Claims Before Refunds Are Paid* 3 (Feb. 26, 2018).

23 TIGTA, Ref. No. 2018-40-015, *Employer Noncompliance With Wage Reporting Requirements Significantly Reduces the Ability to Verify Refundable Tax Credit Claims Before Refunds Are Paid* 9-10 (Feb. 26, 2018).

24 IRS response to TAS information request (Nov. 9, 2018).

25 TIGTA, Ref. No. 2018-40-015, *Employer Noncompliance With Wage Reporting Requirements Significantly Reduces the Ability to Verify Refundable Tax Credit Claims Before Refunds Are Paid* 10 (Feb. 26, 2018).

26 *Id.* at 13 (Feb. 26, 2018).

However, the IRS did not adopt TIGTA's recommendation to substitute a rejection process for e-filed tax returns, citing technical difficulties.²⁷ Upon receipt of the return, the IRS could reject it and immediately inform the taxpayer that the TIN that was used to claim the credit was not issued before the due date of the return.²⁸ Such a process would give the taxpayer an opportunity to address the apparent discrepancy proactively, often with the assistance of his or her preparer or tax preparation software, and save the IRS resources (*i.e.*, over \$400,000, according to TIGTA).²⁹

CONCLUSION

Because of the lack of due process afforded to taxpayers when the IRS uses MEA, it should only be used for clear errors. Clear errors can be detected and addressed immediately when the taxpayer is best prepared to understand the IRS's communications and respond timely and appropriately. To reduce the temptation to use MEA in ways that trample taxpayer rights and create costly rework, the IRS should publicly announce a policy that limits its use. Such a policy would help it resist calls to use MEA and post-processing MEA inappropriately.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS, in collaboration with the National Taxpayer Advocate, adopt a policy statement (or similar guidance) to:

1. Limit the circumstances in which the IRS will use MEA (including post-processing MEA).
2. Voluntarily adopt the limits on the use of MEA recommended to Congress by the National Taxpayer Advocate in her 2015 annual report.³⁰
3. Require the IRS to alert taxpayers to any discrepancies as early as possible, for example, by rejecting an e-filed return, where permissible, rather than waiting to use MEA, or waiting even longer to use post-processing MEA.

27 TIGTA, Ref. No. 2018-40-015, *Employer Noncompliance With Wage Reporting Requirements Significantly Reduces the Ability to Verify Refundable Tax Credit Claims Before Refunds Are Paid 12-13* (Feb. 26, 2018). Any such rejection should obviously be accompanied with a clear and detailed explanation. Before rejecting any return, the IRS's systems should use information in the IRS's possession to help taxpayers correct any apparent discrepancies, such as typos, that might help the taxpayer qualify for the credits they claimed.

28 For the same reasons, the National Taxpayer Advocate recommended the IRS "Reject electronic filed returns when the taxpayer received APTC [the advanced premium tax credit] and did not reconcile on Form 8962, *Premium Tax Credit (PTC)*, as the IRS plans to do for silent returns that do not include Form 8965, *Health Coverage Exemptions*." National Taxpayer Advocate 2017 Annual Report to Congress 266, 276 (Most Serious Problem: *The IRS Has Made Progress in Implementing the Individual and Employer Provisions of the ACA But Challenges Remain*). Of course, the IRS would first have to ensure it is authorized to reject such returns.

29 TIGTA, Ref. No. 2018-40-015, *Employer Noncompliance With Wage Reporting Requirements Significantly Reduces the Ability to Verify Refundable Tax Credit Claims Before Refunds Are Paid 12-13* (Feb. 26, 2018). If the taxpayer felt they were still entitled to the credit, he or she could file on paper and then explain his or her reasons in any subsequent examination or math error process.

30 See National Taxpayer Advocate 2015 Annual Report to Congress 329-339.

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

WHY ARE NOTICES IMPORTANT?

The IRS mailed over 175 million notices in fiscal year (FY) 2018, making notices one of the most frequent interactions between taxpayers and the IRS.¹ In many cases, notices are the primary form of communication from the IRS to taxpayers with respect to matters that have significant impact on taxpayers' lives.

The Taxpayer Bill of Rights lists the *right to be informed* as the first of the ten taxpayer rights because of the importance of taxpayers understanding what they need to do to comply with the tax laws. Taxpayers need clear explanations of the IRS's procedures and actions about their tax liability and the rights they have in response to the IRS's actions. Because notices are often the main communication from the IRS to taxpayers, they are key to ensuring taxpayers are adequately informed. Notices inform taxpayers of important events, such as the IRS's intent to increase the taxpayer's tax liability, the IRS's filing of a Notice of Federal Tax Lien (NFTL) against the taxpayer's property, or of the IRS's intent to levy the taxpayer's wages or bank account. They also inform taxpayers of their right to a hearing to challenge the IRS's actions in the above events—the Collection Due Process (CDP) hearing.² Failure to respond to notices can often lead to the loss of core taxpayer rights, such as the *right to pay no more than the correct amount of tax, to appeal the IRS's decision in an independent forum, and to a fair and just tax system*.

If the IRS determines a taxpayer owes more tax, it generally cannot assess the tax until it first provides the taxpayer with notice and an opportunity to challenge the proposed assessment. For example, the IRS has the authority to assess a tax for mathematical errors (*e.g.*, $2 + 2 = 5$), or clerical errors (*e.g.*, writing the number 12 for an entry on the return instead of 21, or leaving an entry blank) if the error led to the taxpayer paying less tax than they owe.³ This means that, unless taxpayers request an abatement (a reduction or elimination of the deficiency the IRS claims the taxpayer owes) within 60 days from the date on the math error notice, the IRS may proceed with collection of the tax without issuing a Statutory Notice of Deficiency (SNOD) under the normal deficiency procedure as described below.⁴ If taxpayers do not request an abatement when they receive a math error notice, they do not receive a SNOD and, therefore, cannot make a prepayment petition to the United States Tax Court (Tax Court) to review the IRS's assessment.

The SNOD,⁵ also called a 90-day letter, states the proposed amount of additional income, estate, or gift tax, the taxable year involved, and the basis for the increased tax. It also notifies the taxpayer that he or she has 90 days (or 150 days if the taxpayer resides outside the U.S.) from the date of mailing in which

1 The number of notices was pulled from Computer Paragraph (CP) and Correspondex letters from the IRS Notice Gatekeeper, notices from the Notice Delivery System not included on the Notice Gatekeeper site, and Individual Master File (IMF) and Business Master File (BMF) balance due notices based on cases being in notice status in the Accounts Receivable Dollar Inventory files.

2 See Internal Revenue Code (IRC) §§ 6320 & 6330.

3 IRC §§ 6213(b), (g).

4 IRC § 6213(b)(2)(A).

5 The Statutory Notice of Deficiency (SNOD) is sent to the taxpayer by certified or registered mail. IRC § 6212(a).

to file a petition in the Tax Court if he or she disagrees with the IRS's proposed tax assessment.⁶ The notice of deficiency is the taxpayer's "ticket" to the Tax Court, the only prepayment judicial forum where the taxpayer can *appeal an IRS decision*.⁷

After the IRS assesses a liability, the taxpayer may sometimes seek judicial review when the IRS tries to collect. The IRS communicates CDP rights during two critical times. Before the IRS levies property or after it has filed a NFTL, it must send a CDP notice, which gives the taxpayer the right to request an administrative CDP hearing before the IRS Office of Appeals (Appeals).⁸ During the CDP hearing, the Appeals Officer must obtain verification that "requirements of any applicable law or administrative procedure have been met."⁹ The Appeals Officer also must consider "whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary."¹⁰ Taxpayers are given the opportunity to raise a collection alternative, such as an installment agreement or offer in compromise, and in some instances, they can contest the underlying liability.¹¹ The CDP hearing also is a prerequisite for challenging the IRS collection action in court. If taxpayers disagree with the IRS's determination after the CDP hearing and wish to appeal, they must file a petition with the Tax Court within 30 days of the Appeals' determination.¹² If taxpayers miss the deadline, the Tax Court does not have jurisdiction to review the IRS's determination and the taxpayers are deprived of their CDP rights.¹³

SUMMARY

Background: Prior TAS research and recommendations related to IRS notices

The National Taxpayer Advocate previously recommended that SNODs have the contact information and addresses of Local Taxpayer Advocates printed on them so that taxpayers are aware that there is someone in their state who can assist them with their tax issues.¹⁴ The requirement that this address and contact information be included in SNODs is codified at Internal Revenue Code (IRC) § 6212(a),

6 IRC § 6212(a); Internal Revenue Manual (IRM) 4.8.9.8, *Preparing Notices of Deficiency* (July 9, 2013).

7 For a discussion of the difficulties for taxpayers where they are unable to access the Tax Court, see Legislative Recommendation: *Fix the Flora Rule: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*, *infra*.

8 See generally, IRC §§ 6320 (lien), 6330 (levy).

9 IRC § 6330(c)(1).

10 IRC § 6330(c)(3)(C).

11 IRC § 6330(c).

12 IRC § 6330(d)(1). For a discussion of how the current language in several IRS CDP and innocent spouse notices of determination confuses taxpayers, especially *pro se* taxpayers, and causes them to misinterpret the deadline to file a petition with the Tax Court, see National Taxpayer Advocate 2017 Annual Report to Congress 299-306 (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*); National Taxpayer Advocate 2017 Annual Report to Congress 299-306; (Legislative Recommendation: *Collection Due Process and Innocent Spouse Notices: Amend IRC §§ 6320, 6330, and 6015 to Require That IRS Notices Sent to Taxpayers Include a Specific Date by Which Taxpayers Must File Their Tax Court Petitions and Provide That a Petition Filed by Such Specified Date Will Be Treated As Timely*).

13 For a more thorough discussion of the importance of CDP rights in tax administration, see Nina E. Olson, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 63 *TAX LAWYER* 227.

14 National Taxpayer Advocate 2014 Annual Report to Congress 237-244 (Most Serious Problem: *Statutory Notices of Deficiency: Statutory Notices of Deficiency Do Not Include Local Taxpayer Advocate Office Contact Information on the Face of the Notice*).

enacted as part of the Internal Revenue Service Restructuring and Reform Act of 1998.¹⁵ Including this information is especially important given that the IRS lacks a local presence in many areas.¹⁶

Many IRS notices reference the IRS website to inform taxpayers of their rights or the procedures to respond to notices. However, a TAS research study found that millions of mainly low income taxpayers lack adequate internet access and thus are harmed by the IRS not providing the necessary information on the notices themselves.¹⁷ This situation in and of itself, apart from the issue of unclear or overly complex notices, demonstrates that the IRS is not adequately meeting the needs of taxpayers.¹⁸

Another problem the National Taxpayer Advocate has expressed concern with is the IRS's expanding use of math error authority to summarily resolve tax issues against taxpayers.¹⁹ This expansion, along with a lack of notice clarity, creates unnecessary burden for taxpayers.²⁰ In fact, a TAS research study found that 55 percent of math errors involving claimed dependents were abated.²¹ Even worse, in over 50 percent of these cases that received no adjustment, the IRS did not issue any refunds that the taxpayers were at least partially entitled to.²² Due to these problems facing taxpayers, the National Taxpayer Advocate has recommended that the IRS work with TAS to review any proposed expansion of math error authority to ensure taxpayer rights are adequately protected.²³

In the interest of clearer CDP and Innocent Spouse notices and protecting taxpayer rights, the National Taxpayer Advocate has previously recommended amending IRC §§ 6320, 6330, and 6015 to require that these notices include the specific deadline date by which taxpayers must file a petition and that a petition filed by that date should be treated as timely.²⁴

What are the key elements to making the information understandable?

The language and design of notices can help taxpayers understand what they may owe and how to resolve their tax balance, or it can confuse taxpayers. Confused taxpayers may take wrong actions or no action at all, thus, forfeiting their *rights to pay no more than the correct amount of tax*, to have their

15 Pub. L. No. 105-206, § 1102(b), 112 Stat. 685, 703 (1998).

16 National Taxpayer Advocate 2016 Annual Report to Congress 86-97 (Most Serious Problem: *Geographic Focus: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance*).

17 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2 63-64 (Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Towards IRS Options for Fulfilling Common Taxpayer Service Needs*).

18 National Taxpayer Advocate 2009 Annual Report to Congress 110 (Most Serious Problem: *Beyond EITC: The Needs of Low Income Taxpayers Are Not Being Adequately Met*).

19 National Taxpayer Advocate Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 44-45 (Continue to Limit the IRS's Use of "Math Error Authority" to Clear-cut Categories Specified by Statute) (Dec. 2017); National Taxpayer Advocate 2014 Annual Report to Congress 163-171 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*).

20 *Id.*

21 National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 114-144 (Research Study: *Math Errors Committed on Individual Tax Returns: A Review of Math Errors Issued for Claimed Dependents*).

22 *Id.* at 120.

23 National Taxpayer Advocate 2011 Annual Report to Congress 524-530 (Legislative Recommendation: *Mandate That the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights*).

24 National Taxpayer Advocate 2017 Annual Report to Congress 299-306 (Legislative Recommendation: *Collection Due Process and Innocent Spouse Notices: Amend IRC §§ 6320, 6330, and 6015 to Require That IRS Notices Sent to Taxpayers Include a Specific Date by Which Taxpayers Must File Their Tax Court Petitions, and Provide That a Petition Filed by Such Specified Date Will Be Treated As Timely*).

position heard, and to challenge the IRS's actions in Appeals or the Tax Court. All this could result in the IRS wrongfully levying the taxpayers' wages and bank accounts, seizing their home, or prohibiting their freedom to travel internationally.

A literature review in this year's Annual Report to Congress examines the available research on the psychological, cognitive, and behavioral science insights behind effective notice design.²⁵ The IRS should use these insights, such as writing notices in plain language and designing notices to effectively lay out the steps taxpayers must take to complete necessary actions to protect their rights. The IRS should also prominently include important information, such as deadlines and the rights taxpayers have and can lose by not responding in time. This information needs to be highlighted to draw taxpayers' attention and ensure that taxpayers will timely take appropriate action. However, the IRS must be mindful not to use these insights to the detriment of taxpayers, for example, by using behavioral techniques to influence taxpayers to pay tax bills that they cannot afford to pay and are not required to pay if they are eligible for Currently Not Collectible (CNC-hardship) status.²⁶

Most Serious Problems

In the three Most Serious Problems that follow, the National Taxpayer Advocate expresses concerns about IRS notices that fail to adequately inform taxpayers about their rights, responsibilities, and procedural requirements. The National Taxpayer Advocate also makes suggestions for notice redesign based on how taxpayers best perceive and comprehend written information.²⁷

With respect to notice design, the Most Serious Problems described below are detailed in the following pages:

- **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;*
- **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;* and
- **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.*

25 Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

26 National Taxpayer Advocate 2016 Annual Report to Congress vol. 2 54, 60 (Research Study: *The Importance of Financial Analysis in Installment Agreements (IAs) in Minimizing Defaults and Preventing Future Payment Noncompliance*).

27 See 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, 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*; 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*.

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****RESPONSIBLE OFFICIALS**

Ken Corbin, Commissioner, Wage and Investment Division

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

Math error authority was originally intended to give the IRS the ability to summarily correct mistakes that could be fixed just by looking at the face of a taxpayer's return.² At the IRS's behest, Congress has since expanded the definition of math error to include a host of other items.³ Concerned with the consequences to taxpayer rights from the expansion of math error authority, Congress directed that, when the IRS makes an adjustment to a taxpayer's return, it must give an explanation of the adjustment.⁴ The explanation of the adjustment in the math error notice is critical to the taxpayer's ability to challenge the adjustment and preserve the right to petition the United States Tax Court (Tax Court), before paying the tax, by timely requesting abatement.⁵ In calendar years (CYs) 2015-2017, the IRS issued approximately two million math error notices each year.⁶ However, the IRS does not track the abatement rates of math errors.⁷

Despite the congressional directive, math error notices, sent to explain the math error adjustments the IRS made to the taxpayer's return, remain confusing and lack clarity. The National Taxpayer Advocate

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 The Revenue Act of 1926, Pub. L. 69-20 § 274(f) (1926) (codified at IRC §§ 6213(b), (g)).

3 See IRC § 6213(g) (lists all current definitions of mathematical or clerical errors).

4 S. REP. No. 94-938, at 375 (1976); H. REP. No. at 289 (1976).

5 IRC § 6213(b).

6 IRS response to TAS information request (Aug. 22, 2018) (number of math error notices issued from 2015-2017 (2015: 1,953,360; 2016: 1,851,621; 2017: 2,318,399)).

7 IRS response to TAS information request (Aug. 22, 2018).

has expressed concerns about the lack of clarity in math error notices since her 2004 Annual Report to Congress.⁸ Although the IRS has improved its explanations on some math error notices, in many cases the notices remain unclear and complex. 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. Further, because the IRS does not measure the reversal rates of math error assessments,⁹ it has no way of knowing the extent to which it is issuing accurate assessments and forgoes valuable data that could be used to identify which math error notices should be revised for additional clarity.

As a result, the National Taxpayer Advocate remains concerned that:

- The IRS is using its math error authority to summarily resolve increasingly complex issues that go beyond those considered by and allowed by Congress.
- Confusing math error notices affect millions of taxpayers a year and the IRS does not measure math error abatement rates to determine which notices need revisions due to high reversal rates.
- Despite revisions, many math error notices continue to inadequately inform taxpayers of their appeal rights, the consequences of inaction, and the specific nature of the purported error.
- The IRS has failed to use historical data to make simple corrections to taxpayer returns, and instead issues summary assessments and math error notices that are later abated.

ANALYSIS OF PROBLEM

Background

The IRS must generally issue a statutory notice of deficiency (SNOD) before assessing tax adjustments on taxpayers who had errors on their tax returns, which led to them paying less tax than they owed.¹⁰ This notice of deficiency gives taxpayers 90 days to petition the Tax Court for a judicial review of an IRS assessment before paying the tax.¹¹ However, the IRS has the authority to assess a tax for mathematical errors (*e.g.*, $2 + 2 = 5$) or clerical errors (*e.g.*, writing 12 for an entry on the return instead of 21, or leaving an entry blank).¹² This means that, unless taxpayers request an abatement (a reduction or elimination of the deficiency the IRS claims the taxpayer owes) within 60 days from the date on the math error notice, the IRS may proceed with collection of the tax without issuing a SNOD under the normal deficiency procedure.¹³ In other words, a SNOD is the ticket to the Tax Court; if taxpayers do not request an abatement when they receive a math error notice, they do not receive that ticket.

The IRS Is Using its Math Error Authority to Summarily Resolve Increasingly Complex Issues That Go Beyond Those Considered by and Allowed by Congress

In 1976, Congress set new rules around the IRS's math error authority, expanding the errors the IRS could summarily assess to include "clerical errors."¹⁴ Congress sought to improve taxpayer rights around

⁸ See National Taxpayer Advocate 2014 Annual Report to Congress 163-171; National Taxpayer Advocate 2011 Annual Report to Congress 74-92; National Taxpayer Advocate 2011 Annual Report to Congress 524-530; National Taxpayer Advocate 2004 Annual Report to Congress 163-179.

⁹ IRS response to TAS information request (Aug. 22, 2018).

¹⁰ IRC § 6213(a).

¹¹ *Id.*

¹² IRC §§ 6213(b), (g).

¹³ IRC § 6213(b)(2)(A).

¹⁴ Tax Reform Act of 1976, Pub. L. 94-455.

math errors, providing abatement remedies for taxpayers to contest math errors before paying the tax and that the taxpayer “must be given an explanation of the asserted error.”¹⁵ Congress, concerned with the IRS’s use of math error authority where its use was not authorized by statute, also sought to clarify limits to the IRS’s authority, noting that the summary assessment procedure should not be used to merely resolve an uncertainty against the taxpayer.¹⁶ Congress provided extensive examples describing how it envisioned the IRS’s expanded summary assessment authority to work. For instance:

[L]ine 6b of the Form 1040 requires the taxpayer to list, “First names of your dependent children who lived with you” and then to enter the number of those dependent children in a column for personal exemptions. If a taxpayer lists three names on line 6b but then enters “4” in the column, it is not clear whether the taxpayer miscounted (in which case the taxpayer should have written “3” in the column), or whether the taxpayer erroneously omitted the name of one of the dependent children (in which case the taxpayer’s column-entry of “4” would be correct). In this case, the Service should, of course, take steps to determine which entry is correct, and the taxpayer has the obligation of showing that he or she is entitled to the number of exemptions claimed. However, this summary assessment procedure is not to be used where the Service is merely resolving an uncertainty against the taxpayer.¹⁷

Despite this congressional direction, the IRS’s use of math error authority to summarily resolve increasingly complex issues goes beyond those considered by and allowed by Congress.¹⁸ If the IRS uses its math error authority to address these more complex issues that may require additional fact-finding, like correctable error and post-processing, the IRS’s assessments are more likely to be erroneous.¹⁹ Notice unclarity and shorter math error deadlines, along with the expansion of math error authority, increases the risk of incorrect assessments and erosion of taxpayer rights, such as *the right to be informed*, *the right to pay no more than the correct amount of tax*, and *the right to appeal an IRS decision in an independent forum*. Despite this, the Department of Treasury has encouraged the expansion of IRS math error authority because it is cost efficient and simpler than regular deficiency procedures.²⁰

15 General Explanation of the Tax Reform Act of 1976, 94th Cong., 2d Sess., 372 (1976).

16 *Id.*

17 *Id.*

18 For a discussion on the IRS’s expanded use of math error authority for “correctable errors,” see Nina E. Olson, *Why Correctable Error Authority Raises Significant Taxpayer Rights Concerns – Part 1*, NTA BLOG (Aug. 9, 2017), <https://taxpayeradvocate.irs.gov/news/why-correctable-authority-error-raises-significant-taxpayer-rights-concerns-part-1>; Nina E. Olson, *Correctable Error Authority Part 2: Why Correctable Error Authority Creates More Problems Than It Resolves*, NTA BLOG (Aug. 16, 2017), <https://taxpayeradvocate.irs.gov/news/correctable-error-authority-part-2-why-correctable-error-authority-creates-more-problems-than-it-resolves?category=Tax%20News>. For a discussion on the IRS’s use of post-processing with math errors, see Most Serious Problem: *Post-Processing Math Error Authority: The IRS Has Failed to Exercise Self-Restraint in Its Use of Math Error Authority, Thereby Harming Taxpayers*, *supra*.

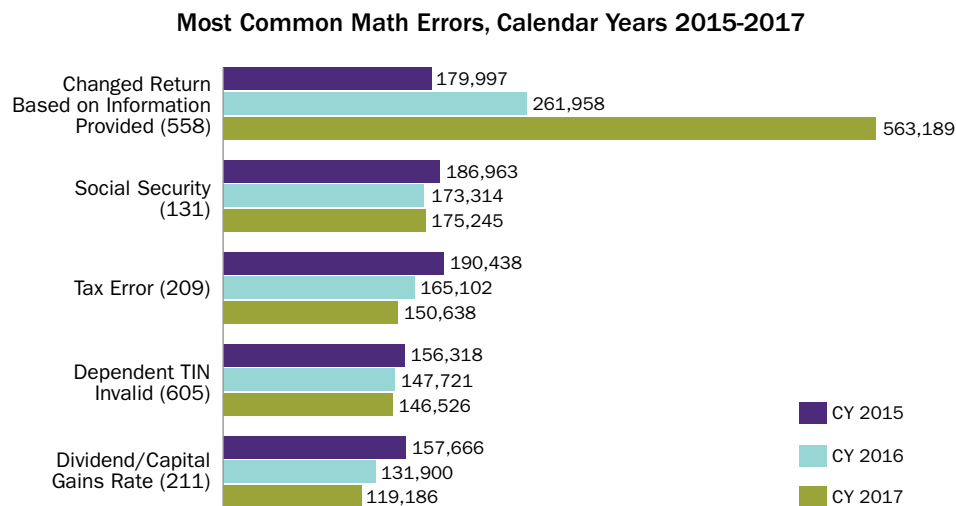
19 See National Taxpayer Advocate Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 44-45 (Continue to Limit the IRS’s Use of “Math Error Authority” to Clear-cut Categories Specified by Statute)* (Dec. 2017); National Taxpayer Advocate 2014 Annual Report to Congress 163-171 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*).

20 Department of the Treasury, *General Explanations of the Administration’s Fiscal Year 2017 Revenue Proposals*, 225-226 (Feb. 2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2017.pdf>. See also National Taxpayer Advocate Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 44-45 (Continue to Limit the IRS’s Use of “Math Error Authority” to Clear-cut Categories Specified by Statute)* (Dec. 2017).

The IRS Use of Math Error Authority Affects Millions of Taxpayers Annually, and Confusing Notices May Disproportionately Affect Low Income Taxpayers

For CYs 2015-2017, the IRS issued approximately two million math error notices each year.²¹ Figure 1.12.1 shows the five most common types of math error notices the IRS issued in CYs 2015-2017.²² In addition to these standard notices, the IRS issued around 20,000 non-standard math error notices annually over the same three-year period.²³

FIGURE 1.12.1²⁴



Math error notices lacking in clarity may disproportionately harm low income taxpayers who more often have limited English proficiency, limited computer access, lower literacy rates, lower education levels, and disabilities.²⁵ Some math error notices may especially affect low income taxpayers. For example, the median income of those with Earned Income Credit (EIC) and Individual Taxpayer Identification Number (ITIN) math errors is lower than for other common math errors.

21 IRS response to TAS information request (Aug. 22, 2018) (number of math error notices issued from 2015-17 (2015: 1,953,360; 2016: 1,851,621; 2017: 2,318,399)).

22 IRS response to TAS information request (Aug. 22, 2018). The five most common math error notices issued from 2015-2017 were, by taxpayer notice code (TPNC): TPNC 558 (We changed the refund amount or the amount you owe on your tax return based on the information you provided in response to our previous correspondence); TPNC 131 (We changed the amount of taxable social security benefits on page 1 of your tax return because there was an error in the computation of the taxable amount); TPNC 209 (We changed the amount of tax shown on your return. The amount entered was incorrect based on your taxable income and filing status); TPNC 605 (Each dependent listed on your tax return must have a valid Social Security number (SSN) or Individual Taxpayer Identification Number (ITIN). For one or more of your dependents the last name doesn't match our records or the records provided by the Social Security Administration...); TPNC 211 (We changed the amount of tax shown on your return. The tax rates on Qualified Dividends and Capital Gains are generally lower than the standard rates. It appears your tax was not computed using these rates or the amount of tax was computed incorrectly).

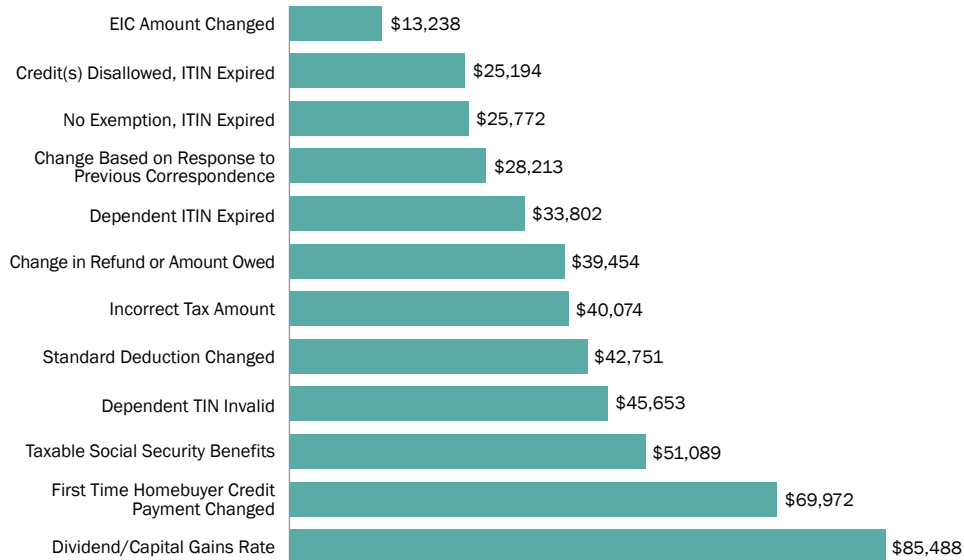
23 IRS response to TAS information request (Aug. 22, 2018) (Nonstandard notices are those errors not assigned a TPNC, and the IRS must write these notices individually depending on the circumstances. From calendar years (CY) 2015-2017, the IRS issued 58,792 nonstandard math error notices; 2015: 16,232; 2016: 23,925; 2017: 18,635).

24 *Id.* We are uncertain of the exact reason for the TPNC 558 spike between CYs 2016 and 2017, but it may have been caused by the IRS using TPNC 558 for a temporary tax issue instead of creating a new code and reprogramming its notices for a short-term issue.

25 National Taxpayer Advocate 2009 Annual Report to Congress 110 (Most Serious Problem: *Beyond EITC: The Needs of Low Income Taxpayers Are Not Being Adequately Met*).

FIGURE 1.12.2²⁶

Median Income by Selected Math Errors, Calendar Year 2017



ME Code	Description	Median TPI	Count
285	EIC Amount Changed	\$13,238	75,957
817	Credit(s) Disallowed, ITIN Expired	\$25,194	75,199
642	No Exemption, ITIN Expired	\$25,772	70,021
558	Change Based on Response to Previous Correspondence	\$28,213	556,113
644	Dependent ITIN Expired	\$33,802	80,426
299	Change in Refund or Amount Owed	\$39,454	87,025
209	Incorrect Tax Amount	\$40,074	153,058
192	Standard Deduction Changed	\$42,751	80,263
605	Dependent TIN Invalid	\$45,653	144,263
131	Taxable Social Security Benefits	\$51,089	181,298
649	First-Time Homebuyer Credit Payment Changed	\$69,972	50,967
211	Dividend/Capital Gains Rate	\$85,488	131,871

However, when TAS asked the IRS directly if it tracks or reports the income demographics for various math error notice recipients, the IRS replied that it, “does not track, report, or collect this data,” which keeps the IRS from making adjustments to its notices based on income demographics.²⁷ The IRS Office

26 Calculation by TAS Research. Median Total Positive Income and counts for taxpayers with presence of Taxpayer Notice Codes, CY 2017. IRS, Compliance Data Warehouse (CDW), Individual Returns Transaction File (IRTF) (data retrieved Oct. 30, 2018).

27 IRS response to TAS information request (Aug. 22, 2018).

of Chief Counsel is given an opportunity to review each math error notice revision and taxpayer notice code (TPNC) language for legal sufficiency,²⁸ although legally sufficient notices may still lack clarity and be difficult for taxpayers, especially low income taxpayers, to understand.

The IRS Conducts Math Error Notice Revisions Piecemeal, and Math Error Notices Continue to Lack Clarity, Despite Revisions

Below are two examples of math error notices that lack clarity and do not ensure that taxpayer rights are being adequately protected. Example 1 discusses a TPNC, a standard math error explanation coded into notices and sent to taxpayers.²⁹ Example 2 discusses the entirety of a math error notice, the CP11.

Example 1: “We changed the refund amount or the amount you owe on your tax return based on the information you provided in response to our previous correspondence.”³⁰

A notice with this TPNC is sent to taxpayers after the IRS has already contacted the taxpayer for additional information and the taxpayer has responded. The letter requesting additional information for processing is the 12C letter, on which TPNC 558 is sometimes included.³¹ Math error notices have a standard layout and the IRS inserts pre-worded paragraphs into certain parts of the notices that fit the circumstances of the taxpayer. If the IRS made a change to a taxpayer’s return based on information the taxpayer provided previously, the taxpayer is sent a notice with this TPNC explanation. However, this explanation lacks clarity and specificity. It does not explicitly describe the issue. Neither does it detail what correspondence the notice is referring to. This provides little clarity when a taxpayer may have had more than one correspondence with the IRS, especially if the taxpayer had multiple questionable items on their tax return. What if the taxpayer made several calls to the IRS, or sent several letters? What specific piece of information is the IRS referring to? The TPNC does not explain whether the IRS accepted or rejected the information the taxpayer provided.

While some notices do cite the line on the return that the IRS changed,³² they often provide an inadequate explanation to the taxpayer of the full nature of the issue with his or her return or previous correspondence. As noted earlier, when Congress expanded summary assessment authority for math errors in 1976, it explicitly instructed the IRS that “the taxpayer must be given an explanation of the asserted error.”³³ Congress also provided examples describing how it envisioned the IRS’s expanded summary assessment authority would work.³⁴ Thus, to be consistent with the examples in the legislative history, the IRS should cite the specific issues and correspondence it is referring to, along with the line numbers and description of what was adjusted, and the amount of increase or decrease in taxable income and tax.

The IRS has recently revised some math error notices (*e.g.*, the CP11). While we commend the IRS for these efforts, the newly revised notices still lack clarity in some areas and can be further improved.

28 IRS response to TAS information request (Aug. 22, 2018).

29 See Internal Revenue Manual (IRM) 3.12.220.1.24 (Jan. 1, 2016).

30 TPNC 558.


31 IRS, Letter 12C, *Individual Return Incomplete for Processing: Forms 1040, 1040A or 1040EZ* (Jan. 2, 2018).

32 For example, IRS, Letter 12C, *Individual Return Incomplete for Processing: Forms 1040, 1040A or 1040EZ* (Jan. 2, 2018).

33 General Explanation of the Tax Reform Act of 1976, 94th Cong., 2d Sess., 372 (1976).

34 See General Explanation of the Tax Reform Act of 1976, 94th Cong., 2d Sess., 372-374 (1976) (for the examples Congress gave on how to handle math error issues for arithmetic errors, use of tables, inconsistent entries, omissions of supporting schedules, and exceeding statutory limits).

FIGURE 1.12.3, Example 2: The 2017 and 2018 CP11 (“Math Error Balance Due of \$5 or More”)



Department of the Treasury
Internal Revenue Service

Changes to your 2015 Form 1040

Amount due: [REDACTED]

We found a miscalculation on your 2015 Form 1040, which affects the following area of your return:

- Tax Computation

We changed your return to correct this error. As a result, you owe [REDACTED]

What you need to do immediately

Includes due by date, but not loss of prepayment appeal date.

Payment

INTERNAL REVENUE SERVICE

Notice	CP11
Tax Year	2015
Notice date	February 20, 2017
Social Security number	[REDACTED]
To contact us	1-800-829-0922
Page 1 of 5	[REDACTED]

Included due date for payment, but nothing for 60day appeal deadline.

Billing Summary

Tax you owed	[REDACTED]
Payments you made	[REDACTED]
Failure-to-file penalty	[REDACTED]
Failure-to-pay penalty	[REDACTED]
Interest charges	[REDACTED]
Amount due by March 13, 2017	[REDACTED]

Review this notice, and compare our changes to the information on your tax return.

If you agree with the changes we made

- Pay the amount due of [REDACTED] by March 13, 2017, to avoid additional penalty and interest charges.

Continued on back...

Notice	CP11
Notice date	February 20, 2017
Social Security number	[REDACTED]

- Make your check or money order payable to the United States Treasury.
- Write your Social Security number [REDACTED] the tax year (2015), and the form number (1040) on your payment and any correspondence.

Amount due by March 13, 2017 [REDACTED]



Notice	CP11
Tax Year	2015
Notice date	February 20, 2017
Social Security number	[REDACTED]
Page 2 of 5	

What you need to do immediately — continued

If you agree with the changes we made — continued

- Pay online or mail a check or money order with the attached payment stub. **You can pay online now at www.irs.gov/payments.**

No information about appeal rights or the 60-day deadline.



If you disagree with the amount due

- Call us at 1-800-829-0922 to review your account with a representative. Be sure to have your account information available when you call.

We'll assume you agree with the information in this notice if we don't hear from you.

Payment options

Pay now electronically

We offer free payment options to securely pay your tax bill directly from your checking or savings account. When you pay online or with your mobile device, you can:

- Receive instant confirmation of your payment
- Schedule payments in advance
- Reschedule or cancel a payment before the due date

You can also pay by debit or credit card for a small fee. To see all of our payment options, visit www.irs.gov/payments.

Payment plans

If you can't pay the full amount you owe, pay as much as you can now and make arrangements to pay your remaining balance. Visit www.irs.gov/paymentplan for more information on installment agreements and online payment agreements. You can also call us at 1-800-829-0922 to discuss your options.

Offer in Compromise

An offer in compromise allows you to settle your tax debt for less than the full amount you owe. If we accept your offer, you can pay with either a lump sum cash payment plan or periodic payment plan. To see if you qualify, use the Offer in Compromise Pre-Qualifier tool on our website. For more information, visit www.irs.gov/offers.

The explanation of the error is not provided until page 3, instead of on page 1 as a vital piece of information, which studies show will make it less likely taxpayers will read it.

CP11
Tax Year 2015
Notice date February 30, 2017
Social Security number
Page 3 of 5

Payment options – continued

Account balance and payment history

For information on how to obtain your current account balance or payment history, go to www.irs.gov/balancedue.

If you already paid your balance in full within the past 21 days or made payment arrangements, please disregard this notice.

If you think we made a mistake, call 1-800-829-0922 to review your account.

If we don't hear from you

- Pay by March 13, 2017, to avoid penalty and interest charges.

Changes to your 2015 tax return

Information was changed because of the following:

- We changed the refund amount or the amount you owe on your tax return because the amount entered on your tax return was computed incorrectly.

Your tax calculations

Description	Amount
Adjusted gross income, line 37	
Taxable income, line 43	
Total tax, line 63	

Your payments and credits

Description	Amount
Income tax withheld, line 64	
Estimated tax payments, line 65	
Other credits, lines 66a, 67-73	
Other payments	
Total payments and credits	

The notice now includes the lines on the return where the errors occurred, which assists with taxpayer understanding.

Penalties

We are required by law to charge any applicable penalties.

Failure-to-file

Description	Amount
Total failure-to-file	

We assess a 5% monthly penalty for filing your return late for each month or part of a month the return is late, for up to 5 months. When a penalty for paying late applies for the same month, the amount of the penalty for filing late for that month is reduced by the amount of the penalty for paying late for that month. The penalty for paying late is 1/2% for each month or part of a month. We base the monthly penalty for filing late on the tax required to be shown on the return that you didn't pay by the original return due date, without regard to extensions. We base the monthly penalty for paying late on the net unpaid tax at the beginning of each penalty month following the payment due date for that tax. When an income tax return is more than 60 days late, the minimum penalty is \$205 or 100% of the tax required to be shown on the return that you didn't pay on time, whichever is less. (Internal Revenue Code section 6651)

Failure-to-pay

Date received	Months late	Unpaid amount	Penalty rate	Amount

Notice CP11
 Tax Year 2015
 Notice date February 20, 2017
 Social Security number [REDACTED]
 Page 4 of 5

Total failure-to-pay

We assess a 1/2% monthly penalty for not paying the tax you owe by the due date. We base the monthly penalty for paying late on the net unpaid tax at the beginning of each penalty month following the payment due date for that tax. This penalty applies even if you filed the return on time. We charge the penalty for each month or part of a month the payment is late; however, the penalty can't be more than 25% in total.

- The due date for payment of the tax shown on a return generally is the return due date, without regard to extensions.
- The due date for paying increases in tax is within 21 days of the date of our notice demanding payment (10 business days if the amount in the notice is \$100,000 or more).

If we issue a Notice of Intent to Levy and you don't pay the balance due within 10 days of the date of the notice, the penalty for paying late increases to 1% per month. For individuals who filed on time, the penalty decreases to 1/4% per month while an approved installment agreement with the IRS is in effect for payment of that tax. (Internal Revenue Code section 6651)

Removal or reduction of penalties

We understand that circumstances - such as economic hardship, a family member's death, or loss of financial records due to natural disaster - may make it difficult for you to meet your taxpayer responsibility in a timely manner.

If you would like us to consider removing or reducing any of your penalty charges, please do the following:

- Identify which penalty charges you would like us to reconsider (e.g., 2005 late filing penalty).
- For each penalty charge, explain why you believe it should be reconsidered.
- Sign your statement, and mail it to us.



We will review your statement and let you know whether we accept your explanation as reasonable cause to reduce or remove the penalty charge(s).

Removal of penalties due to erroneous written advice from the IRS

If you were penalized based on written advice from the IRS, we will remove the penalty if you meet the following criteria:

- If you asked the IRS for written advice on a specific issue.
- You gave us complete and accurate information.
- You received written advice from us.
- You relied on our written advice and were penalized based on that advice.

To request removal of penalties based on erroneous written advice from us, submit a completed Claim for Refund and Request for Abatement (Form 843) to the IRS service center where you filed your tax return. For a copy of the form or to find your IRS service center, go to www.irs.gov or call 1-800-829-0922.


Notice CP11
Tax Year 2015
Notice date February 20, 2017
Social Security number 
 Page 5 of 5

Interest charges

We are required by law to charge interest when you do not pay your liability on time. Generally, we calculate interest from the due date of your return (regardless of extensions) until you pay the amount you owe in full, including accrued interest and any penalty charges. Interest on some penalties accrues from the date we notify you of the penalty until it is paid in full. Interest on other penalties, such as failure to file a tax return, starts from the due date or extended due date of the return. Interest rates are variable and may change quarterly. (Internal Revenue Code section 6601)

Period	Days	Interest rate	Interest factor	Amount due	Interest charge
					

We multiply your unpaid tax, penalties, and interest (the amount due) by the interest rate factor to determine the interest due.

Additional information

- Visit www.irs.gov/cp11
 - You may find the following publications helpful:
 - Publication 1, Your Rights as a Taxpayer
 - Publication 594, The Collection Process
 - For tax forms, instructions, and publications, visit www.irs.gov or call 1-800-TAX-FORM (1-800-829-3676).
 - Did you e-file your tax return? Electronically filed returns are less likely to have math errors resulting in notices such as this one. It's free to file your taxes electronically. Go to www.irs.gov/efile for information and instructions.
 - Paying online is convenient, secure, and ensures timely receipt of your payment. To pay your taxes online or for more information, go to www.irs.gov/payments.
 - You can contact us by mail at the address at the top of this notice. Be sure to include your social security number, the tax year, and the form number you are writing about.
 - Keep this notice for your records.
- If you need assistance, please don't hesitate to contact us.

Nothing about right to appeal. No mention of TAS or LITCs, unlike 2018 CP11.





Department of the Treasury
Internal Revenue Service
Atlanta, GA 39901-0010

[Redacted]

Notice	CP11
Tax year	2017
Notice date	February 24, 2018
Social security number	nnn-nn-nnnn
To contact us	Phone 1-NNN-NNN-NNNN
Your caller ID	nnnn

Page 1 of 7

Changes to your 2017 Form 1040

Amount due: \$362.73

We found miscalculations on your 2017 Form 1040, which affect the following areas of your return:

- Child Tax Credit
- Earned Income Tax Credit

We changed your return to correct these errors. As a result, you owe \$362.73.

Billing Summary

Tax you owed	\$1,828.00
Shared responsibility payment	2.00
Payments you made	-1,624.00
Failure-to-file penalty	135.00
Interest charges	21.73
Amount due by March 16, 2018	\$362.73

What you need to do immediately

Large, bold font on first page draws attention to need to pay.

Review this notice and compare our changes to the information on your tax return

If you agree with the changes we made

- Pay the amount due of \$362.73 by March 16, 2018, to avoid additional penalty and interest charges.
- Pay online or mail a check or money order with the attached payment stub. **You can pay online now at www.irs.gov/payments.**

Continued on back...



Actual deadline date for payment is included, but no mention of 60-day deadline to request abatement.

[Redacted]

Notice	CP11
Notice date	February 24, 2018
Social security number	nnn-nn-nnnn

Payment

- Make your check or money order payable to the United States Treasury.
- Write your social security number (nnn-nn-nnnn), the tax year (2017), and the form number (1040) on your payment.

INTERNAL REVENUE SERVICE
AUSTIN, TX 73301-0023
s018999546711s

Amount due by March 16, 2018

\$362.73

0000 0000000 00000000000 00000000 0000

First page is designed like a bill, with amount due and due by date before any mention of appeal rights or deadlines.

Smaller font and non-bold, deemphasizes this section on appeal rights compared to the "if you agree" and payment information above.

Notice CP11
Tax year 2017
Notice date February 24, 2018
Social security number nnn-nn-nnnn
Page 2 of 7

What you need to do immediately – continued

If you disagree with the amount due

Call us at [1-800-xxx-xxxx] to review your account with a representative. Be sure to have your account information available when you call.

Though 60 days mentioned, does not include the actual deadline date like "amount due by" on page 1.

- If you contact us in writing within 60 days of the date of this notice, we will reverse the change we made to your account. However, if you are unable to provide us additional information that justifies the reversal and we believe the reversal is in error, we will forward your case for audit. This step gives you formal appeal rights, including the right to appeal our decision in court before you have to pay the additional tax. After we forward your case, the audit staff will contact you within 5 to 6 weeks to fully explain the audit process and your rights. If you do not contact us within the 60-day period, you will lose your right to appeal our decision before payment of tax.

Improvement from previous math error notices by including the taxpayer's appeal rights and 60-day deadline.

- If you do not contact us within 60 days, the change will not be reversed and you must pay the additional tax. You may then file a claim for refund. You must submit the claim within 3 years of the date you filed the tax return, or within 2 years of the date of your last payment for this tax.

We'll assume you agree with the information in this notice if we don't hear from you.

[Back of payment stub]

Appeal rights are on page 2 of a 7-page notice, and research shows that many people do not even read the second page. Such important information should be on the first page.

Payment options are included and emphasized before the notice explains the specific nature of the math error.



Notice CP11
Tax year 2017
Notice date February 24, 2018
Social security number nnn-nn-nnnn
 Page 3 of 7

Payment options

Pay now electronically

We offer free payment options to securely pay your tax bill directly from your checking or savings account. When you pay online or with your mobile device, you can:

- Receive instant confirmation of your payment
- Schedule payments in advance
- Reschedule or cancel a payment before the due date

You can also pay by debit or credit card for a small fee. To see all of our payment options, visit www.irs.gov/payments.

Payment plans

If you can't pay the full amount you owe, pay as much as you can now and make arrangements to pay your remaining balance. Visit www.irs.gov/paymentplan for more information on installment agreements and online payment agreements. You can also call us at 1-800-829-8374 to discuss your options.

Offer in Compromise

An offer in compromise allows you to settle your tax debt for less than the full amount you owe. If we accept your offer, you can pay with either a lump sum cash payment plan or periodic payment plan. To see if you qualify, use the Offer in Compromise Pre-Qualifier tool on our website. For more information, visit www.irs.gov/offers.

Account balance and payment history

For information on how to obtain your current account balance or payment history, go to www.irs.gov/payments.

If you already paid your balance in full within the past 21 days or made payment arrangements, please disregard this notice.

If you think we made a mistake, call 1-800-829-8374 to review your account.

If we don't hear from you

Pay \$362.73 by March 16, 2018, to avoid additional penalty and interest charges.

Explanation of error does not appear until page 4. Taxpayers must read through many pages to find this critical information. Appeal rights come before, but the error the taxpayer may appeal does not appear until this page. Most people won't even read this far.

Notice CP11
Tax year 2017
Notice date February 24, 2018
Social security number nnn-nn-nnnn
Page 4 of 7

Changes to your 2017 tax return

Was it one? Was it more than one? What is the age limitation? More specific information should be included so that the taxpayer will know if the adjustment was correct and the nature of the error.

We changed your information because:

- We didn't allow part or all of your child tax credit and/or additional child tax credit on page 2 of your tax return. One or more of your children exceeds the age limitation
- We changed the amount claimed as Earned Income Credit (EIC) on your tax return. The amount claimed as EIC was figured or entered incorrectly on your tax return.

Your tax calculations

Including the line number and the differences in calculations is an improvement over previous notices.

Description	Your calculation	IRS calculation
Adjusted gross income, line 37	\$13,829.00	\$13,829.00
Taxable income, line 43	\$0.00	\$0.00
Shared responsibility payment	\$0.00	\$2.00
Total tax, line 63	\$1,828.00	\$1,828.00

Your payments and credits

Description	IRS calculations
Income tax withheld, line 64	\$0
Estimated tax payments, line 65	0
Other credits, line 66	1,624.00
Other payments line 74	0
Total payments and credits	\$1,624.00

Penalties

We are required by law to charge any applicable penalties

Failure-to-file

Description	Amount
Total failure-to-file	\$135.00

We assess a 5% monthly penalty for filing your return late for each month or part of a month the return is late, for up to 5 months.

When a penalty for paying late applies for the same month, the amount of the penalty for filing late for that month is reduced by the amount of the penalty for paying late for that month. The penalty for paying late is ½% for each month or part of a month.

We base the monthly penalty for filing late on the tax required to be shown on the return that you didn't pay by the original return due date, without regard to extensions. We base the monthly penalty for paying late on the net unpaid tax at the beginning of each penalty month following the payment due date for that tax.

When an income tax return is more than 60 days late, the minimum penalty is \$210 or 100% of the tax required to be shown on the return that you didn't pay on time, whichever is less.

(Internal Revenue Code Section 6651)

Notice	CP11
Tax year	2017
Notice date	February 24, 2018
Social security number	nnn-nn-nnnn
Page 5 of 7	

Removal or reduction of penalties

We understand that circumstances—such as a serious illness or injury, a family member's death, or loss of financial records due to natural disaster—may make it difficult for you to meet your taxpayer responsibility in a timely manner.

We can generally process your request for penalty removal or reduction quicker if you contact us at the number listed above with the following information:

- Identify which penalty charges you would like us to reconsider (e.g., 2016 late filing penalty).
- For each penalty charge, explain why you believe it should be reconsidered.

If you write us, include a signed statement and supporting documentation for penalty abatement request.

We'll review your statement and let you know whether we accept your explanation as reasonable cause to reduce or remove the penalty charge(s).

Removal of penalties due to erroneous written advice from the IRS

If you were penalized based on written advice from the IRS, we will remove the penalty if you meet the following criteria:

- You wrote us asking for written advice on a specific issue
- You gave us adequate and accurate information
- You received written advice from us
- You reasonably relied on our written advice and were penalized based on that advice

To request removal of penalties based on erroneous written advice from us, submit a completed Claim for Refund and Request for Abatement (Form 843) to the address shown above. For a copy of the form, go to www.irs.gov or call 1-800-TAX-FORM (1-800-843-8374).

	Notice	CP11
	Tax year	2017
	Notice date	February 24, 2018
	Social security number	nnn-nn-nnnn
	Page 6 of 7	

Interest charges We are required by law to charge interest on unpaid tax from the date the tax return was due to the due date the tax is paid in full. The interest is charged as long as there is an unpaid amount due, including penalties, if applicable. (Internal Revenue Code section 6601)

Description	Amount
Total interest	\$21.73

The table below shows the rates used to calculate the interest on your unpaid amount due. For a detailed calculation of your interest, call 1-800-829-8374.

Period	Interest rate
Beginning October 1, 2017	3%

We multiply your unpaid tax, penalties, and interest (the amount due) by the interest rate factor to determine the interest due.

Additional interest charges If the amount you owe is \$100,000 or more, please make sure that we receive your payment within 10 work days from the date of your notice. If the amount you owe is less than \$100,000, please make sure that we receive your payment within 21 calendar days from the date of your notice. If we don't receive full payment within these time frames, the law requires us to charge interest until you pay the full amount you owe.

Notice CP11
Tax year 2017
Notice date February 24, 2018
Social security number nnn-nn-xxxx
Page 7 of 7

Additional information

Information about taxpayer rights is included, but it is relegated to the last page of the notice. This shows the importance the IRS places on taxpayer rights. Collection is on the first page, while rights are on the last.

- Visit www.irs.gov/cp11
- You may find the following publications helpful:
 - Publication 1, Your Rights as a Taxpayer
 - Publication 594, The Collection Process
- For tax forms, instructions, and publications, visit www.irs.gov/formspubs or call 1-800-TAX-FORM (1-800-829-3676).
- Did you e-file your tax return? Electronically filed returns are less likely to have math errors resulting in notices such as this one. It's free to file your taxes electronically. Go to www.irs.gov/efile for information and instructions.
- Paying online is convenient, secure, and ensures timely receipt of your payment. To pay your taxes online or for more information, go to www.irs.gov/payments.
- You can contact us by mail at the address at the top of the first page of this notice. Be sure to include your social security number and the tax year and form number you are writing about.
- Keep this notice for your records..

The IRS should be commended for including information about TAS and LITCs that can assist taxpayers with understanding the math error notice and their rights. However, this is on page 7. Taxpayers may learn of their right to appeal earlier in the notice, but dismiss it as too costly before reading this information.

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit www.taxpayeradvocate.irs.gov or call 1-877-777-4778.

Assistance can be obtained from individuals and organizations that are independent from the IRS. The Directory of Federal Tax Return Preparers with credentials recognized by the IRS can be found at <http://irs.treasury.gov/rpo/rpo.jsf>. IRS Publication 4134 provides a listing of Low Income Taxpayer Clinics (LITCs) and is available at www.irs.gov. Also, see the LITC page at www.taxpayeradvocate.irs.gov/litcmap. Assistance may also be available from a referral system operated by a state bar association, a state or local society of accountants or enrolled agents or another nonprofit tax professional organization. The decision to obtain assistance from any of these individuals and organizations will not result in the IRS giving preferential treatment in the handling of the issue, dispute or problem. You don't need to seek assistance to contact us. We will be pleased to deal with you directly and help you resolve your situation.

We're required to send a copy of this notice to both you and your spouse. Each copy contains the information you are authorized to receive. Please note: Only pay the amount due once.

- If you need assistance, please don't hesitate to contact us.

The new draft 2018 CP11 addresses some past TAS recommendations, such as including the exact tax return line where the math error occurred.³⁵ It also contains a portion on the taxpayer's rights, and reference to TAS and Low Income Taxpayer Clinics (LITC), including that they could assist the taxpayer, though this is buried on page seven of the notice.

Notwithstanding these somewhat positive changes, there are still several areas that could be improved to ensure clarity. For example, while the notice does include language advising that a taxpayer must contact the IRS to protest the change made within 60 days to retain the right to appeal pre-tax (which the 2017 CP11, currently in use, does not have), it does not include the date of the deadline itself. Including the date of the deadline would ensure that taxpayers are not confused about the date by which they must file to retain their appeal rights. Added clarity with a listed deadline date may be especially beneficial considering that the taxpayers in question may have made mathematical or clerical errors on their tax forms, so adding 60 days to the notice date may lead them to calculate an inaccurate filing date. This language should be on the first page to ensure taxpayers read it.

Another improvement that the IRS should make is with the placement of the proposed errors on the notice. The 2017 CP11 is five pages long and the 2018 CP11 is seven pages long, and neither discuss the specifics of the actual error committed by the taxpayer until the third and fourth page, respectively. Payment options are displayed before an explanation of the math error and the return line the error was committed on, emphasizing payment over the specifics of the proposed error. As discussed below, the way the forms are presented, and choices are displayed, impacts how taxpayers view and interpret the forms, potentially steering them away from exercising their rights to challenge the IRS's decision.³⁶

The way the forms are presented, and choices are displayed, impacts how taxpayers view and interpret the forms, potentially steering them away from exercising their rights to challenge the IRS's decision The structure of these notices actively discourages abatement requests and places obstacles into taxpayers' efforts to learn about and use their rights.

Further, with respect to the 2018 CP11, the taxpayer's appeal rights or deadlines are not mentioned on the first page, which is designed like a bill, prioritizing the amount owed and payment due date. The *right to challenge the IRS's position and be heard*, by requesting deficiency procedures, is de-emphasized. On the second page, the "what you need to do immediately" section is continued, in smaller and non-bold font, different than how it is on the first page. This, along with its placement on the second page, de-emphasizes the appeal rights section of the form, which contains a wall of text that taxpayers may merely scan over. The "what you need to do immediately—continued" heading should be similarly as big and bold as it is on the first page, and the appeal information should be broken down into more

35 See, e.g., National Taxpayer Advocate 2011 Annual Report to Congress 74-92 (Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*).

36 See, e.g., IRS, *Behavioral Insights Toolkit 21* (2017) (discussing "choice architecture," how the way choices are structured can influence a taxpayer's decision making); see Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

manageable segments³⁷ to ensure that taxpayers are drawn to the information about their appeal rights and read through it, ideally on the first page itself.

The explanation of the math error the taxpayer committed is on the fourth page, so, though they are informed of their appeal rights in the 2018 CP11, taxpayers don't know what to protest until page four of the notice. Taxpayers are not informed that they have rights or that they could qualify for free assistance until page seven of the notice. Few taxpayers are likely to read through these text-heavy seven pages to reach this important information. The structure of these notices actively discourages abatement requests and places obstacles into taxpayers' efforts to learn about and use their rights.

Compared to the 2017 CP11, the 2018 CP11 is better. However, the CP11 could still be further improved, as discussed below. If taxpayers do not understand that they can challenge the IRS's change to their return (and must do so within 60 days) because a notice is unclear, they may pay more tax than they owe. Unclear notices may also prevent taxpayers from understanding that they will lose the right to prepayment judicial review in Tax Court, before paying the assessment, if they don't respond to the math error notice by the 60-day deadline. Math error notices are not collection notices, they are notices to inform taxpayers that the IRS has made some adjustments to their tax return and assessed a tax against them. These notices must inform taxpayers that they have the right to dispute the assessed tax within 60 days, which will give them an opportunity to petition the Tax Court. They must also inform taxpayers that there are resources available to help them, namely TAS and LITCs. All this important information should be on the first page of the notice. Also on the first page, the IRS can include language that, if the taxpayer agrees with the change, information on how to pay is available on the next page of the notice. This informs taxpayers of their rights and deadlines and directs them through the necessary steps of the math error process.

In its response to the National Taxpayer Advocate's 2014 Math Error Notice Most Serious Problem recommendations, the IRS decided to not take action recommended by the National Taxpayer Advocate to organize a team, which would include TAS, to review all current explanations of math error adjustments, and rewrite, where necessary, to ensure that the congressional directive for clarity is met.³⁸ The IRS instead cited its own process to create and revise taxpayer correspondence as sufficient. The IRS did take action on creating IRM guidelines for crafting math error explanations that do not have an applicable TPNC (non-standard notices).³⁹ The IRS postponed action on updating math error notices to clearly disclose that taxpayers may request abatement without providing an explanation or substantiating documentation until "resources will allow."⁴⁰

The IRS has not conducted any studies to explore math error notice clarity in the past five years.⁴¹ TAS requested that the IRS measure the abatement rates for math error assessments by notice number or TPNC in 2011.⁴² The IRS has not developed a system to measure math error reversal rates for math

37 See Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights* (discussing the psychological concept of "chunking," that the human brain can only consciously retain roughly four chunks of different information at one time), *infra*.

38 National Taxpayer Advocate Fiscal Year (FY) 2016 Objectives Report to Congress vol. 2 58-60 (IRS and TAS Responses: Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making it Difficult for Taxpayers to Understand and Exercise Their Rights*).

39 *Id.*

40 *Id.*

41 IRS response to TAS information request (Aug. 22, 2018).

42 See National Taxpayer Advocate 2011 Annual Report to Congress 74-92 (Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*).

The IRS has not developed a system to measure math error reversal rates for math error assessments by notice number or Taxpayer Notice Code (TPNC), which limits the ability of the IRS or TAS to analyze if there are problems with over-selection or clarity of particular math error notices.

error assessments by notice number or TPNC,⁴³ which limits the ability of the IRS or TAS to analyze if there are problems with over-selection or clarity of particular math error notices.

The IRS's Failure to Use Historical Data to Correct Taxpayer Returns Unnecessarily Burdens Taxpayers and Wastes IRS Resources

The IRS places the burden on taxpayers for errors that the IRS could solve using internal data, instead of denying credits that taxpayers actually qualify for and using valuable IRS time and resources answering responses to math error notices that the IRS should not have sent.⁴⁴ For example, TAS found, in its 2011 study on math error authority and dependent TINs, that 55 percent of these types of errors were abated, and 56 percent of the abatements could have been identified by the IRS with internal data.⁴⁵ Additionally, a TAS study found that, in a sample of cases where taxpayers had a missing or incorrect dependent TIN math error and received no refund, 41 percent of the cases that received no adjustment could have been corrected, and all the refunds allowed, by the IRS examining its own records.⁴⁶ Another 11 percent of these cases could have been at least partially corrected by historical data.⁴⁷ This translates to more than 40,000 taxpayers who may have not received refunds that they were entitled to.⁴⁸ These taxpayers lost an average of \$1,274.⁴⁹

There is no legal prohibition against the IRS using historical data and making these types of corrections without burdening taxpayers with math error notices.⁵⁰ In fact, the IRS directs employees to perform research and make changes to perfect a taxpayer's return before contacting the taxpayer for additional information.⁵¹ The IRS could similarly direct its employees to search historical return information and make those changes that benefit taxpayers, such as correcting a dependent TIN to allow for a refund. The IRS should also measure abatement rates and review them to identify and correct potential math error problems like those it has had before.

43 IRS response to TAS information request (Aug. 22, 2018).

44 National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 114-144 (Research Study: *Math Errors Committed on Individual Tax Returns: A Review of Math Errors Issued for Claimed Dependents*).

45 *Id.* at 117.

46 *Id.* at 120.

47 *Id.*

48 *Id.*

49 *Id.*

50 Email from Division Counsel/Associate Chief Counsel (NTA Program) (Nov. 14, 2018) (on file with TAS).

51 See, e.g., IRM 3.12.3.4.3.3 (Jan. 1, 2019) (this IRM section instructs IRS employees to search the taxpayer's return and attachments, as well as perform Integrated Data Retrieval System (IDRS) research, to correct missing or incorrect TINs before contacting the taxpayer for additional information).

The IRS has stated that it reviews TPNC descriptive paragraphs annually.⁵² However, in reviewing the top ten most frequent math error notices TPNC descriptive paragraphs from CYs 2015-2017, there were no discernible changes in language.⁵³ As demonstrated by Example 1, these descriptive paragraphs remain confusing, using language that does not always clearly direct the taxpayer to the problem with their return.

New Laws and Research-Based TAS-Designed Notices Can Guide the IRS In Making Clearer Notices

Executive Order 13707 and associated guidance recognized that behavioral science insights could benefit the American people and provided instructions to federal agencies how to use and implement the available behavioral science research.⁵⁴ Recently introduced legislation in the House of Representatives would require federal agencies to provide greater notice clarity.⁵⁵ The legislation would require notices that agencies send to individuals to contain:

- (1) the action item;
- (2) information on whether a response is required, optional, or not required;
- (3) the deadline, if applicable;
- (4) how to complete the action item; and
- (5) the agency's contact information.⁵⁶

All the above items would need to be in a clearly marked section at the top of the first page of the notice.⁵⁷ The 2018 CP11, although an improvement over past IRS math error notices, would be inadequate under this legislation because the required items are spread over multiple pages, and the exact date of the deadline to retain appeal rights is not included.

TAS is currently working on new notice designs that would enhance clarity and taxpayer rights. The language of IRS notices should be framed in the language of the Taxpayer Bill of Rights. For example, a sample notice could read:

You have the right to challenge the IRS and be heard. So, if you disagree with the adjustment we've made to your return, you must call or write us and ask us to reverse the change to your return. This is a request to abate the tax and you must do so within 60 days of the date of this notice, by [last day to request abatement]. If you do this, we will then contact you for more information, and if we still believe your tax return is incorrect, we will

52 IRS response to TAS information request (Aug. 22, 2018) ("annually, the Business Operating Division's (BOD) Subject Matter Experts (SME) review existing TPNCs. The SMEs submit requests to the Office of Taxpayer Correspondence (OTC) to revise existing TPNCs or develop new TPNCs, as appropriate. The OTC works with the SMEs to develop language that is compliant with the Plain Language Act, IRS Style Guide, and the Gregg Reference Manual." The OTC then secures business approval for technical accuracy, obtains approval from Counsel for statutory compliance, and sends to TAS for review and feedback); IRS response to TAS fact check (Nov. 26, 2018) ("Each year, the IRS makes numerous changes to the verbiage of existing TPNCs, deletes obsolete TPNCs, and creates new TPNCs.").

53 IRS response to TAS information request (Aug. 22, 2018).

54 Exec. Order No. 13707, 3 C.F.R. § 13707 (Sept. 15, 2015); Executive Office of the President, Memorandum from John P. Holdren, Director, Office of Science and Technology Policy, to the Heads of Executive Departments and Agencies, *Implementation Guidance for Executive Order 13707: Using Behavioral Science Insights to Better Serve the American People* (Sept. 15, 2016).

55 Too Long Didn't Read Act of 2018, H.R. 5321, 115th Cong. (2018).

56 *Id.*

57 *Id.*

keep the change we made. If you disagree with our decision, you will have the chance to challenge our decision by petitioning the United States Tax Court without having to pay the tax first.

TAS is working on suggested updated notices that take current research on how humans best perceive and understand writing and using those principles to design new notices based on researched best practices.⁵⁸ One such practice is the concept of framing, a behavioral science concept that, by framing information in a particular way, can influence how people respond to it.⁵⁹

The framing in the IRS math error notices appears to be framing them like a bill, with the amount owed and payment information featured first and prominently. However, framing a notice in the context of taxpayer rights could be beneficial to taxpayers to help them understand their rights and what they can and must do in response to a notice; for a math error notice, either paying what they owe or petitioning the change to their return.

Another concept is the idea that making things even incrementally more difficult will reduce action. For example, in a study on Medicare notices, researchers found that simply making information available (through a web link or telephone number) was much less successful than actually including the information itself on the notice.⁶⁰ This means that the IRS should strive to create fewer steps and make each process easier for taxpayers to increase their likelihood to engage and understand. One way the IRS could do this with regards to notices is to include an abatement form within the notice package, so that if a taxpayer would like to request abatement, they do not need to go through as many steps, such as calling the IRS, but can instead simply fill out a mostly pre-populated form and return it. The IRS should work with TAS and follow its researched suggestions to improve notice clarity and prevent the infringement of taxpayer rights.

CONCLUSION

Math error authority has its place as an effective tool to correct unambiguous errors. While the IRS has improved some explanations on some math error notices, these revisions remain short of providing clear, concise, and visually prominent information 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. Most importantly, the notices do not clearly frame the steps to be taken in the language of taxpayer rights—specifically, *the right to challenge the IRS and be heard*, and *the right to appeal to an independent forum*. Framing notices in the context of a taxpayer's rights may make taxpayers pay more attention to the notices. Moreover, the IRS does not measure the reversal rates of math error assessments and, as a result, cannot determine the extent to which it is issuing accurate assessments and forgoes valuable data that could be used both in identifying which math error notices should be revised for added clarity and in using historical data to eliminate the need for issuing math error notices that are later abated.

58 See Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*; see also IRS, *Behavioral Insights Toolkit* (2017).

59 Deloitte Consulting LLP, *Using the Nudge in Tax Compliance: Leveraging Behavioral Insights to Boost Tax Revenue* 9 (2017); see also Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

60 Jeffrey R. Kling et. al., *Comparison Friction: Experimental Evidence from Medicare Drug Plans*, 127 Q. J. Econ. 199, 200-201 (2012); see also Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

RECOMMENDATIONS

The National Taxpayer recommends that the IRS:

1. Measure the abatement rates of its math errors and use the data to assess which math errors are most problematic and which notices need to be revised for clarity.
2. On all math error notices, cite to the actual line on the return that the IRS is changing, and the reason why the IRS is making the change (*e.g.*, “you claimed 6 dependents on line x, but multiplied the dependency exemption by 7 on line y”).
3. Emphasize the Taxpayer Bill of Rights, and specific taxpayer rights on math error notices by including the taxpayer’s *right to challenge the IRS and be heard*, and the *right to appeal*, the specific deadline date the taxpayer must respond by, and the loss of their right to make a prepayment petition of the IRS’s change to their return to the Tax Court, if the taxpayer does not respond by the date in the notice.
4. Further emphasize the steps that taxpayers may take (pay or file to petition) on the first page of its math error notices, so that taxpayers are clear on what their options are in response to notices. The section heading that discusses appeal options should be similarly as big and bold as the section heading discussing payment.
5. Place the explanation of the math error on the first page of the notice, not the third or fourth, so that taxpayers see and read the explanation before they read about the numerous payment options, which nudges them to pay and not question the purported error or if they should appeal. Page one should also include the deadline date to appeal, and what taxpayers lose if they do not appeal, as well as information about the TBOR, TAS, and LITCs.
6. Work directly with TAS on notice redesign to ensure notice clarity and adequate inclusion of taxpayer rights on math error notices.
7. Use internal data to make corrections to returns that benefit taxpayers, instead of burdening taxpayers with unnecessary math error assessments that are later abated.

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****RESPONSIBLE OFFICIALS**

Ken Corbin, Commissioner, Wage and Investment Division
 Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division
 Douglas O'Donnell, Commissioner, Large Business and International Division
 David Horton, Acting Commissioner, Tax Exempt and Government Entities Division
 Donna Hansberry, Chief, Office of Appeals

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The statutory notice of deficiency (SNOD) notifies the taxpayer that 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.² The taxpayer has 90 days (or 150 days if the taxpayer resides outside the United States) to petition the U.S. Tax Court.³ If the taxpayer does not petition the Tax Court, after the 90 (or 150) days expire, the IRS will assess the tax, send the taxpayer a tax bill, and start collections.⁴ The notice of deficiency is the taxpayer's "ticket" to the Tax Court, the only pre-payment judicial forum where the taxpayer can *appeal an IRS decision*. 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 in an independent judicial forum. The notice also provides due process, as part of procedural justice, to taxpayers, especially those who cannot afford representation.⁵ Approximately 69 percent of cases in Tax Court are brought by unrepresented

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified at Internal Revenue Code (IRC) § 7803(a)(3).

2 IRC §§ 6212(a), 6213(a); Internal Revenue Manual (IRM) 4.8.9.8, *Preparing Notices of Deficiency* (July 9, 2013).

3 IRC § 6213(a).

4 IRC § 6212(a); IRM 4.8.9.8, *Preparing Notices of Deficiency* (July 9, 2013).

5 See Most Serious Problem: *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*, *infra*.

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.⁶

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”), as shown on Figure 1.13.1.⁷ 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.⁸ 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.⁹ The majority of these three types of 3219 SNODs (called 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.¹⁰ Yet low income taxpayers, who may be eligible for representation through Low Income Taxpayer Clinics (LITCs), are less likely to petition the Tax Court.¹¹ In FY 2018, the median total positive income (TPI) for individuals who did not petition the Tax Court in response to a SNOD issued after an audit was about \$24,000.¹²

The National Taxpayer Advocate is concerned that the lack of taxpayers’ responses to SNODs may be, in part, due to faulty design and poor presentation of information in the notices, making it difficult for taxpayers to understand critical information and exercise their rights. We have identified the following issues pertaining to IRS SNODs:

- SNODs do not alert taxpayers of their rights and the consequences for not exercising them;
- SNODs do not sufficiently apply plain writing principles, nor incorporate behavioral research insights, as directed by the Plain Writing Act and Executive Order 13707; and
- The IRS continues to omit Local Taxpayer Advocate (LTA) information required by law on certain SNODs, thereby violating taxpayer rights.

6 American Bar Association (ABA), Section of Taxation, *Comment Letter on the Tax Court Rules of Practice and Procedure Relating to the Appearance and Representation before the Court 2* (Oct. 3, 2018), <https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/100318comments.pdf>. The small tax case criteria are provided in IRC § 7463.

7 Although there are many versions of the Statutory Notice of Deficiency (SNOD), the four types being referenced are: CP 3219A, LTR 3219, LTR 3219C, and LTR 3219N, as discussed below.

8 IRS Office of Chief Counsel, ABA Report, Tax Section, Court Procedure Committee 12 (Sept. 30, 2017) (providing the sources of cases petitioned to the Tax Court for fiscal year (FY) 2017) (on file). Some of the SNODs issued in FY 2017 would not have resulted in docketed cases before FY 2018. In addition, some cases docketed in FY 2017 could have resulted from SNODs issued in an earlier year.

9 We can also determine the income of other taxpayers who received a SNOD after an audit—even if we do not know which type of SNOD they received — because these cases are tracked on the Compliance Data Warehouse (CDW) Audit Information Management System (AIMS) Closed Case Database, and we can obtain the taxpayer’s income from the Individual Returns Transaction File (IRTF) F1040 table.

10 CDW Notice Delivery System (NDS) Notice Table (Dec. 11, 2018); IRTF Form 1040 Table (Dec. 11, 2018). Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

11 See Most Serious Problem: *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*, *infra*. In order to qualify for assistance from an Low Income Tax Clinic (LITC), generally a taxpayer’s income must be below 250 percent of the current year’s federal poverty guidelines, based on family size and with income adjustments for Hawaii and Alaska. IRC § 7526(b)(1)(b)(ii). As of January 2018, 250 percent of the federal poverty level was \$51,950 for a family of three. See IRS Pub. 3319, *Low Income Taxpayer Clinics (LITC) Grant Application Package and Guidelines* 45-46 (May 2018).

12 CDW AIMS Closed Case Database (Dec. 11, 2018); IRTF F1040 table (Dec. 11, 2018). In computing this income level, TAS excluded accounts for which the IRS had no record of the taxpayer’s income in any of the prior three tax years. The IRS had such records for more than 90 percent of these accounts. Total positive income (TPI) is the taxpayer’s income from all sources before adjusting for deductions and exemptions. Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

ANALYSIS OF PROBLEM

Background

Generally, taxpayers self-assess taxes when filing their income tax returns. However, the IRS may determine that a taxpayer owes additional tax and may request additional information or select the taxpayer's return for an audit.¹³ If the taxpayer and the IRS cannot agree on the alleged tax liability in connection with an audit, document matching (*e.g.*, after issuance of a CP 2000), or appeals process, the IRS will issue a notice of deficiency.¹⁴ When the IRS issues a SNOD, the taxpayer has 90 days to file a petition in Tax Court.¹⁵ No assessment of any tax or collection through levy or proceeding in court may begin until after the notice has been mailed and this 90-day period has expired.¹⁶ When a taxpayer timely files a petition with the Tax Court, no assessment or collection is allowed until the Tax Court enters a final decision.¹⁷

If the taxpayer files a petition with the Tax Court, the Tax Court provides support and special procedures for unrepresented taxpayers. In accordance with IRC § 7463, the Tax Court offers simplified and expedited procedures for tax disputes involving amounts of \$50,000 or less. For example, if a taxpayer elects small tax case status, and the case goes to trial, under Rule 174 of the Tax Court Rules and Procedure, the trial will be conducted as “informally as possible consistent with orderly procedure”¹⁸ and “any evidence deemed by the Court to have probative value shall be admissible.”¹⁹ Neither briefs nor oral arguments will be required unless the court otherwise directs.²⁰

The tax assessment is an important administrative act because it sets the stage for the IRS to start collecting unpaid tax balances using methods such as seizure and levy of a taxpayer's property.²¹ The Supreme Court explained the significance of the assessment in *Bull v. United States*: “The assessment is given the force of a judgment, and if the amount assessed is not paid when due, administrative officials may seize the debtor's property to satisfy the debt.”²² If, after the IRS issues a series of notices and the taxpayer does not dispute the IRS collection actions by requesting a hearing or paying the tax, the IRS may file a lien or levy the taxpayer's property, including the taxpayer's bank accounts or wages.²³

13 See IRC 7602(a); see also IRS Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refunds* (Rev. Sept. 2013).

14 IRM 11.4.2.7.4, *CP 2000* (Oct. 5, 2006). The CP 2000 notice is issued to taxpayers proposing an adjustment to their tax account based on disparities found between the taxpayers return and information returns.

15 IRC §§ 6212, 6213. If the notice is addressed to a person outside the United States, the taxpayer has 150 days to file a petition in the Tax Court.

16 See IRC § 6213(a). However, if collection of an unassessed liability is in jeopardy, the IRS may make an immediate assessment and pursue collection without the need to follow normal assessment and collection procedures. As soon as a “jeopardy assessment” is made, the tax, penalties, and interest become due and payable. IRC §§ 6851, 6861. See also IRC §§ 6201-6207, 6303(a). If no petition is filed with the Tax Court, upon the expiration of the 90-day period, the IRS will assess the tax liability. Within 60 days of making the assessment, the IRS must provide the taxpayer notice of the assessment and demand for payment.

17 See IRC §§ 6213(a), 7481.

18 Rule 174(b), Tax Court Rules and Procedure.

19 *Id.*

20 Rule 174(c), Tax Court Rules and Procedure.

21 IRC §§ 6320, 6330.

22 *Bull v. United States*, 295 U.S. 247, 259-260 (1935). See also IRC § 6321.

23 The IRS must issue a Notice of Federal Tax Lien after filing a federal tax lien and provide taxpayers with the right to a hearing under IRC § 6320. The IRS must also give notice to the taxpayer before issuing a levy under IRC § 6330. See also IRC § 6331.

The notice of deficiency is the taxpayer’s “ticket” to the Tax Court, the only pre-payment judicial forum where the taxpayer can *appeal an IRS decision*.

Thus, it is critical that taxpayers dispute the tax before the 90 days expires if they disagree with the IRS’s proposed assessment. Otherwise, once the tax is assessed, the IRS will start collecting the liability. In most cases, for taxpayers to challenge the tax in an independent judicial forum, they must pay the tax and then request a refund.²⁴ This option is costly and unfeasible for some taxpayers.

As noted above, available data suggest that less than one percent of the taxpayers, who receive one of the four types of SNODs separately, file a petition with the Tax Court. Other taxpayers are not availing themselves of a fundamental taxpayer right—the *right to appeal an IRS decision in an independent forum*. They may not be availing themselves of their rights because the SNODs do not effectively communicate the information needed for taxpayers to understand their rights, the relevant tax issues, nor how to respond.

The most commonly issued SNODs are the 3219 SNODs.²⁵ The 3219 SNODs include:

- CP 3219A, *Automated Underreporter* (The IRS issues CP 3219A when the taxpayer’s return information does not match third-party information sent to the IRS.);
- LTR 3219, *Correspondence Exam* (The LTR 3219, which is mailed from the IRS Service Center, is issued after a correspondence exam where there is no agreement between the IRS and the taxpayer.);
- LTR 3219C, *Automated Questionable Credit* (The LTR 3219C is issued to taxpayers who may have false wages or withholding, or who are being denied refundable credits.);²⁶ and
- LTR 3219N, *Automated Substitute for Return (ASFR)* (The LTR 3219N is issued to assess tax against those who have unfiled returns.).²⁷

24 In order to bring a refund suit, the taxpayer must first file a claim for refund with the IRS and, upon its denial by the IRS or the IRS’s failure to act within six months, the taxpayer must then file a suit for refund in the district courts or the U.S. Court of Federal Claims. See IRC § 7422. In certain cases, audit reconsideration is available to eligible taxpayers who have a tax balance and can provide new documents to the examination division. IRM 4.13.1.2, *Definition of an Audit Reconsideration* (Dec. 16, 2015). Under IRC § 6330 (c)(2)(b), taxpayers may challenge a tax liability at a collection due process hearing. Specifically, the taxpayer may also raise at the hearing challenges to the existence or amount of the underlying tax liability for any tax period if the taxpayer did not receive a statutory notice of deficiency for the tax liability or did not otherwise have an opportunity to dispute the tax liability (e.g., if the SNOD was not sent to the last known address). See also 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*. For a proposal that would allow taxpayers to file suit in a United States District Court or in the United States Court of Federal Claims without first paying an assessment in full, see Legislative Recommendation: *Fix the Flora Rule: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*, *infra*.

25 IRS response to TAS information request (Dec. 12, 2018).

26 IRM 25.25.7.4, *Taxpayer Responses* (Aug. 23, 2018).

27 IRM 3.10.72-2, *Correspondence C Letters – Routing Guide* (Jan. 1, 2018); Exhibit IRM. 3.10.72-3, *Computer Paragraph (CP) Notices – Routing Guide* (Jan. 1, 2018).

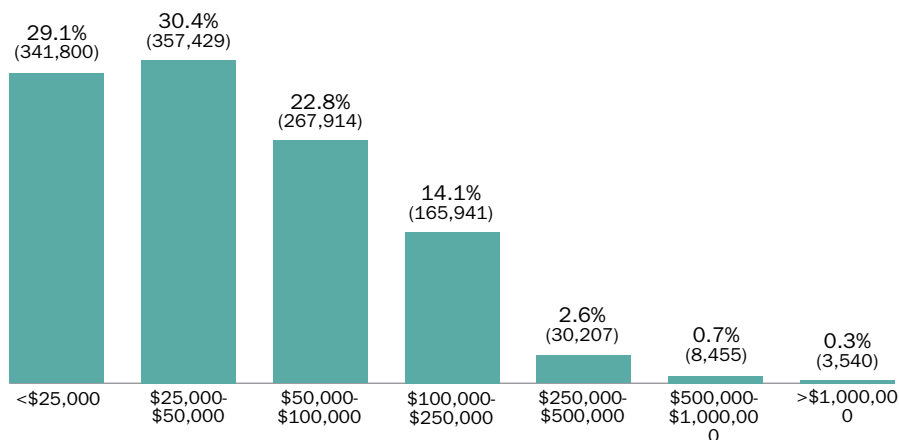
FIGURE 1.13.1, Number of 3219 SNODs Mailed Over Past Five Years²⁸

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
CP 3219A	1,898,982	2,697,153	2,580,817	2,151,790	2,208,720
LTR 3219	1,664,838	523,635	617,170	463,748	463,067
LTR 3219C	31,156	38,891	37,791	34,562	15,186
LTR 3219N	149,901	175,183	192,481	13,570	32,204
Total	3,744,877	3,434,862	3,428,259	2,663,670	2,719,177

As shown in Figure 1.13.2, about 59 percent of all those receiving Non-ASFR SNODs make less than \$50,000 per year, while only 41 percent have incomes between \$50,000 and one million dollars per year. Clearly, the majority are issued to low income taxpayers.

FIGURE 1.13.2²⁹

Distribution of Taxpayers with Non-ASFR SNODs by Total Positive Income (TPI) in TY 2017



The income distribution of taxpayers petitioning or not petitioning the Tax Court after an audit in response to a SNOD also indicates that lower income taxpayers are less likely to petition the Tax Court. The median TPI for those individuals who did *not* petition the Tax Court was nearly \$24,000,³⁰ whereas, the median TPI for those who *did* petition the Tax Court during that same period was slightly over \$72,000.³¹ A more detailed breakdown of these income distributions as reflected on Figures 1.13.3 and 1.13.4, show the same thing.

28 IRS response to TAS information request (Dec. 12, 2018).

29 CDW Notice Delivery System NDS Notice table (Dec. 11, 2018); CDW AIMS Closed Case Database (Dec. 11, 2018); IRTF F1040 table (Dec. 11, 2018). These figures are based on the total number of CP 3219A, LTR 3219, and LTR 3219C. They do not include the LTR 3219N, which is issued in the Automated Substitute for Return (ASFR) Program. Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

30 CDW AIMS Closed Case Database and FY 2018 IRTF F1040 table. Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

31 *Id.*

FIGURE 1.13.3, Distribution of Taxpayers Petitioning the Tax Court After an Audit in Response to SNODs in FY 2018³²

FY 2018	Percentage
Total Positive Income < \$25k	20.5%
Total Positive Income ≥ \$25k and < \$50k	16.3%
Total Positive Income ≥ \$50k and < \$100k	25.1%
Total Positive Income ≥ \$100k and < \$250k	25.7%
Total Positive Income ≥ \$250k and < \$500k	5.8%
Total Positive Income ≥ \$500k and < \$1M	3.0%
Total Positive Income ≥ \$1M	3.5%
Total	100.0%

Figure 1.13.3 shows that most, or 63 percent, of individual taxpayers who filed petitions in FY 2018 after an audit in response to a SNOD, had incomes *of at least* \$50,000. In contrast, only a minority or 37 percent had incomes *below* \$50,000.

FIGURE 1.13.4, Distribution of Taxpayers Not Petitioning the Tax Court After an Audit in Response to SNODs in FY 2018³³

FY 2018	Percentage
Total Positive Income < \$25k	52.6%
Total Positive Income ≥ \$25k and < \$50k	22.4%
Total Positive Income ≥ \$50k and < \$100k	16.7%
Total Positive Income ≥ \$100k and < \$250k	7.3%
Total Positive Income ≥ \$250k and < \$500k	0.7%
Total Positive Income ≥ \$500k and < \$1M	0.2%
Total Positive Income ≥ \$1M	0.1%
Total	100.0%

Figure 1.13.4 shows that the majority, or 75 percent, of individual taxpayers who did not file petitions in FY 2018 after an audit in response to a SNOD, had TPI of less than \$50,000. These taxpayers may not realize they may be eligible for free representation at the Tax Court by LITCs.³⁴ Alternatively, they may not understand the SNODs they have received from the IRS.

32 CDW AIMS Closed Case Database, Petitioned Cases, FY 2018 (Dec. 11, 2018). This figure shows the subset of petitions following an audit (and appeal, if any) and case closure. It does not include petitions following more automated procedures (e.g., AUR and ASFR). Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

33 *Id.* Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

34 See Most Serious Problem: *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*, *infra*.


SNODs Do Not Alert Taxpayers of Their Rights and the Consequences for Not Exercising Them

In 2008, the IRS embarked on a major initiative to improve the clarity, accuracy, and effectiveness of its taxpayer correspondence.³⁵ The Taxpayer Communications Task group (TACT), with the aid of Siegel+Gale (now Siegelvision), conducted a review of taxpayer correspondence. Siegel+Gale concluded that “the differences among many letters reflected internal IRS structure, as opposed to taxpayer needs.”³⁶ The IRS developed a new framework for IRS letters based on suggestions from both IRS employees and stakeholders. SNODs, however, continue to fail in conveying critical information necessary for taxpayers to understand their obligations and rights, and to take appropriate action.

We have selected the CP 3219A SNOD to examine because it comprises over 80 percent of the 3219 SNODs, as depicted in Figure 1.13.1.³⁷ The CP 3219A SNOD fails to adequately inform taxpayers of their rights and protections with regard to the IRS’s actions. Notably, while the IRS has a Spanish version of the notice, it does not have SNODs available in other major world languages.³⁸ Moreover, there is no mechanism whereby a taxpayer can *proactively* request a Spanish-language SNOD. Instead, he or she must contact the IRS upon receiving the English-language SNOD and request a Spanish-language one. This request does not toll the running of the 90-day period to petition the Tax Court.³⁹

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- 35 See Siegel+Gale, *2A Report: Analysis of the IRS Correspondence System; Taxpayer Communications Taskgroup (TACT) Charter* (Nov. 2008).
- 36 Siegel+Gale, Case study, Internal Revenue Service, *Making Paperwork Less Taxing*, <https://www.siegelgale.com/wp-content/uploads/2011/05/Case-Study-IRS.pdf> (last visited Jan. 29, 2018). Accord Siegel+Gale, *2A Report: Analysis of the IRS Correspondence System; Taxpayer Communications Taskgroup (TACT) Charter* 8 (Nov. 2008) (noting “some notices do not clearly provide the taxpayers with the information needed to respond.”).
- 37 CDW Notice Delivery System NDS Notice table. See Exhibit IRM 3.10.72-3, *Computer Paragraph (CP) Notices – Routing Guide* (Jan. 1, 2018). As noted above, the CP 3219A, also known as an Automated Under Reporter (AUR) SNOD, is issued when the taxpayer’s return information does not match third party information sent to the IRS, such as wage and income information from employers and financial institutions. Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.
- 38 For further discussion on the National Taxpayer Advocate’s efforts to address the IRS’s lack of access to multilingual notices, see National Taxpayer Advocate 2011 Annual Report to Congress 137-150 (Most Serious Problem: *Foreign Taxpayers Face Challenges in Fulfilling U.S. Tax Obligations*). The National Taxpayer Advocate has long highlighted the lack of forms and publications for taxpayers with limited English proficiency. See, e.g., National Taxpayer Advocate 2017 Annual Report to Congress 181-194 (Most Serious Problem: *Individual Taxpayer Identification Numbers (ITINs): The IRS’s Failure to Understand and Effectively Communicate With the ITIN Population Imposes Unnecessary Burden and Hinders Compliance*); National Taxpayer Advocate 2011 Annual Report to Congress 273-283 (Most Serious Problem: *Introduction to Diversity Issues: The IRS Should Do More to Accommodate Changing Taxpayer Demographics*); National Taxpayer Advocate 2008 Annual Report to Congress 141-157 (Most Serious Problem: *Access to the IRS by Individual Taxpayers Located Outside the United States*); and National Taxpayer Advocate 2006 Annual Report to Congress 222-247 (Most Serious Problem: *Correspondence Delays*).
- 39 Although the IRS provides various telephone prompts in several different languages, if a taxpayer calls in a language other than Spanish and the IRS assistant cannot understand the taxpayer’s question, the IRS instructs assistants to tell callers they are attempting to contact interpreters. IRM 3.42.7.14.4, *Over the Phone Interpreter Service (OPI)* (June 1, 2018) discusses the IRS Language Service webpage with resources for limited English proficiency (LEP) taxpayers and provides nine telephone prompts in various foreign languages. When the interpreter service is unable to provide an interpreter, assistants are directed to apprise the interpreter vendor using a “feedback form;” however, the IRM provides no mechanism for IRS assistants to follow up with the non-English speaking taxpayer. Further, IRS assistants are told if a taxpayer is calling in a language other than Spanish and assistants cannot understand the taxpayer, assistants should instruct the caller to call back with an interpreter. See IRM 21.3.10.5(7), *Transfers and/or Referrals* (Oct. 1, 2018).

FIGURE 1.13.5, Excerpt of Statutory Notice of Deficiency CP 3219A



Department of the Treasury
Internal Revenue Service

[Redacted]

[Redacted]

[Redacted]

Notice CP3219A

Tax year [Redacted]

Notice date [Redacted]

Social security number [Redacted]

AUR control number [Redacted]

To contact us [Redacted]

Last date to petition Tax Court [Redacted]

Page 1 of 9

1 Notice of Deficiency
Proposed increase in tax and notice of your right to challenge

2 We have determined there is a deficiency (increase) in your [Redacted] income tax based on information we received from third parties (such as employers or financial institutions) that doesn't match the information you reported on your tax return. See below for an explanation of how this increase was calculated. This letter is your NOTICE OF DEFICIENCY, as required by law.

3a If you disagree
You have the right to challenge this determination in U.S. Tax Court. If you choose to do so, you must file your petition with the Tax Court by March 5, 2018. This date can't be extended. See below for details about how and where to file a petition.

3c If you agree
You can pay now or receive a bill. See the section below titled "If you agree with the proposed changes, you can pay now or receive a bill."

Summary of proposed changes

[Redacted]

3b If you want to resolve this matter with the IRS
You may be able to resolve this matter without going to the U.S. Tax Court if you contact us directly. See the "You may be able to resolve your dispute with the IRS" section below.

3d If you want assistance
You may be able to receive assistance from a Low Income Taxpayer Clinic or from the Taxpayer Advocate Service. See the "Additional information" section below.

You have the right to petition the Tax Court

You have the right to challenge our deficiency determination, including penalties, before making any payment by filing a petition with the U.S. Tax Court. You must file your petition within 90 days (or 150 days if the notice is addressed to a person outside of the United States) from the date of this letter, which is [Redacted]. The Tax Court can't consider your case if the petition is filed late. If you decide to file a petition, send that petition to the following address:

United States Tax Court
400 Second Street, NW
Washington, DC 20217

Continued on back...

The 3219A SNOD⁴⁰ suffers from the following issues:

1. **Title of Notice:** “Notice of Deficiency, Proposed Increase in Tax.” This title should clearly and simply explain the purpose of the notice in plain language. However, the IRS uses technical terms, such as deficiency.⁴¹ A better title could be: “The IRS Will Increase Your Tax After 90 Days Unless You Disagree and Use Your Right to Petition the Tax Court. This is Your Legal Notice, a Notice of Deficiency.” This title still references the legal concept of “deficiency” but clearly explains to the taxpayer why they need to read the content of the notice.
2. **Purpose of Notice:** This section should explain, in plain language, the purpose of the SNOD. For example, this section could state: “We have determined you owe more tax based on information we received from your employer or financial institution. The attached summary shows in detail, the basis for the tax increase. You have the right to challenge the IRS determination, without paying the tax first, by petitioning the U.S. Tax Court by [fill in date]. If you miss this deadline or fail to pay the tax, the IRS will then assess the tax and begin collection, including garnishing your wages or placing a lien on your property. If you need help in preparing a petition, you may be eligible for assistance from Low Income Taxpayer Clinics (LITC), which represent low income taxpayers who need help in resolving a tax dispute and are unable to afford to hire representatives to advocate on their behalf before the IRS or the courts.”
3. **Actions Required:** Here, the IRS structures its options without regard to taxpayer rights and protections.⁴² The choices are not only confusing to taxpayers, but also undermine critical taxpayer rights, including the *right to be informed*, the *right to pay no more than the correct amount of tax*, and the *right to a hearing in an independent forum*. Based on the number of “ifs,” there appear to be four options: [a], [b], [c], and [d]. In reality, the taxpayer has two choices—either to agree or to disagree with the proposed increased tax. Instead, the SNOD should present options for taxpayers, such as:

If you disagree, you can petition the Tax Court by [fill in deadline]. If you agree, you can sign the waiver and pay now, or wait for an IRS bill.
4. **Help:** This section should explain the assistance available to taxpayers. Although the notice includes information about LITCs and TAS, it could state: “If you need help, including understanding this notice, you can contact a Low Income Taxpayer Clinic, a Local Taxpayer Advocate, the United States Tax Court website, or the IRS.” More detailed information concerning each of these resources could go on page two of the SNOD.
5. **Consequences for Failing to Act:** The consequences for a taxpayer failing to respond is provided on the third page and should instead be clearly spelled out on the first page. This section could instead state: “If you do not petition the Tax Court by [fill-in deadline], you will lose your chance

40 The complete AUR SNOD is located at IRS website, https://www.irs.gov/pub/notices/cp3219a_english.pdf (last visited Feb. 2, 2019).

41 IRC § 6211(a). See also Iva W. Cheung, *Plain Language to Minimize Cognitive Load: A Social Justice Perspective*, 60 IEEE TRANSACTIONS ON PROF. COMM. 448, 454 (2017) (“Applying plain-language principles is an evidence based way to reduce cognitive load. Minimizing cognitive load increases the likelihood that people with heavy mental burdens will read and understand the communication.”). See also Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

42 MDRC, News from the BIAS Project, BEHAVIORAL BUZZ, Sept. 2015, at 1. “Research has shown that simplifying forms and providing information can increase take-up of government programs. Making messages clearer and easier to understand and streamlining choices can reduce procrastination and make it easier for clients to complete complex paperwork. Clear instructions, few required fields, and visual prompts that draw the eye to key information are examples of techniques that can improve applications and make it less likely that these forms are barriers to service receipt.” See also Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

to dispute the tax in court without paying the tax first. If the tax is not paid, the IRS will assess the tax and begin collection, including garnishing your wages or placing a lien on your property.”

6. **Organization and Design:** The SNOD’s content should be structured to guide taxpayers in understanding the IRS’s proposed action, the taxpayer’s rights and obligations, and the assistance available to them. The IRS should use the following principles:
- Organize the content so that it flows logically;
 - Break content into short sections that reflect natural stopping points; and
 - Write headings that help readers anticipate what will follow.⁴³

Moreover, the CP 3219A SNOD refers taxpayers to the IRS website’s web page, “Understanding Your CP 3219A Notice,” which also presents confusing information. For example, the web page states the following:

If you **don’t agree** with the changes and have additional information for us to consider, mail or fax the information with the **Form 5564** to the address or fax number on the notice.
(*Emphasis added.*)

The IRS confuses taxpayers by advising taxpayers to use the same form, Form 5564, *Notice of Deficiency-Waiver*, both when they agree with the tax changes and when they disagree with the tax changes. In addition, if taxpayers disagree with the tax changes and submit the Form 5564 with additional information, and the IRS does not resolve their tax issue, they risk missing the Tax Court filing deadline.⁴⁴

In redesigning the SNOD, the IRS should include the Tax Court website and telephone number, as well as a copy of IRS Publication 4134, *Low Income Taxpayer Clinic List*. Furthermore, the IRS should develop and train its employees to educate taxpayers who call the IRS telephone number listed in the SNOD about the Tax Court petition process. IRS employees should emphasize the importance and necessity of filing a petition with the Tax Court, as well as guide taxpayers through the Tax Court petition filing process when taxpayers express that they do not agree with the tax adjustments. Most importantly, IRS employees should make referrals to TAS and LITCs because of the urgency of pending Tax Court petition filing deadlines.

43 Center for Plain Language, *Five Steps to Plain Language*, <https://centerforplainlanguage.org/learning-training/five-steps-plain-language/> (last visited Oct. 2, 2018).

44 See IRS website at <https://www.irs.gov/individuals/understanding-your-cp3219a-notice> (last visited Dec. 13, 2018).

SNODs Do Not Sufficiently Apply Plain Writing Principles nor Incorporate Behavioral Research Insights as Directed by the Plain Writing Act and Executive Order 13707

To improve the IRS notice clarity, the National Taxpayer Advocate has included a literature review in this year's report that discusses plain language principles and behavioral science research methods. The literature review explores what influences people's decision making, including small changes in language, choice architecture, as well as the salience and framing of information.⁴⁵

Under the Plain Writing Act of 2010, federal agencies are required to use clear, concise, and well-organized government communication the public can understand.⁴⁶

Additionally, federal agencies are required to consider employing behavioral science research to improve how its information is presented.⁴⁷ Specifically, federal agencies are to consider how the content, format, timing, and medium by which information is conveyed to the public affects comprehension and action by individuals.⁴⁸

The National Taxpayer Advocate believes the IRS should redesign notices of deficiency, using plain language principles and behavioral science methods, to clearly convey the proposed tax increase to taxpayer's account, to emphasize the taxpayer's right to challenge the IRS's determination before the Tax Court, and to obtain assistance from LITCs and TAS.

In addition, the IRS should collaborate with TAS and stakeholders, especially the Taxpayer Advisory Panel (TAP) and LITCs, in designing the SNOD. The redesign process should consist of the IRS conducting a pilot of several SNODs, including its current notices and rights-based prototypes, and measuring such attributes as: (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).

45 See Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

46 5 U.S.C. § 301; 3 C.F.R. 13707.

47 3 C.F.R. 13707; see Memorandum from Executive Office of the President, Office of Science and Technology Policy to the Heads of Executive Departments and Agencies, *RE: Implementation Guidance for Executive Order 13707: Using Behavioral Science Insights to Better Serve the American People* (Sept. 15, 2016).

48 *Id.* See also Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

The IRS Continues to Omit LTA Information Required By Law on Certain SNODs, Thereby Violating Taxpayer Rights

The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98),⁴⁹ codified at 26 U.S.C. § 6212(a), requires the IRS to provide notice of the taxpayer's right to contact the local office of the taxpayer advocate and the location and phone number of the appropriate office.⁵⁰ TAS offices are now aligned with the taxpayer population by ZIP code, so the IRS can easily identify the correct office for inclusion in the notices.

If the taxpayer contacts the LTA before the 90 days expires, some examples of how an LTA could assist these taxpayer include:

- TAS may be able to have the SNOD rescinded on the grounds that the IRS has not responded to the taxpayer's documents or addressed documentation sent in by the taxpayer;
- TAS may be able to have the IRS review the taxpayer's documents quickly in order to resolve the case within 90 days;
- TAS may be able to explain to the taxpayer the IRS's proposed action and if they disagree with the IRS, provide guidance in filing a petition with the Tax Court;
- TAS may also explain to the taxpayer the basis for the IRS action and if the taxpayer agrees, TAS will have educated the taxpayer and enhanced future compliance; and
- TAS may provide contact information for LITCs and encourage taxpayers to seek assistance.

In the twenty years since Congress enacted this requirement, the National Taxpayer Advocate has raised this issue in several congressional reports, and TAS has worked extensively with the IRS to ensure the service is complying with the law.⁵¹ Since 2015, TAS has partnered with the Office of Taxpayer Correspondence to update notices with the required LTA information.

Several notices, however, still do not include the required information.⁵² The IRS has informed TAS that because its notice-producing systems are old and inflexible, adding the LTA information to these notices is impossible.⁵³ Instead, the IRS has included reference to the Taxpayer Bill of Rights (TBOR), TAS, the TAS website, and the TAS toll-free phone number in notices. While this is important information, it does not meet the statutory requirement, which was established at the same time

49 Pub. L. No. 105-206, 112 Stat. 703 (1998).

50 26 U.S.C. § 6212(b). See also 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*. Although there is no legislative history available to explain why Congress felt that notices of deficiency should include a mention of TAS, the Joint Committee on Taxation's explanation of the IRS Restructuring and Reform Act of 1998 sections that created the position of the National Taxpayer Advocate, indicate that Congress envisioned the newly created National Taxpayer Advocate playing an important role in "preserving taxpayer rights and solving problems that taxpayers encounter in their dealings with the IRS."

51 See National Taxpayer Advocate 2016 Annual Report to Congress 36 (Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*); National Taxpayer Advocate 2014 Annual Report to Congress 237-244 (Most Serious Problem: *Statutory Notices of Deficiency: Statutory Notices of Deficiency Do Not Include Local Taxpayer Advocate Office Contact Information on the Face of the Notice*).

52 For example, the following letters still lack LTA information: Letter 3219-C, *Notice of Deficiency*; Letter 1753, *Notice of Excise Tax Change*; Letter 531-A, *90-Day Letter Form 1040*; Letter 1120, *Discrepancy Adjustments*; and Letter 531-B, *90-Day Letter*; Form 5330, *Return of Excise Taxes Related to Employee Benefit Plans*; and Form 990-T, *Exempt Organization Business Income Tax Return*.

53 Email from Wage and Investment Division (W&I) (Oct. 24, 2018) (on file with TAS).

Congress required the National Taxpayer Advocate to maintain at least one local office in each state.⁵⁴ Without knowing that *local* assistance is available, a taxpayer may not call a national toll-free number or visit an internet site. In addition, the TAS website may not be easily accessible to the 11 million taxpayers who never use the internet, the 14 million without internet access at home, or the 41 million taxpayers without broadband access.⁵⁵ While the TAS national toll-free number is included in notices, that number is not staffed by TAS employees. Moreover, taxpayers need to know that they can talk with someone who is located in the same locale or community, and has knowledge of the underlying economic conditions that may affect their cases.⁵⁶

The failure of the IRS to include LTA information on its notices of deficiency harms taxpayers and violates taxpayers' *right to be informed* and *right to a fair and just tax system*.⁵⁷

CONCLUSION

Despite the IRS's efforts over the past ten years, the IRS has not designed its SNODs from a taxpayer rights perspective. SNODs fail to alert taxpayers of the IRS's proposed action and its consequences, such as levying the taxpayer's property. Moreover, current SNODs fail to clearly convey taxpayers' obligations and rights and the free resources available to help them understand the SNOD and respond to the IRS. To be most effective, SNODs need to emphasize the taxpayer's right to obtain assistance through TAS and LITCs, right to object to the IRS's decision before an independent forum, and right to representation, if eligible. As described in the literature review compiled by TAS, the IRS should use plain language principles and behavioral insights to redesign SNODs in collaboration with TAS and stakeholders. Because of the sheer number of SNODs being sent to low income taxpayers and the number of taxpayers who do not petition the Tax Court in response to a SNOD, it is critical that the IRS make the SNOD redesign a priority.

54 See IRC 7803(c). The National Taxpayer Advocate has the responsibility of appointing Local Taxpayer Advocates and making available at least one such advocate for each state.

55 See National Taxpayer Advocate 2017 Annual Report to Congress vol. 2 63 (Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Towards IRS Options for Fulfilling Common Taxpayer Service Needs*).

56 See National Taxpayer Advocate 2016 Annual Report to Congress 86-97 (Most Serious Problem: *Geographic Focus: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance*); National Taxpayer Advocate 2016 Annual Report to Congress vol. 2 102-122 (Literature Review: *Geographic Considerations for Tax Administration*).

57 See TBOR, www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in IRC § 7803(a)(3).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. 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.
 - a. Collaborate with the TAS and stakeholders, especially the TAP and LITCs, in designing the SNOD.
 - b. 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).
2. Develop and train IRS employees in best practices for assisting taxpayers who call the IRS in response to a SNOD, to include having IRS employees remind and guide taxpayers in filing Tax Court petitions.
3. 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*.
4. Include the Local Taxpayer Advocate's contact information on the face of the notices, specifically on Letters 3219-C, 1753, 531-A, and 531-B.
 - a. If the IRS is unable to update computer programming to provide the telephone number and address information of LTAs pursuant to IRC § 6212(a) during the current year, include Notice 1214,⁵⁸ listing all LTA office contact information, when mailing letters 3219-C, 1753, 531-A, and 531-B.
 - b. 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 letters 3219-C, 1753, 531-A, and 531-B, as required by law.

⁵⁸ Notice 1214, *Helpful Contacts for your "Notice of Deficiency"* (Jan. 2018).

**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****RESPONSIBLE OFFICIALS**

Mary Beth Murphy, Small Business/Self-Employed Division
Ken Corbin, Commissioner, Wage and Investment Division
Donna Hansberry, Chief, Office of Appeals

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

DEFINITION OF THE PROBLEM

Collection Due Process (CDP) hearings are one of the most important taxpayer protections created by the IRS Restructuring and Reform Act of 1998 (RRA 98).² CDP hearings 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. If the taxpayer disagrees with the outcome of the CDP hearing, he or she can seek review by the U.S. Tax Court.

Collection due process rights further the *right to privacy*, the *right to a fair and just tax system*, and the *right to challenge the IRS's position and be heard*.³ For instance, during the CDP hearing, the Appeals Officer (AO) must obtain verification that “requirements of any applicable law or administrative procedure have been met.”⁴ The AO also must consider “whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary.”⁵ Taxpayers are given the opportunity to raise a collection alternative, such as an installment agreement or offer in compromise, and in some instances they can contest the underlying liability.⁶

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

3 For a more thorough discussion of the importance of CDP rights in tax administration, see Nina E. Olson, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 63 TAX LAWYER 227.

4 IRC § 6330(c)(1).

5 IRC § 6330(c)(3)(C).

6 IRC § 6330(c).

However, as discussed below, the response rate for CDP notices is quite low, between less than one percent and ten percent, depending on the taxpayer's income level and notice type. Many and diverse stakeholders have expressed concerns that CDP rights are communicated poorly to taxpayers.⁷ The Treasury Inspector General for Tax Administration (TIGTA) reports that some taxpayers were denied a CDP hearing because they sent their request for a CDP hearing to the wrong office.⁸ The Tax Court has also noted confusion surrounding the notice of determination.⁹

Given what is at stake in CDP cases, any confusing or inadequate correspondence can have grave consequences for a taxpayer's rights. The National Taxpayer Advocate has the following concerns about the current CDP notices:

- The design and wording in CDP administrative notices underemphasize the importance of CDP rights;
- Important information for exercising CDP administrative rights are not clearly communicated to taxpayers; and
- The defects in the notice of determination may prevent some taxpayers from appealing their cases to Tax Court.

ANALYSIS OF THE PROBLEM

Background

During hearings leading to the enactment of RRA 98, Senator Roth, Chairman of the Senate Finance Committee, explained in 1998:

There is no doubt that the powers of the Internal Revenue Service are extraordinary. The IRS can seize property, paychecks, and even the residences of the people it serves. Businesses can be padlocked, sometimes causing hundreds of employees who are also taxpayers to be put out of work ... This is an awesome amount of power to place in the hands of any government agency. Is it appropriate? Perhaps. But with such power there must be an effective counterbalance of responsibility. Why? Because the greater the power, the more extensive the damage that can be done if that power is abused.¹⁰

Senator Roth's concerns were not far-fetched. To draft RRA 98, legislators heard testimony from taxpayers. Thomas Savage, owner of a construction management company, testified about his experience where a subcontractor he worked with accrued a tax debt. The IRS determined the

⁷ National Taxpayer Advocate 2017 Annual Report to Congress 299-306 (Legislative Recommendation: *Collection Due Process and Innocent Spouse Notices: Amend IRC §§ 6320, 6330, and 6015 to Require That IRS Notices Sent to Taxpayers Include a Specific Date by Which Taxpayers Must File Their Tax Court Petitions, and Provide That a Petition Filed by Such Specified Date Will Be Treated As Timely*); Carlton Smith, PROCEDURALLY TAXING, *CDP Notice of Determination Sentence Causing Late Pro Se Petitions*, <http://procedurallytaxing.com/cdp-notice-of-determination-sentence-causing-late-pro-se-petitions/> (Mar. 24, 2016); TAX NOTES TODAY, *Harvard Federal Tax Clinic Provides IRS Reform Recommendations*, 2018 TNT 70-19 (Apr. 17, 2018).

⁸ Treasury Inspector for Tax Administration (TIGTA), Ref. No. 2018-10-054, *Review of the Office of Appeals Collection Due Process Program* 6 (Sept. 5, 2018).

⁹ In *Houk v. Commissioner*, the court noted that "people of ordinary intelligence who do not have tax training and who have previously received both a lien notice and a levy notice and have requested CDP hearings for both ... must find [the title of the notice of determination] confusing." *Houk v. Comm'r.*, Order for Supplement to Motion for Entry of Decision, Tax Ct. No. 22140-15L (June 2, 2018).

¹⁰ *Practices and Procedures of the Internal Revenue Service: Hearing Before the S. Comm. on Finance*, 105th Cong. 2 (1998) (opening statement of Senator William V. Roth, Jr.).

subcontractor to be currently not collectible and turned its attention to Mr. Savage. The IRS incorrectly argued there was a partnership between Mr. Savage and the subcontractor. Mr. Savage testified that:

Undaunted by the challenge to provide the authority in support of this fictitious partnership, the revenue officer caused the IRS to issue a 30-day letter which proposed an assessment against the fictitious partnership. We immediately filed a written protest with the IRS appeals officer and eagerly awaited an appeals conference to put the case behind us. As things turned out, we were never given an opportunity to present our case to the appeals office.”¹¹

CDP hearings were designed not to limit the IRS’s awesome collection powers but to serve as a check on abuses of that power. Moreover, CDP hearings ensure taxpayers have an opportunity to raise their concerns to an independent official prior to the IRS taking its first potentially devastating collection action.

CDP Processes and Procedures

The IRS communicates CDP rights during two critical times. First, the IRS communicates the right to request a CDP administrative hearing with notices such as Letter 1058, *Final Notice of Intent to Levy and Notice of Your Right to a Hearing* (notice of intent to levy), or Letter 3172, *Notice of Federal Tax Lien and Your Rights to a Hearing Under IRC 6320* (NFTL).¹² Following the CDP hearing, the IRS communicates its determination to the taxpayer via a notice of determination, such as Letter 3193, *Notice of Determination: Concerning Collection Action(s) Under Section 6320 and/or 6330 of the Internal Revenue Code* (notice of determination), which includes the right to appeal the determination to Tax Court.¹³

The IRS provides the taxpayer with 30 days in which to request an administrative CDP hearing.¹⁴ Taxpayers who miss the 30-day deadline to request a CDP hearing may still receive an equivalent hearing within one year from the day after the date of the intent to levy notice or within one year from the day after the end of the five business day period following the filing of the NFTL.¹⁵ It is unclear if missing the deadline to request an administrative CDP hearing in the first place is a matter of jurisdiction for the Tax Court and can be subject to equitable tolling if later litigated.¹⁶

11 *Practices and Procedures of the Internal Revenue Service: Hearing Before the S. Comm. on Finance*, 105th Cong. 83 (1998) (statement of Thomas Savage, business owner).

12 IRS, Letter 1058, *Final Notice Notice of Intent to Levy and Notice of Your Right to a Hearing* (Jan. 2017); IRS, Letter 3172, *Notice of Federal Tax Lien and Your Rights to a Hearing Under IRC 6320* (Mar. 2017). Notice LT11, *Notice of Intent to Levy and Notice of Your Right to a Hearing*, is sent to taxpayers whose cases are in Automated Collection Services (ACS) and Letter 1058 is sent to taxpayers whose cases are assigned to Revenue Officers. This discussion will focus on Letter 1058 for the conversation regarding intent to levy notices.

13 IRS Letter L3193, *Notice of Determination: Concerning Collection Action(s) Under Section 6320 and/or 6330 of The Internal Revenue Code* (July 2018).

14 IRC §§ 6320(a)(3)(B) and 6330(a)(3)(B).

15 Treas. Reg. § 301.6330-1(h)(2)(iv)(Q&A17). The equivalent hearing will be held by Appeals and generally will follow Appeals’ procedures for a CDP hearing. Appeals will not, however, issue a notice of determination, it will issue a decision letter. Also, unlike with a CDP hearing, the IRS may continue collection action while the equivalent hearing is pending, and the taxpayer cannot appeal the decision letter to Tax Court. Treas. Reg. § 301.6320-1(h)(2); Treas. Reg. § 301.6330-1(h)(2).

16 *Kim v. Comm’r.*, T.C. Memo. 2005-96. For a discussion about how the time period for filing a CDP hearing request is not an issue of jurisdiction, see Keith Fogg, *The Jurisdictional Ramifications of Where You Send a CDP Request*, TAX NOTES (Nov. 12, 2018).

However, if the taxpayer disagrees with the IRS's determination after the CDP hearing and wishes to appeal, he or she must file a petition with the U.S. Tax Court within 30 days of the IRS's determination.¹⁷ The Tax Court has held that the 30-day filing deadline to seek judicial review under IRC § 6330(d)(1) is an issue of jurisdiction.¹⁸ Without jurisdiction, the Tax Court cannot hear a case. Furthermore, the deadline is not subject to equitable tolling, meaning the court cannot extend the deadline for any reason.¹⁹

CDP Notices Have a Low Response Rate

Figure 1.14.1 shows the number and response rate (percentage) for CDP notices issued in fiscal year (FY) 2017 by the taxpayer's income.²⁰ Regardless of income, all the notices had a very low response rate. For instance, 162,887 taxpayers who live in poverty received the intent to levy CDP notice during FY 2017. Of the 162,887 such taxpayers who received a levy notice, only 1,733 (approximately one percent) requested a CDP hearing. An additional 267 of those taxpayers requested an equivalent hearing. This is roughly 13 percent of the taxpayers who responded.²¹

There is a small increase in the response rate as the taxpayer's income increases but differs depending on which notice is being considered. The largest response rate is the group of taxpayers who received both a notice of intent to levy and an NFTL, and whose income was above 250 percent of the federal poverty level. In this group, the IRS issued 40,338 notices and the IRS received 4,194 CDP hearing requests, creating a response rate of around ten percent. An additional 797 taxpayers (two percent of the taxpayers) requested an equivalent hearing, which represents nearly 16 percent of the responses.²²

17 IRC § 6330(d)(1).

18 *Weber v. Commissioner*, 122 T.C. 258 (Mar. 22, 2004).

19 *Duggan v. Commissioner*, Tax Ct. Docket No. 4100-15L (order dated June 26, 2015). The Ninth circuit affirmed the 30-day deadline is a matter of jurisdiction. *Duggan v. Commissioner*, 2018 U.S. App. LEXIS 886 (9th Cir. Jan. 12, 2018).

20 The analysis broke down income according to the guidelines found in IRC § 7526(b)(1)(B), which considers eligibility for low income tax clinic (LITC) representation based on a financial breakdown where 90 percent of the clients do not exceed 250 percent of the federal poverty level. However, the IRS will process taxpayers through a low income filter for the purposes of the Federal Payment Levy Program (FPLP) if the taxpayer's income falls below 250 percent of the federal poverty level. IRM 5.19.9.3.2.3, *Low Income Filter Exclusion* (Oct. 20, 2016).

21 The 267 equivalent hearing requests constitute 13 percent of the 2,000 responses to the intent to levy CDP notice (1,733 timely requests and 267 equivalent hearing requests).

22 The 797 equivalent hearing requests constitute 16 percent of the 4,991 responses to both the lien and levy CDP notice (4,194 timely requests and 797 equivalent hearing requests).

FIGURE 1.14.1, CDP Notices Issued in FY 2017 and Hearing Requests by Income Level²³

Income Group	CDP Notice Type	TPs mailed Notices	Appeal Requested	Equivalent Hearing Requested	Notice of Determination Issued
In Poverty	Levy only	162,887 (75%)	1,733 (1%)	267 (<1%)	1,361 (1%)
	Lien only	41,058 (19%)	1,413 (3%)	226 (1%)	1,096 (3%)
	Both Levy and Lien	14,041 (6%)	1,064 (8%)	197 (2%)	802 (6%)
	Subtotal	217,986	4,210 (2%)	690 (<1%)	3,259 (1%)
Above Poverty to 250% Federal Poverty Level	Levy only	261,658 (88%)	2,767 (1%)	396 (<1%)	2,228 (1%)
	Lien only	25,207 (8%)	1,128 (4%)	168 (1%)	908 (4%)
	Both Levy and Lien	10,647 (4%)	867 (8%)	155 (2%)	643 (6%)
	Subtotal	297,512	4,762 (2%)	719 (<1%)	3,779 (1%)
Above 250% of Federal Poverty Level	Levy only	641,469 (83%)	9,144 (1%)	1,472 (<1%)	7,393 (1%)
	Lien only	94,046 (12%)	5,789 (6%)	794 (1%)	4,721 (5%)
	Both Levy and Lien	40,338 (5%)	4,194 (10%)	797 (2%)	3,225 (8%)
	Subtotal	775,853	19,127 (2%)	3,063 (<1%)	15,339 (2%)
Overall Total TPs	Total	1,291,351	28,099 (2%)	4,472 (<1%)	22,377 (2%)

Additionally, many taxpayers navigate the CDP process (including litigation in Tax Court) without representation. In fact, for the period between June 1, 2016 and May 31, 2017, there were 568 Tax Court petitions filed in CDP cases.²⁴ Of those, 335 petitions were filed by *pro se* taxpayers, meaning that approximately 59 percent of taxpayers who appealed a CDP determination were unrepresented.²⁵

23 Compliance Data Warehouse, Individual Returns Transaction File, Information Returns Master File. A single taxpayer could have received CDP notices for more than one module. A tax module is a combination of a type of tax and the tax period when it was originally due. A total of 72,215 taxpayers were categorized into the “in poverty” group because for tax year 2017 they did not file a return and there were no third-party reports of income for them. It is possible that some of these taxpayers may have had unreported income. This data does not include information from businesses.

24 Data pulled from Tax Litigation Counsel Automated Tracking System (TLCATS) and Counsel Automated Systems Environment – Management Information System (CASE-MIS) (July 26, 2018).

25 *Id.*

To Address Practitioners' Criticisms, TAS Reviewed CDP Notices

TAS started an ongoing review of CDP-related notices in FY 2018. As part of this review, TAS first reviewed the legal requirements for each notice. According to IRC § 6330, the notice of intent to levy must:

- Include notice of the taxpayer's right to a CDP hearing before a levy is made;²⁶
- Include the following information in "simple and nontechnical terms":
 - a) The amount of unpaid taxes;²⁷
 - b) The right to request a CDP hearing during the 30-day period;²⁸
 - c) The proposed IRS action and the rights of the taxpayer with respect to such action, including a brief statement setting forth:
 - i. The Code provisions relating to levy and sale of property;
 - ii. Levy and sale of property procedures;
 - iii. Available administrative appeals and associated procedures;
 - iv. Available alternatives that could prevent the levy (including installment agreements); and
 - v. Provisions of this title and procedures relating to redemption of property and release of liens on property.²⁹

The NFTL notice has similar legal requirements under IRC § 6320(a)(3).

An NFTL notice must include:

- The amount of unpaid tax;
- The right of the person to request a hearing during the 30-day timeframe beginning five days after the lien is filed;
- The administrative appeals available to the taxpayer with respect to such lien and the procedures relating to such appeals;
- The provisions relating to the release of liens on property; and
- The provisions of IRC § 7345 relating to the certification of seriously delinquent tax debts and the denial, revocation, or limitation of passports of individuals with such debts pursuant to § 32101 of the Fixing America's Surface Transportation (FAST) Act.³⁰

There are requirements for the notice of determination, but most apply to the results of the specific CDP hearing. For instance, the notice of determination must address whether the proposed collection action represents a balance between the need for the efficient collection of taxes and the legitimate concern of

²⁶ This notice requirement does not apply to levies on state tax refunds, jeopardy levies, federal contractor levies, or disqualified employment tax levies. IRC § 6330(a)(1).

²⁷ IRC § 6330(a)(3)(A).

²⁸ IRC § 6330(a)(3)(B).

²⁹ IRC § 6330(a)(3)(C).

³⁰ IRC § 6320(a)(3)(E). Comparable language is not required for intent to levy CDP notices, however, the IRS currently does include it. Such language is required in the levy notice following notice and demand for payment under IRC § 6331(d). IRC § 6331(d)(4)(G).

the taxpayer that any collection action be no more intrusive than necessary.³¹ Most pertinent to this discussion is the requirement that the notice will advise the taxpayer of his or her right to seek judicial review within 30 days of the date of the Notice of Determination.³²

The Design and Wording in CDP Notices Underemphasize the Importance of CDP Rights

The current CDP administrative notices do not inform taxpayers about *why* CDP rights are important to taxpayers. For instance, the intent to levy notice says, “This is your notice of our intent to levy ... and your right to request a Collection Due Process hearing ...” It does not explain what a CDP hearing is, why a taxpayer would want to request one, and does not adequately explain equivalent hearings. Telling a taxpayer why CDP rights are important furthers the *right to be informed*.³³ And from a behavioral science perspective, including an explanation would provide a “nudge” that could increase a taxpayer’s decision to exercise his or her rights. A “nudge” steers people in a particular direction while allowing them to maintain their choice.³⁴

The current Collection Due Process (CDP) administrative notices do not inform taxpayers about *why* CDP rights are important to taxpayers It does not explain what a CDP hearing is, why a taxpayer would want to request one, and does not adequately explain equivalent hearings.

Important information for Exercising CDP Rights Is Not Clearly Communicated to Taxpayers

The Deadline to Request a CDP Hearing May Be Missed By Taxpayers

The intent to levy notice mentions the deadline to request the CDP hearing in the fourth paragraph of the first page. It is not in bold font or otherwise set apart from the rest of the text. Based on behavioral research, we know that plain language helps a reader understand material. However, plain language does not just consist of simple wording. Plain language also means structuring the material so that it flows easily for the reader as well as incorporating typography (bold font, etc.) and white space to guide the reader.³⁵ The current intent to levy notice does not effectively communicate the file-by date by burying it in text and not putting it in bold font to guide the reader’s attention.

The National Taxpayer Advocate is also concerned with how the response due date is communicated to taxpayers who receive an NFTL. According to IRC § 6320(a)(2), the IRS must provide notice to the taxpayer of the NFTL “not more than 5 business days after the day of the *filing* of the notice of lien.” [Emphasis added.] The taxpayer’s 30-day timeframe to request a CDP hearing starts “on the day after

31 Treas. Reg. § 301.6330-1(e)(3)(Q&A E-8).

32 *Id.*

33 IRC § 7803(a)(3)(A).

34 Deloitte Consulting LLP, *Using the Nudge in Tax Compliance: Leveraging Behavioral Insights to Boost Tax Revenue* 9 (2017). See also Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

35 Center for Plain Language, *Five Steps to Plain Language*, <https://centerforplainlanguage.org/learning-training/five-steps-plain-language/>. For more information on how plain language can help taxpayers, see Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

the 5-day period” mentioned in IRC § 6320(a)(2).³⁶ However, the IRS considers the NFTL to be filed on the date it *should* be received by the recording office and to determine this date, the IRS adds three days to the NFTL mailing date.³⁷

Here is an example:

1. IRS mails NFTL to the recording office on September 6, 2017.
2. Estimated Filing Date: (+ 3 business days) = September 11.
3. Required notification to the taxpayer: (+ 5 business days) = September 18 (IRS mails NFTL letter to TP, with date on it).
4. File By Date: (30 days from required notification) = October 18.

However, in reality the recording office does not receive the NFTL until September 20, 2017. Based on this date, the IRS would have been required to mail notification to the taxpayer within five business days of September 20, or by September 27. The taxpayer’s 30-day deadline to request a CDP hearing would expire 30 days later, on October 27. The lag time in receiving the notice should have allowed the taxpayer an additional nine days to request a CDP hearing.

While including an exact date to request a CDP hearing based on a projected filing date may allow the IRS to issue large amounts of NFTLs and CDP notices, untold circumstances could prevent the delay of the filing of an NFTL. Since the filing date is critical to the timeframe for requesting a CDP hearing, the taxpayer could have a longer period of time to request a CDP hearing than the NFTL letter indicates, but he or she would not know it.³⁸

CDP Administrative Notices Do Not Clearly Instruct Taxpayers Where to Send Their CDP Hearing Requests

The intent to levy notice instructs the taxpayer to send his or her CDP hearing request to “the above address.” Again, this information is buried in text. Multiple addresses may also appear on the notice, one for a response and one for payment. The harm caused by this confusion is evident in the order issued by the Tax Court in *Zonies v. Commissioner*, where Mr. Zonies sent his CDP request to the wrong office and by the time it arrived at the right office, his 30-day time frame had expired.³⁹ A recent TIGTA report reviewed 70 CDP cases and found that approximately 11 percent of the taxpayers sent their CDP hearing requests to the wrong office.⁴⁰ As mentioned earlier, to help taxpayers read and understand the notice, the IRS needs to place the address early in the notice and set apart by bold font. Moreover, since the CDP notice provides significant, one-time due process rights, the address to make a CDP hearing request should be more prominent than the address for making payments. The CDP notice should prioritize taxpayer rights.

36 IRC § 6320(a)(3)(B).

37 IRM 5.12.6.3.6(3), *CDP Notice Time Frames* (Jan. 19, 2018).

38 TAS is reviewing the data for taxpayers filing lien and levy CDP hearing requests to determine whether a longer time period would mitigate some of the low hearing rates and late filing issues. We may make a legislative recommendation regarding these deadlines in later reports.

39 *Zonies v. Comm’r.*, Docket No. 18711-15L, Order (Feb. 22, 2016). See also Keith Fogg, *Sending Your Collection Due Process Hearing Request to the Correct Address*, PROCEDURALLY TAXING (Apr. 26, 2016), <http://procedurallytaxing.com/sending-your-collection-due-process-hearing-request-to-the-correct-address/>; Keith Fogg, *The Jurisdictional Ramifications of Where You Send a CDP Request*, TAX NOTES (Nov. 12, 2018).

40 TIGTA, *Review of the Office of Appeals Collection Due Process Program*, Report No. 2018-10-054 6 (Sept. 5, 2018). TIGTA reviewed 70 CDP cases and identified 8 taxpayers who mailed or faxed their CDP hearing request to the wrong office.

Notices Should Include References to TAS and Low Income Taxpayer Clinics

IRC § 6212(a) requires that the notice of deficiency, which is sent to a taxpayer prior to assessment of a liability, include “a notice to the taxpayer of the taxpayer’s right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.” However, no such requirement exists for CDP notices. The IRS includes a reference to TAS and Low Income Taxpayer Clinics (LITC) in publications 594, *The IRS Collection Process*, and 1660, *Collection Appeal Rights*. However, the taxpayer may not read to the end of the notice or to read the enclosed publications if he or she does not find the notice easy to read or salient to them.

There is no legislative history available to explain why Congress felt that notices of deficiency should include a mention of TAS but CDP notices should not. However, we can glean some understanding from the Joint Committee on Taxation’s explanation of the RRA 98 sections that created the position of the National Taxpayer Advocate. Congress envisioned the newly created National Taxpayer Advocate playing an important role in “preserving taxpayer rights and solving problems that taxpayers encounter in their dealings with the IRS.”⁴¹ Additionally, the Local Taxpayer Advocates were set up to report directly to the National Taxpayer Advocate and not another IRS function.⁴² Including a reference to TAS in the CDP notices will further the National Taxpayer Advocate’s ability to fulfill her duties to taxpayers and Congress. It will also fulfill the taxpayer’s *right to be informed* during a critical juncture of his or her case. Including a reference to the LITC program will also further the taxpayer’s *right to be informed* and the *right to retain representation* during a crucial time in their case.⁴³

Because Collection Due Process (CDP) hearings offer the taxpayer an opportunity to raise alternatives to IRS collection actions, require balancing the government’s interest in the efficient collection of tax with the taxpayer’s interest that such action be no more intrusive than necessary, and in some instances provide taxpayers with an opportunity to challenge the underlying liability, CDP notices should be models of clarity and educate the taxpayer about the importance of the hearing process itself.

Defects in the Notice of Determination May Prevent Some Taxpayers From Appealing Their Cases to Tax Court

Following the CDP hearing with Appeals, the IRS will issue a notice of determination to the taxpayer. Taxpayers have 30 days in which to request Tax Court review of a notice of determination.⁴⁴ Unlike a notice of deficiency, which legally requires a specific date by which the taxpayer must file his or her petition in Tax Court, the IRS is not required to include a specific date in a notice of determination.⁴⁵

41 J. Comm. on Tax’n, *General Explanation of Tax Legislation Enacted in 1998* 32 (Nov. 24, 1998).

42 *Id.*

43 The LITC program provides free representation to low income taxpayers and outreach to taxpayers who speak English as a second language. IRC § 7526.

44 IRC § 6330(d)(1). Treasury regulations stipulate that the “30-day period within which the taxpayer is permitted to seek judicial review of Appeals’ determination commences the day after the date of the Notice of Determination.” Treas. Reg. 301.6330-1(e)(3)(Q&A E-10).

45 IRC § 6213(a).

The IRS chose not to include a date on the notice because Appeals employees date and mail the notice of determination manually. The IRS is concerned that manually calculating a specific date by which the taxpayers must respond would “add complexity and additional time to the processing of letters and any erroneous calculations could result in taxpayers missing the petition deadline through no fault of their own.”⁴⁶ The process for including a date on the notice of deficiency is included in IRM 8.20.6.8.4, which Appeals employees follow. It is unclear why this process could not apply to the notice of determination.⁴⁷

A review of court cases illustrates why the filing deadline needs to be plainly communicated to taxpayers.⁴⁸ The current notice of determination reads, “If you want to dispute this determination in court, you must file a petition with the United States Tax Court within 30 days from the date of this letter.”⁴⁹ This language may confuse taxpayers. For instance, what does the term “within” mean to the non-expert taxpayer? Is the date of the letter day one or day zero? The best way to protect taxpayer rights is to include a specific date by which taxpayers must file their petition in Tax Court. The National Taxpayer Advocate made a legislative recommendation in her 2017 Annual Report to Congress to require a specific response date in CDP notices; others in the tax field have called for similar reform.⁵⁰

This date should be provided in bold and in a prominent place, such as in the upper righthand corner of the notice. Including this information up front and in bold font is not just a matter of convenience. The IRS acknowledges that “much behavior is driven by what we pay attention to. Saliency is the ability to command attention to something by giving it more weight or putting it in a position that will capture attention and influence choices.”⁵¹ The current notice of determination lacks saliency as taxpayers cannot ascertain easily when they need to file their petition. In fact, simply changing the location and presentation of choices in a notice can decrease “cognitive burden.”⁵² With an easier understanding, taxpayers may be more inclined to exercise their CDP rights.

Similar to the CDP administrative notices, the notice of determination also does not explain the significance of the right to go to Tax Court and why a taxpayer should file a petition. The right to go to Tax Court is at the heart of the taxpayers’ *right to appeal an IRS decision in an independent forum*; it gives the taxpayer the opportunity to present his or her concerns about the IRS’s proposed action before a fully independent tribunal, and provides important oversight to the IRS’s collection powers. As discussed with the CDP administrative notices, language added to explain why a taxpayer would want to file a petition in Tax Court could “nudge” taxpayers.

46 IRS response to TAS information request (Dec. 6, 2018).

47 *Id.*

48 For instance, see *Duggan v. Commissioner*, Tax Ct. Docket No. 4100-15L 2 (order dated June 26, 2015); *Swanson v. Commissioner*, Tax Ct. Docket No. 14406-15S (order dated Jan. 14, 2016); *Pottgen v. Commissioner*, Tax Ct. Docket No. 1410-15L (order dated Mar. 4, 2016); *Integrated Management, Inc., v. Commissioner*, Tax Ct. Docket No. 27674-16SL (order dated May 31, 2017); *Protter v. Commissioner*, Tax Ct. Docket No. 22975-15SL (order dated Sept. 26, 2017). These cases are not cited for precedent, rather only for the fact patterns showing taxpayers miscalculated the deadline to file.

49 The previous language reads “If you want to dispute this determination in court, you must file a petition with the United States Tax Court within a 30-day period beginning the day after the date of this letter.” IRS, Letter 3193, *Notice of Determination Concerning Collection Actions Under Sections 6320 and 6330* (Dec. 2016).

50 National Taxpayer Advocate 2017 Annual Report to Congress 299-306 (Legislative Recommendation: *Collection Due Process and Innocent Spouse Notices: Amend IRC §§ 6320, 6330, and 6015 to Require That IRS Notices Sent to Taxpayers Include a Specific Date by Which Taxpayers Must File Their Tax Court Petitions, and Provide That a Petition Filed by Such Specified Date Will Be Treated As Timely*); Carlton Smith, *CDP Notice of Determination Sentence Causing Late Pro Se Petitions*, PROCEDURALLY TAXING (Mar. 24, 2016), <http://procedurallytaxing.com/cdp-notice-of-determination-sentence-causing-late-pro-se-petitions>.

51 IRS, *Behavioral Insights Toolkit 24* (2017).

52 *Id.*

CONCLUSION

Correspondence issued by the IRS plays a crucial role in tax administration. If drafted appropriately, it can educate and empower taxpayers. For CDP notices in particular, this may be the first time taxpayers have run into a situation where they need to exercise their due process rights. Because CDP hearings offer the taxpayer an opportunity to raise alternatives to IRS collection actions, require balancing the government's interest in the efficient collection of tax with the taxpayer's interest that such action be no more intrusive than necessary, and in some instances provide taxpayers with an opportunity to challenge the underlying liability, CDP notices should be models of clarity and educate the taxpayer about the importance of the hearing process itself. This education includes filing instructions and deadlines as well as additional resources the taxpayer can use if they have questions.

The IRS's current approach with communications that relate to CDP rights often overlooks some valuable opportunities to maximize the benefits of informing, educating, and interacting with taxpayers. For example, behavioral science shows us that location of text and typography can make a notice easier to read. The important aspects of the notice, such as the deadline to file and address to respond, should be early in the notice and easy to discern from the rest of the text. On a larger scale, taxpayers need to understand why these notices are salient to them and how CDP rights can impact their lives. They need to understand what the IRS proposes to do, what they will experience if they do not respond, and how to exercise their rights.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Include the exact date on the Notices of Determination by which the taxpayer must file a petition in Tax Court.
2. 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:
 - (a) Putting clear explanations about the importance of these hearings in terms relating to taxpayer rights and protections;
 - (b) Highlighting deadlines early in the notices and in bold font; and
 - (c) Including references to TAS and the LITC program.
3. Work with TAS to explore methods of more accurate notification of the due date for CDP hearing requests with respect to lien filings.

INTRODUCTION TO COLLECTION: A Roadmap to the IRS Collection Process

One of the most obvious and important roles of the IRS is the collection of taxes. In 2014, the IRS restructured its Collection organization, which is housed within the Small Business/Self-Employed (SB/SE) Division.¹ The stated mission for this organization is:

To collect delinquent taxes and secure delinquent tax returns through the fair and equitable application of the tax laws, including the use of enforcement tools when appropriate, provide education to customers to enable future compliance, and thereby protect and promote public confidence in the American tax system.

In 2015, Congress codified the Taxpayer Bill of Rights (TBOR) into the tax code; these ten rights are enumerated in Internal Revenue Code (IRC) § 7803(a)(3) and include *the right to pay no more than the correct amount of tax, the right to privacy, and the right to a fair and just tax system*. One of the challenges for the IRS is to fulfill its obligation to collect taxes while comporting with its stated mission of educating taxpayers and with the TBOR.

In fiscal year (FY) 2017, the IRS brought in \$3.4 trillion in revenue.² The vast majority of those payments were made voluntarily by taxpayers.³ There are generally three ways in which taxpayers may voluntarily submit tax payments to the IRS: (1) through withholding by third parties (*e.g.*, employers); (2) making estimated payments (typically on a quarterly basis); or (3) submitting payments with their tax return.

The Taxpayer's Journey: Roadmaps of the Taxpayer's Path Through the Tax System section, following the Preface, includes a graphical overview of how the Collection process works and how taxpayers may progress through it, along with the applicable deadlines taxpayers must be aware of to retain their rights.

The Collection Notice Stream

If taxpayers do not voluntarily pay taxes assessed, the IRS may initiate collection action. IRS collection actions brought in nearly \$40 billion in FY 2017 (1.2 percent of total revenue collected).⁴ The majority (\$30.6 billion in FY 2017) of the amount collected is from the “notice stream,” a series of letters issued early in the life of the debt, notifying the taxpayer of the balance due and requesting payment of the full amount.⁵

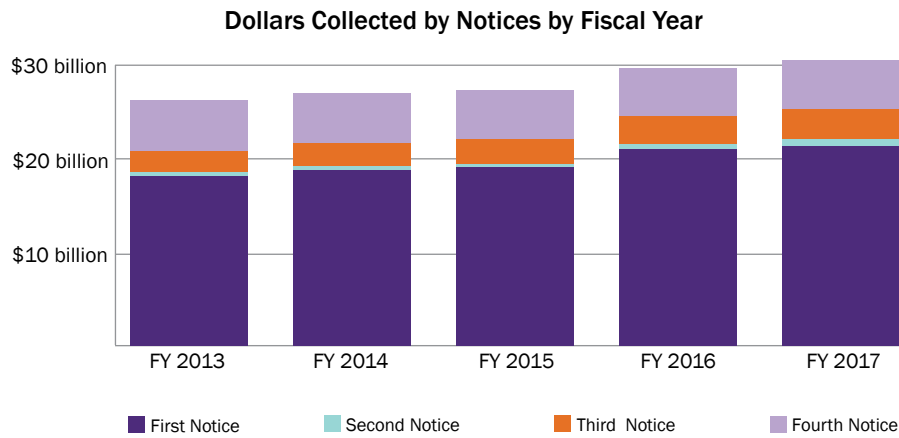
1 IRS, Small Business/Self-Employed (SB/SE) Executive Organizational Chart (Mar. 2018).

2 IRS, *2017 Data Book* iii.

3 Less than one percent of revenue came from cases that were generally in a collection status where enforced collection could occur.

4 IRS, *2017 Data Book* 17, 41. This figure includes dollars collected from all collection activity.

5 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2018-30-069, *Trends in Compliance Activities Through Fiscal Year 2017* 6 (Sept. 13, 2018).

FIGURE 1.0.1⁶

If the taxpayer does not pay in full or otherwise respond to the notice stream, the IRS issues a notice of intent to levy via certified mail.⁷ If the taxpayer does not pay within 30 days of that notice, the IRS sends a collection due process (CDP) notice that provides a taxpayer the opportunity to appeal the filing or issuance of liens or levies.⁸

Right to CDP Hearings

CDP hearings are one of the most important taxpayer protections created by the IRS Restructuring and Reform Act of 1998 (RRA 98).⁹ CDP hearings 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. If the taxpayer disagrees with the outcome of the CDP hearing, he or she can seek review by the U.S. Tax Court.

CDP rights further *the right to privacy, the right to a fair and just tax system, and the right to challenge the IRS's position and be heard*.¹⁰ For instance, during the CDP hearing, the Appeals Officer (AO) must obtain verification that "requirements of any applicable law or administrative procedure have been met."¹¹ The AO also must consider "whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary."¹² Taxpayers are given the opportunity to raise a collection alternative,

6 Enforcement Revenue Information System (July 2018).

7 See Internal Revenue Code (IRC) § 6331(d).

8 See IRC §§ 6320 and 6330. For an in-depth discussion of the Collection Due Process (CDP) process, please 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*.

9 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

10 For a more thorough discussion of the importance of CDP rights in tax administration, see Nina E. Olson, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 63 TAX LAWYER 227 (2010).

11 IRC § 6330(c)(1).

12 IRC § 6330(c)(3)(C).

such as an installment agreement or offer in compromise, and in some instances they can contest the underlying liability.¹³

CDP hearings were designed not to limit the IRS's awesome collection powers but to serve as a check on abuses of that power. Moreover, CDP hearings ensure taxpayers have an opportunity to raise their concerns to an independent official prior to the IRS taking its first potentially devastating collection action.

CDP Processes and Procedures

The IRS communicates CDP rights during two critical times. First, the IRS communicates the right to request a CDP administrative hearing with notices such as Letter 1058, *Final Notice of Intent to Levy and Notice of Your Right to a Hearing* (Notice of Intent to Levy), or Letter 3172, *Notice of Federal Tax Lien and Your Rights to a Hearing Under IRC 6320* (NFTL).¹⁴ Following the CDP hearing, the IRS communicates its determination to the taxpayer via a notice of determination, such as Letter 3193, *Notice of Determination: Concerning Collection Action(s) Under Section 6320 and/or 6330 of the Internal Revenue Code* (notice of determination), which includes the right to appeal the determination to Tax Court.¹⁵

The IRS provides the taxpayer with 30 days in which to request an administrative CDP hearing.¹⁶ Taxpayers who miss the 30-day deadline to request a CDP hearing may still receive an equivalent hearing within one year from the day after the date of the intent to levy notice or within one year from the day after the end of the five-business-day period following the filing of the NFTL.¹⁷ It is unclear if missing the deadline to request an administrative CDP hearing in the first place is a matter of jurisdiction for the Tax Court and can be subject to equitable tolling if later litigated.¹⁸

However, if the taxpayer disagrees with the IRS's determination after the CDP hearing and wishes to appeal, he or she must file a petition with the U.S. Tax Court within 30 days of the IRS's determination.¹⁹ The Tax Court has held that the 30-day filing deadline to seek judicial review under IRC § 6330(d)(1) is an issue of jurisdiction.²⁰ Without jurisdiction, the Tax Court cannot hear a case.

13 IRC § 6330(c).

14 IRS, Letter 1058, *Final Notice of Intent to Levy and Notice of Your Right to a Hearing* (Jan. 2017); IRS, Letter 3172, *Notice of Federal Tax Lien and Your Rights to a Hearing Under IRC 6320* (Mar. 2017). Notice LT11, *Notice of Intent to Levy and Notice of Your Right to a Hearing*, is sent to taxpayers whose cases are in Automated Collection System (ACS) and Letter 1058 is sent to taxpayers whose cases are assigned to Revenue Officers. This discussion will focus on Letter 1058 for the conversation regarding intent to levy notices.

15 IRS Letter L3193, *Notice of Determination: Concerning Collection Action(s) Under Section 6320 and/or 6330 of The Internal Revenue Code* (July 2018).

16 IRC §§ 6320(a)(3)(B) and 6330(a)(3)(B).

17 Treas. Reg. 301.6330-1(i)(1)(iv)(Q&A 17). The equivalent hearing will be held by Appeals and generally will follow Appeals' procedures for a CDP hearing. Appeals will not, however, issue a notice of determination, it will issue a decision letter. Also, unlike with a CDP hearing, the IRS may continue collection action while the equivalent hearing is pending, and the taxpayer cannot appeal the decision letter to Tax Court. Treas. Reg. 301.6320-1(i); Treas. Reg. 301.6330-1(i).

18 *Kim v. Comm'r.*, T.C. Memo. 2005-96. For a discussion about how the time period for filing a CDP hearing request is not an issue of jurisdiction, see Keith Fogg, *The Jurisdictional Ramifications of Where You Send a CDP Request*, TAX NOTES (Nov. 12, 2018).

19 IRC § 6330(d)(1).

20 *Weber v. Comm'r.*, 122 T.C. 258 (2004).

Furthermore, courts have held the deadline is not subject to equitable tolling, meaning the court cannot extend the deadline for any reason.²¹

Scoring and Routing of Collection Cases

If a taxpayer continues to have a tax liability after being sent a series of notices from the IRS, the IRS generally assigns the liability to Taxpayer Delinquent Accounts (TDA) status.²² The case is scored and routed through the IRS's Inventory Delivery System (IDS), which uses analytical scoring models and business rules to manage unresolved cases.²³ IDS is designed to (1) identify and filter out cases that should not be pursued further (*i.e.*, those that should be “shelved”), (2) categorize some cases as high risk (*e.g.*, those in which the period of limitations on collection will expire soon), and (3) determine whether cases should be routed to either the IRS's Automated Collection System (ACS) or Field Collection to be worked.²⁴ In FY 2018, the IDS routed 87 percent of TDA taxpayers to ACS, which is mainly responsible for responding to taxpayers' calls and sending notices, while about one percent of TDA taxpayers were sent to Field Collection, where a case can be assigned to a specific Revenue Officer.²⁵

Shelved cases are those that the IRS sets aside without pursuing enforced collection action (such as levies).²⁶ They may continue in that status until the period of limitations on collection expires.²⁷ The liabilities of over 950,000 taxpayers were routed to the Shelf in FY 2018.²⁸ Shelved cases are still subject to systemic collection action, such as a refund offset, and the IRS is required to assign some shelved cases to a private collection agency.²⁹ Shelved cases are closed with a generic closing code, Currently

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- 21 *Duggan v. Comm'r*, Tax Ct. Docket No. 4100-15L (order dated June 26, 2015). The Court of Appeals for the Ninth Circuit affirmed the 30-day deadline is a matter of jurisdiction. *Duggan v. Comm'r*, 2018 U.S. App. LEXIS 886 (9th Cir. 2018). See National Taxpayer Advocate 2017 Annual Report to Congress 283-292 (Legislative Recommendation: *Make the Time Limits for Bringing Tax Litigation Subject to the Judicial Doctrines of Forfeiture, Waiver, Estoppel, and Equitable Tolling, and Clarify That Dismissal of an Untimely Petition Filed in Response to a Statutory Notice of Deficiency Is Not a Decision on the Merits of a Case*); The National Taxpayer Advocate reiterates her recommendation this year. See National Taxpayer Advocate 2019 Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* (Dec. 31, 2018).
- 22 Taxpayer Delinquent Account (TDA) status applies to balance due accounts when “the taxpayer has an outstanding liability for taxes, penalties and/or interest.” Internal Revenue Manual (IRM) 19.16.4 (Oct. 10, 2012).
- 23 See IRM 5.1.20.2 (Nov. 2, 2016).
- 24 Government Accountability Office (GAO), GAO-15-647, *Collection Process Is Largely Automated, but Lacks Adequate Internal Controls* 11 (2015). For a description of ACS, 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*. For a description of the Field, see Most Serious Problem: *Field Collection: The IRS Has Not Appropriately Staffed and Trained Its Field Collection Function to Minimize Taxpayer Burden and Ensure Taxpayer Rights Are Protected*, *infra*.
- 25 IRS, Collection Activity Report NO-5000-2 (Oct. 1, 2018) (showing the cases of 3,048,419 TDA taxpayers were sent to ACS, while the cases of 34,511 TDA taxpayers were sent to the Field).
- 26 Cases can be shelved by the Inventory Delivery System (IDS) or later on in the collection stream by ACS or Field Collection if it remains unworked.
- 27 Under IRC § 6502, the IRS must generally collect tax within ten years after assessment. Shelved cases may be reactivated in certain situations, such as when a taxpayer owes a liability in future years. IRS response to TAS information request (Oct. 17, 2018).
- 28 IRS Compliance Data Warehouse, Individual Accounts Receivable Dollar Inventory Module File (current through cycle 2018-37) (data drawn Nov. 8, 2018). The IRS maintains records of individual taxpayers' accounts on the Individual Master File (IMF). Each module on the IMF represents a specific tax liability. Taxpayers may have unpaid liabilities with respect to more than one tax year, or module.
- 29 IRC § 6306(c) generally requires the IRS to assign to private collection agencies all “inactive tax receivables,” defined as any “tax receivable” that meets any one of three criteria, including if 365 days have passed without taxpayer or third-party interaction to further collection of the account. A “tax receivable” for purposes of the statute is an account the IRS includes in “potentially collectible inventory,” a term not defined in the statute or in Treasury regulations. See Most Serious Problem: *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*, *infra*.

Not Collectible (CNC) Unproductive.³⁰ The IRS may assign a specific reason for designating a case as CNC, such as the taxpayer's economic hardship, only later in the collection process.³¹

Most Serious Problems

With respect to collection, we include Most Serious Problems providing an in-depth look at concerns with the IRS's Field Collection and ACS functions, and a Most Serious Problem discussing the risks of the IRS not proactively identifying economic hardship throughout the collection process.

- **ECONOMIC HARDSHIP:** *The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process;*
- **FIELD COLLECTION:** *The IRS Has Not Appropriately Staffed and Trained Its Field Collection Function to Minimize Taxpayer Burden and Ensure Taxpayer Rights Are Protected;* and
- **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.*

³⁰ IRS response to TAS information request (Oct. 17, 2018).

³¹ See IRM 5.16.1.2, *Currently Not Collectible Procedures* (Sept. 18, 2018); IRM 5.16.1.2.9, *Hardship* (Sept. 18, 2018); IRM 5.15.1.17, *Making the Collection Decision* (Aug. 29, 2018).

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

RESPONSIBLE OFFICIAL

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to a Fair and Just Tax System*

DEFINITION OF 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.”² Congress has repeatedly emphasized the importance of protecting taxpayers experiencing economic hardship from collection actions that would exceed their ability to pay. For example, in the collection arena:

- Since 1988, Internal Revenue Code (IRC) § 6343 has required the IRS to release a levy if the IRS determines that “such levy is creating an economic hardship due to the financial condition of the taxpayer;”³
- Since 1998, IRC § 6330 has permitted a taxpayer, in a collection due process hearing, to raise the inability to pay due to hardship as a “challenge to the appropriateness of collection action;”⁴ and
- Since 1998, IRC § 7122 has required the IRS to develop allowable living expense (ALE) guidelines to determine when an offer in compromise (OIC) is adequate and should be accepted to resolve a dispute.⁵

The IRS has internal data that it can use to identify taxpayers at risk of economic hardship. For example, when a taxpayer calls the IRS stating that he or she cannot pay the tax due, the IRS collection employee is able to verify some or all of the financial information provided by the taxpayer. If the employee determines the taxpayer’s ALEs exceed his income, the employee will place the taxpayer’s

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 See IRC § 6343, Treas. Reg. § 301.6343-1, and Internal Revenue Manual (IRM) 5.8.11.2.1 (Aug. 5, 2015).

3 IRC § 6343(a)(1)(D).

4 IRC §§ 6320(c), 6330(c)(2)(A)(ii).

5 IRC § 7122(d). If the allowable living expense (ALE) standards exceed the taxpayer’s income, the taxpayer is unable to pay his or her necessary living expenses. Statutory protections of taxpayers who are likely in economic hardship are available in other contexts. See, e.g., IRC § 7526, authorizing funding for the Low Income Taxpayer Clinic (LITC) grant program for taxpayers who cannot afford representation in IRS disputes (generally, those with incomes below 250 percent of the federal poverty level) and are therefore vulnerable to overreaching, and IRC § 6159(f), excusing taxpayers whose incomes do not exceed 250 percent of the federal poverty level from paying user fees to enter into installment agreements (IAs).

account into “currently not collectible (CNC) - hardship” status.⁶ As a result, the taxpayer is protected from IRS collection action to ensure he is left with an adequate means to provide for basic living expenses.

However, despite the availability of this information and Congressional guidance to shield these taxpayers from harmful collection activity, the IRS does not *proactively* identify taxpayers likely in economic hardship throughout the collection process.⁷ The IRS does not consider ALE guidelines in deciding which collection cases to work, although research by TAS shows that about 93 percent of payments received by the IRS in a sample group came from taxpayers with income exceeding their calculated ALEs or who have assets that can be detected through systemic means.⁸ In fact, the IRS does not use internal data at any stage of the collection process to automatically place an indicator that the taxpayer is at risk of economic hardship.⁹ 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.

The IRS’s failure to use information in its databases to consider facts and circumstances that might affect taxpayers’ ability to pay, and respond to them appropriately, violates taxpayers’ *rights to a fair and just tax system* and *to finality*. Many if not most taxpayers who cannot afford to pay their tax liabilities are likely unaware the IRS is required to halt collection action if they are in economic hardship. Thus, they may enter into payment agreements they cannot afford, including streamlined installment agreements (IAs) that do not require financial information from the taxpayer.¹⁰ Furthermore, this approach causes IRS to expend resources attempting to collect from taxpayers who cannot afford to pay, and creates unnecessary rework when those taxpayers default on IAs. TAS’s research shows:

- In fiscal year (FY) 2018, about 40 percent of taxpayers who entered into streamlined IAs within the Automated Collection System (ACS) had incomes at or below their ALEs;¹¹

6 IRM 5.16.1.2.9 (Sep. 18, 2018).

7 The IRS has internal data available to provide an initial indicator of whether a taxpayer may be at risk of economic hardship, but uses this information in very limited circumstances, such as the Low Income Indicator (LII) used to determine whether taxpayers entering into an IA are eligible for a reduced waived user fee. The LII is placed on the IRS’s internal Masterfile system, and is determined by reviewing the taxpayer’s income and exemptions on the taxpayer’s most recent tax return and comparing them with the poverty level charts created by the Department of Health and Human Services (HHS). IRM 5.14.1.2 (July 16, 2018); see also IRS response to TAS information request (Sept. 14, 2018).

8 See Research Study: *Further Analyses of “Federal Tax Liens and Letters: Effectiveness of the Notice of Federal Tax Liens (NFTL) and Alternative IRS Letters on Individual Tax Debt Resolution,”* *infra*. 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 within ACS who generally owed between \$10,000 and \$25,000 whose liabilities were being transferred to the collection queue. TAS Research’s analysis of these cases showed that taxpayers with income exceeding their calculated ALE or who have systemically detected assets account for about 93 percent of the payments made over two years regardless of the treatment type.

9 An exception to this approach is the IRS’s automatic Federal Payment Levy Program (FPLP). At the urging of the National Taxpayer Advocate, the IRS adopted 250 percent of the federal poverty level as a proxy for identifying taxpayers likely in economic hardship for purposes of FPLP. Recipients of Social Security Administration (SSA) retirement benefits with incomes below that level are generally excluded from the FPLP program. See IRM 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (Oct. 20, 2016).

10 See National Taxpayer Advocate 2016 Annual Report to Congress 230-238 (Most Serious Problem: *Installment Agreements: The IRS Is Failing to Properly Evaluate Taxpayers’ Living Expenses and Is Placing Taxpayers in IAs They Cannot Afford*).

11 Due to the lapse in appropriations, Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process. See also 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*.

- About 39 percent of streamlined IAs within ACS involving taxpayers with income at or below their ALES defaulted in FY 2018;¹²
- Forty percent of taxpayers who entered into IAs while their debts were assigned to private collection agencies (PCAs) had incomes at or below their ALES;¹³ and
- In FY 2018, the IRS placed 155,186 taxpayers in CNC-Hardship status.¹⁴

ANALYSIS OF PROBLEM

For Decades Congress Recognized the Need to Protect Taxpayers Who Are in Economic Hardship

Prior to 1988, IRC § 6343 authorized the release of a levy only if the IRS determined that release would facilitate collection of the tax.¹⁵ Amendments to IRC § 6343 in 1988 set out conditions under which the IRS is *required* to release a levy, including when “the Secretary has determined that such levy is creating an economic hardship due to the financial condition of the taxpayer.”¹⁶ Economic hardship is present “if satisfaction of the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses.”¹⁷

Prior to 1998, there was no statutory procedure for any independent review of the IRS’s collection decision.¹⁸ In 1998, Congress enacted IRC §§ 6320 and 6330 to provide for a collection due process (CDP) hearing at the administrative level and for Tax Court review of the IRS’s resulting determination—both to take place after the Notice of Federal Tax Lien (NFTL) is filed but before the IRS takes enforced collection action, such as a levy.¹⁹ At the CDP hearing, taxpayers may challenge the appropriateness of the proposed collection action.²⁰ If they demonstrate they are in economic hardship, the IRS is obliged to consider alternatives, such as CNC Hardship status.²¹

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- 12 TAS Research analysis of the Individual Master File and Individual Returns Transaction File on IAs established in fiscal year (FY) 2018. This figure assumes taxpayers have one IRS-allowed vehicle ownership and operating expense, and a second if they were married filing jointly. As discussed below, if we assume the taxpayers did not have vehicle ownership expenses, the default rate would be about 32 percent.
- 13 See Most Serious Problem: *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*, *infra*.
- 14 Custom analysis by TAS Research. IRS, IMF, Collection Activity Report NO-5000-149 (Oct. 11, 2018).
- 15 See Internal Revenue Code of 1954, Pub. L. No. 83-591, 68A Stat. 3 (1954). Section 6334 provided in its entirety: “It shall be lawful for the Secretary or his delegate, under regulations prescribed by the Secretary or his delegate, to release the levy upon all or part of the property or rights to property levied upon where the Secretary or his delegate determines that such action will facilitate the collection of the liability, but such release shall not operate to prevent any subsequent levy.”
- 16 See Omnibus Taxpayer Bill of Rights, Pub. L. No. 100-647, § 6236(f), 102 Stat. 3342, 3740 (1988), also known as Taxpayer Bill of Rights 1 (TBOR 1), enacting IRC § 6343(a)(1)(D).
- 17 Treas. Reg. § 301.6343-1(b)(4).
- 18 See *IRS Restructuring: Hearings on H.R. 2676 Before the S. Finance Comm.*, 105th Cong. 376, 377 (1998) (testimony of Michael Saltzman, tax attorney, White and Case).
- 19 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3401, enacting IRC §§ 6320 and 6330.
- 20 IRC §§ 6320(c), 6330(c)(2)(A)(ii).
- 21 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.”

Prior to 1998, the IRS evaluated taxpayers' abilities to pay their tax liabilities by comparing their incomes to their ALEs.²² In 1998, Congress codified this practice by amending IRC § 7122 to *require* the IRS to develop ALEs "designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses."²³ The ALE standards, also known as the Collection Financial Standards, include national and local standards, which are guidelines established by the IRS to provide consistency in certain expense allowances.²⁴ These standards determine how much money taxpayers need for basic living expenses such as housing and utilities, food, transportation, and health care, based on family size and where they live.²⁵ The National Taxpayer Advocate continues to have concerns that ALE standards fail to reflect what it truly costs to meet necessary living expenses, but ALEs can nevertheless be an important starting point to detect taxpayers at risk of economic hardship.²⁶

The IRS Scores and Routes Collection Cases Using Internal Data About Taxpayers

If a taxpayer continues to have a tax liability after being sent a series of notices from the IRS, the IRS generally assigns the liability to Taxpayer Delinquent Accounts (TDA) status.²⁷ The case is scored and routed through the IRS's Inventory Delivery System (IDS), which uses analytical scoring models and business rules to manage unresolved cases.²⁸ IDS is designed to (1) identify and filter out cases that should not be pursued further (*i.e.*, those that should be shelved), (2) categorize some cases as high risk (*e.g.*, those in which the period of limitations on collection will expire soon), and (3) determine whether cases should be routed to either the IRS's ACS or the Collection Field function (the Field) to be worked.²⁹ In FY 2018, the IDS routed 87 percent of TDA taxpayers to ACS, which is mainly responsible for responding to taxpayers' calls and sending notices, while about one percent of TDA taxpayers were sent to the Field, where a case can be assigned to a specific Revenue Officer.³⁰

22 See, e.g., IRM 105.1.3 (Sept. 25, 1996), <http://core.publish.no.irs.gov/irm/p05/pdf/30353i96.pdf>; IRM 57(10)(10).1(4), *Determination of Adequate Offer* (Sept. 22, 1994), cross referencing IRM 5323 on IAs, <http://core.publish.no.irs.gov/irm/p05/pdf/35490e98.pdf>.

23 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3462, 112 Stat. 685, 764 (Jul. 22, 1998), adding subsection (c) (which is now subsection (d)) to IRC § 7122.

24 IRM 5.15.1.8 (Aug. 29, 2018).

25 See IRS, *Collection Financial Standards*, <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>. The ALEs are guidelines that "establish the minimum a taxpayer and family needs to live." The IRS may allow additional amounts for basic living expenses if the taxpayer substantiates the need to deviate from the standards. IRM 5.15.1.8 (6), *Financial Analysis Handbook: Allowable Expense Overview* (Aug. 29, 2018). Allowable expenses include transportation expenses, which may consist of ownership expenses (loan or lease payments) and operating expenses (maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking, and tolls). Unless otherwise indicated, in calculating taxpayers' ALEs, we allowed operating expenses (two allowances in the case of joint filers and one allowance for all other taxpayers), and all taxpayers were allowed one vehicle ownership expense.

26 See Research Study: *A Study of the IRS's Use of the Allowable Living Expense Standards*, *infra*.

27 Taxpayer Delinquent Account (TDA) status applies to balance due accounts when "the taxpayer has an outstanding liability for taxes, penalties and/or interest." IRM 19.16.4 (Oct. 10, 2012).

28 See IRM 5.1.20.2 (Nov. 2, 2016).

29 Government Accountability Office (GAO) GAO-15-647, *Collection Process Is Largely Automated, but Lacks Adequate Internal Controls* 11 (Jul. 2015). For a description of the ACS, 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*. For a description of field collection, see Most Serious Problem: *Field Collection: The IRS Has Not Appropriately Staffed and Trained Its Field Collection Function to Minimize Taxpayer Burden and Ensure Taxpayer Rights Are Protected*, *infra*.

30 IRS, *Collection Activity Report NO-5000-2* (Oct. 1, 2018), (showing the cases of 3,048,419 TDA taxpayers were sent to ACS, while the cases of 34,511 TDA taxpayers were sent to the Field).

Shelved cases are those that the IRS sets aside without pursuing enforced collection action (such as levies).³¹ They may continue in that status until the period of limitations on collection expires.³² The liabilities of over 950,000 taxpayers were routed to the Shelf in FY 2018.³³ Shelved cases are still subject to systemic collection action, such as a refund offset, and the IRS is required to assign some shelved cases to a PCA.³⁴ Shelved cases are closed with a generic closing code, CNC-Unproductive.³⁵ The IRS may assign a specific reason for designating a case as CNC, such as the taxpayer's economic hardship, only later in the collection process.³⁶

The Models Used by the IRS to Score and Route Cases Do Not Adequately Identify Taxpayers Experiencing Economic Hardship

As discussed above, Congress has repeatedly directed the IRS to protect taxpayers who experience economic hardship or who cannot pay their basic living expenses. This concept is also embedded in the Taxpayer Bill of Rights.³⁷ In 2014, the Treasury Inspector General for Tax Administration found that IRS case selection criteria did not consider the financial condition of delinquent taxpayers.³⁸ Similarly, in 2015, the Government Accountability Office reviewed the IRS's case categorizing and routing process and found effectiveness was not routinely monitored.³⁹ As a result of these reports and a study by the IRS assessing the collection impact of working different types of cases, the IRS redeveloped the models used within IDS to better predict and filter unproductive cases, or cases where no payments are expected.⁴⁰

While the models used in the case scoring process are designed to identify and shelve unproductive cases, they are not designed to specifically identify if a taxpayer is at risk of economic hardship.⁴¹ The models do not incorporate ALEs, developed by the IRS to identify the amount of expenses "necessary to

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- 31 Cases can be shelved by the Inventory Delivery System (IDS) or later on in the collection stream by ACS or the Field if it remains unworked.
- 32 Under IRC § 6502, the IRS must generally collect tax within ten years after assessment. Shelved cases may be reactivated in certain situations, such as when a taxpayer owes a liability in future years. IRS response to TAS information request (Oct. 17, 2018).
- 33 IRS Compliance Data Warehouse, Individual Accounts Receivable Dollar Inventory Module File (current through cycle 2018-37) (data drawn Nov. 8, 2018). The IRS maintains records of individual taxpayers' accounts on the Individual Master File (IMF). Each module on the IMF represents a specific tax liability. Taxpayers may have unpaid liabilities with respect to more than one tax year, or module.
- 34 IRC § 6306(c) generally requires the IRS to assign to Private Collection Agencies (PCAs) all "inactive tax receivables," defined as any "tax receivable" that meets any one of three criteria, including if 365 days have passed without taxpayer or third-party interaction to further collection of the account. A "tax receivable" for purposes of the statute is an account the IRS includes in "potentially collectible inventory" (PCI), a term not defined in the statute or in Treasury regulations. See also Most Serious Problem: *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*, *infra*.
- 35 IRS response to TAS information request (Oct. 17, 2018).
- 36 See IRM 5.16.1.2, *Currently Not Collectible Procedures* (Sept. 18, 2018); IRM 5.16.1.2.9, *Hardship* (Sept. 18, 2018); IRM 5.15.1.17, *Making the Collection Decision* (Aug. 29, 2018).
- 37 Taxpayers' *right to a fair and just tax system* includes the right to expect the IRS consider facts and circumstances that might affect their ability to pay.
- 38 See Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2014-30-068, *Field Collection Could Work Cases With Better Collection Potential*, (Sept. 12, 2014).
- 39 See GAO, GAO-15-647, *IRS Case Selection: Collection Process Is Largely Automated, but Lacks Adequate Internal Controls* (July 2015).
- 40 Erik Miller, Stacy Orlett, and Alex Turk, IRS, *Uncollectible Versus Unproductive: Compliance Impact of Working Collection Cases That Are Ultimately Not Fully Collectible*, (2014). See also IRS response to TAS information request (Oct. 17, 2018).
- 41 IRS response to TAS information request (Oct. 17, 2018).

provide for a taxpayer's and his or her family's health and welfare and/or production of income."⁴² Thus, taxpayers meeting the IRS's own definition of economic hardship may go undetected at the scoring phase.

Failing to Identify Taxpayers at Risk of Economic Hardship and Appropriately Manage Their Liabilities Throughout the Collection Process May Exacerbate Their Financial Struggles and Jeopardize Their Ability to Become Compliant

Taxpayers Experiencing Economic Hardship May Enter Into Payment Agreements They Cannot Afford

Because economic hardship cases are not flagged at the onset of the collection process, there is no indicator to alert IRS employees that a taxpayer may be unable to pay and to consider collection alternatives. For example, if a taxpayer calls ACS in response to a threatening collection notice, a telephone assistor may not be alerted to consider collection alternatives or take a full look at the taxpayer's financial situation.⁴³ Thus, many anxious or intimidated taxpayers may enter into payment agreements they cannot afford, even though additional financial analysis would show that other collection alternatives, such as an OIC, a Partial Pay IA, or CNC-Hardship status, would be more appropriate.⁴⁴

The IRS routinely undertakes collection treatments that do not require any financial analysis, including entering taxpayers into streamlined IAs. Over the last six years, nearly 4.3 million IAs have been arranged for cases assigned to ACS and about 84 percent of those IAs were streamlined—that is, entered into with no financial analysis.⁴⁵ Figure 1.15.1 shows a breakdown of alternative collection arrangements entered into by taxpayers in FY 2018 by all collection units, showing OICs were the least used collection alternative.

42 IRM 5.15.1.7(1) (Oct. 2, 2012). The National Taxpayer Advocate continues to have concerns over how the IRS applies ALEs in other collection activities, and believe that ALE standards should be based on costs rather than expenditures, and cover a wider range of expenses. See Research Study: *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,"* *infra*; National Taxpayer Advocate 2016 Annual Report to Congress 192-202 (Most Serious Problem: *Allowable Living Expense (ALE) Standard: The IRS's Development and Use of ALEs Does Not Adequately Ensure Taxpayers Can Maintain a Basic Standard of Living for the Health and Welfare of Their Households While Complying With Their Tax Obligations*). Still, ALEs can be an important starting point to detect taxpayers that may be experiencing economic hardship.

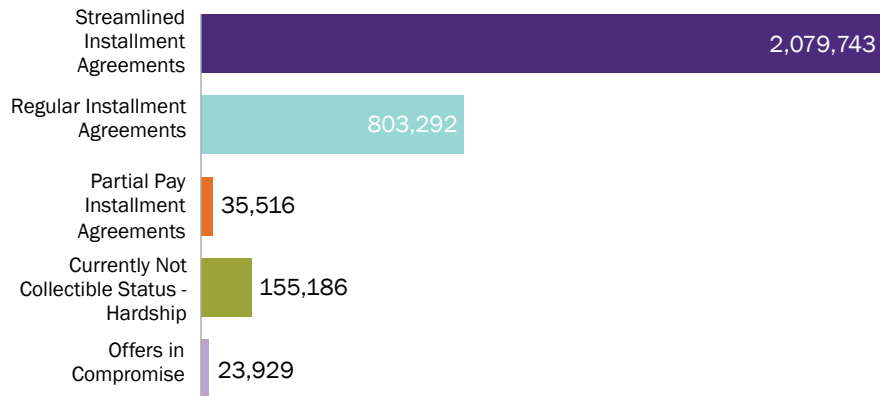
43 Failing to identify economic hardship cases is particularly a problem for cases with delinquencies assigned to ACS. See Most Serious Problem: *IRS'S Automated Collection System (ACS): ACS Lacks a Taxpayer-Centered Approach, Resulting in a Challenging Taxpayer Experience and Generating Less Than Optimal Collection Outcomes for the IRS,* *infra* ("Taxpayers are further frustrated when talking to ACS because they may be talking to an employee who is unfamiliar with their geographic circumstances, and because they may have to explain the conditions in their region over and over since ACS provides no single point of contact.").

44 A Partial Pay IA is a type of IA in which the taxpayer makes payments over the length of time remaining on the collection statute, even though these payments will not fully pay the liability. For additional discussion of concerns regarding the types of collection arrangements taxpayers enter into in ACS, 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*.

45 There are instances where IAs maybe arranged by other Collection units than ACS. In FY 2018, streamlined IAs made up about 72 percent of total installment agreements. IRS, Collection Activity Report NO-5000-6 (Oct. 1, 2018).

FIGURE 1.15.1⁴⁶

Alternative Collection Arrangements in FY 2018



Forty percent of taxpayers who entered into a streamlined IA in ACS in FY 2018 had incomes at or below their ALEs.⁴⁷ These taxpayers agreed to pay their tax debts while, even by the IRS's own standards, they could not pay for their basic living expenses. These taxpayers may default on their IAs, or continue to make payments but be unable to meet what the IRS has determined are basic living expenses.⁴⁸ TAS research shows the default rate for streamlined IAs of taxpayers whose income was at or below their ALEs within ACS in FY 2018 was about 39 percent.⁴⁹

As discussed above, shelved cases that are not designated as CNC-Hardship may be eligible for assignment to a PCA.⁵⁰ PCAs do not have the authority to assist taxpayers in resolving their accounts, *e.g.*, by designating the account as CNC-Hardship. PCAs may only request full payment of the liability or, if the taxpayer cannot immediately pay in full, the PCA may propose a streamlined IA.⁵¹ Forty percent of taxpayers who entered into IAs while their debts were assigned to PCAs had incomes at or below their ALEs.⁵² This result shows the grave consequences faced by taxpayers when economic hardship cases are not detected and flagged in the case scoring stage, or later as part of the process of determining which cases are sent to the PCAs.

46 IRS, Collection Activity Report NO-5000-6 (Oct. 1, 2018) (showing number of IAs); IRS, Collection Activity Report NO-5000-108 (Oct. 2, 2018) (showing number of OICs); IRS, Collection Activity Report NO-5000-149 (Oct. 11, 2018) (showing number of cases closed as CNC-Hardship).

47 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*.

48 The IRS does not track why IAs default, so it has no way to know how many taxpayers in streamlined IAs could no longer afford to pay.

49 TAS Research analysis of the IMF and Individual Returns Transaction File on IAs established in FY 2018. This figure assumes taxpayers have one IRS-allowed vehicle ownership and operating expenses, and only a second one if the taxpayer filed jointly with his or her spouse. As discussed below, if we assume the taxpayers did not have vehicle ownership expenses, the default rate would be about 32 percent.

50 IRC § 6306(c). Liabilities in Currently Not Collectible (CNC)-Hardship status are not selected for assignment to PCAs. An account that is assigned to a PCA and then placed in CNC-Hardship status is recalled from PCA inventory. IRS response to TAS information request (Dec. 19, 2017).

51 See IRC § 6306(b).

52 See Most Serious Problem: *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*, *infra*.

Over the last six years, about 4.3 million Installment Agreements (IAs) have been arranged for cases assigned to Automated Collection System (ACS) and about 84 percent of those IAs were streamlined—that is, entered into with no financial analysis.

Shelving Economic Hardship Cases Does Not Help Taxpayers Resolve Their Liabilities and Can Harm Future Compliance

Taxpayers with cases shelved by the IRS receive no further communications from the IRS to resolve the liability other than an annual balance due reminder.⁵³ This means that penalties and interest will continue to accrue on the taxpayer's liability unless the taxpayer reaches out on his or her own to make a payment. Yet without any nudges from the IRS, many taxpayers may not understand the significance of their balance due and not prioritize paying it off.⁵⁴ This can lead to the accumulation of interest and penalties, which make the balance more difficult to pay off down the road.

Furthermore, working a case, even when it is not likely to produce full payment, produces downstream benefits by helping taxpayers become more compliant in the future. The IRS currently does not have any established measures to identify a change in compliance behavior after contact with ACS, although it intends to include behavioral tracking of how taxpayers respond to notices in its notice redesign process.⁵⁵ However, the 2014 “Uncollectible Versus Unproductive” study relied on by the IRS to update IDS scoring found that while working CNC cases would produce smaller payments than other types of cases, “the estimated subsequent compliance impact of working CNC cases is relatively large compared to cases without a CNC determination.”⁵⁶ While the National Taxpayer Advocate does not believe the IRS should pursue collection enforcement activity against taxpayers with a CNC determination, engaging these taxpayers through additional correspondence could be effective at bringing them back into compliance and should be studied in greater detail by the IRS.⁵⁷

53 IRS response to TAS information Request (Oct. 17, 2018). See also CP 71A, *Annual Reminder of Balance Due Taxes*. TAS has previously recommended that the IRS send notices at least quarterly to taxpayers with delinquent tax liabilities to collect more revenue and remind taxpayers of the accumulation of interest and penalties. See National Taxpayer Advocate Purple Book 46 (*Amend IRC § 7524 to Require the IRS to Mail Notices at Least Quarterly to Taxpayers With Delinquent Tax Liabilities*) (Dec. 31, 2017). This recommendation was adopted in the Protecting Taxpayers Act introduced by Senators Portman and Cardin. S. 3278, 115th Cong. § 201 (2018).

54 See Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

55 IRS response to TAS information Request (Oct. 17, 2018).

56 Erik Miller, Stacy Orlett, and Alex Turk, IRS, *Uncollectible Versus Unproductive: Compliance Impact of Working Collection Cases That Are Ultimately Not Fully Collectible*, (2014) (“Overall, 12 percent of the individual taxpayers in our study acquired an additional module with an average unpaid assessment of \$804. Cases routed to ACS with a subsequent CNC determination had the lowest percentage of subsequent modules at 8 percent.”).

57 For a discussion of the impact of additional correspondence, see Research Study: *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,”* *infra*.

The IRS Should Better Identify Taxpayers at Risk of Economic Hardship and Develop a Communications Strategy to Work With These Taxpayers Rather Than Taking Automated Collection Action

The IRS Should Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Prior to Undertaking Collection Action

TAS's research shows that an algorithm using internal data about a taxpayer's income and assets, and comparing that information to ALEs, can be a reliable way to predict taxpayers at risk of economic hardship. TAS evaluated a sample of 278 cases in which a taxpayer's account was closed by ACS or the Field with an IA in FY 2018—all cases in which the IRS obtained financial information from the taxpayer which showed ability to pay—and analyzed whether filtering those cases based on systemic information about a taxpayer's income and ALEs would arrive at the same result.⁵⁸ Only 14 cases, or five percent of the sample group, showed no ability to pay by the algorithm—meaning that TAS's algorithm arrived at the same result as the IRS employee in 95 percent of the cases. In five of the 14 cases where TAS's algorithm indicated the taxpayer had no ability to pay, the IRS employee initiated a back-up CNC determination in case the IA defaulted. This suggests that even in cases where TAS's algorithm arrived at a different result than on the financial information statement, it didn't miss by much and the IRS recognized these taxpayers could still be at risk of economic hardship.⁵⁹ Thus, these results indicate that the IRS could use internal data as an effective starting point in financial analysis of a taxpayer's ability to pay.⁶⁰

Using an automated algorithm to proactively identify taxpayers at risk of economic hardship would allow the IRS to address these cases more appropriately, and could be used in several scenarios:

- **Case Scoring:** The algorithm could apply a marker during case scoring to show the case is at risk of economic hardship and route it a new specific group within ACS, or the “Economic Hardship Shelter.”
- **Telephone Correspondence:** The algorithm could be used to create a template for telephone assistors to view a comparison of the taxpayer's income to ALEs upon inputting the taxpayer's Social Security number. This way, if a taxpayer calls in about his or her tax liability, the assistor would be automatically alerted to ask more questions about the taxpayer's finances prior to setting the taxpayer up on an IA.⁶¹

58 TAS excluded two cases from the sample because we could not find additional information on the two cases because of an error in the data collection instrument. TAS Research estimated the income for taxpayers in these cases using the Total Positive Income (TPI) reported on the taxpayer's FY 2017 tax return. To evaluate taxpayers that may not have filed a prior-year return, TAS also considered information from third party Information Reporting Program (IRP) documents, including Forms 1099 interest, 1099 dividends, 1099 R (retirement income), 1099 B (stocks and bonds), 1099 MISC, 1099 SSA, and W-2. To incorporate assets, TAS Research looked at Form 1098 (Mortgage Interest), and real estate tax or mortgage interest paid on Schedule A. TAS calculated the amount of ALEs for each case by using the National Standards (with household size determined based on the number of exemptions claimed on the return), Local Standards (determined by the zip code on the return), Vehicle Ownership Expense, and Out of Pocket Healthcare Expenses (determined by the taxpayer's age). If the taxpayer did not file a return in a previous year, TAS allocated the lower amount.

59 The filter's computed ALE amount did not exceed the IRS's computed amount in 82 percent of the cases in our sample.

60 The IRS has expressed concern regarding the ALE determination methodology and how to address income when no income tax return is found. However, the results of TAS's research highlight the need for the IRS to study the feasibility of using internal data further and in which situations the algorithm could be beneficial.

61 While the National Taxpayer Advocate believes the flag indicating a case is at risk of economic hardship should trigger this discussion, using this template would update the information and help ensure the taxpayer's financial situation has not changed since initial case scoring.

- **Online Installment Agreements:** The algorithm could provide a warning for taxpayers entering into streamlined IAs online that they have been flagged as at risk of economic hardship, and could provide the contact number to call if they believe they cannot pay the tax debt without incurring economic hardship.
- **Automated Collection Treatments:** The algorithm could screen out taxpayers with income below their ALEs from automated collection treatments such as the Federal Payment Levy Program, selection for referral to PCAs, or for passport certification unless and until the IRS makes a direct personal contact with the taxpayer to verify the information.⁶²
- **CNC-Hardship Review:** The algorithm could be incorporated into the IRS's systemic follow-up review of hardship cases to determine whether the taxpayer's current financial situation has positively changed and the taxpayer's case can be put back into the active inventory.⁶³

Systemically flagging cases as at risk of economic hardship would not automatically place these taxpayers in CNC-Hardship status, but it would protect these taxpayers from further collection action until the IRS gathers sufficient financial information to make a determination.⁶⁴

The IRS Should Contact Taxpayers Likely at Risk of Economic Hardship by Letter and Create a Dedicated Phonenumber to Discuss Potential Collection Alternatives With Those Taxpayers

Rather than leaving the case neglected while penalties and interest continue to accrue as on the shelf, the IRS should take steps to facilitate communication with taxpayers identified as at risk of economic hardship. Identified cases should be routed to a specific group within ACS, or the “Economic Hardship Shelter.” From that group, the IRS could provide:

- **Hardship Help Line:** A dedicated help line would help the IRS work with taxpayers at risk of economic hardship and collect any other information needed to make the determination that the taxpayer should be placed in CNC-Hardship status.
- **Hardship Notice:** TAS's research shows that additional, targeted contact with taxpayers can help them understand their obligations and avoid future mistakes.⁶⁵ The IRS should send a specific notice to educate flagged taxpayers on potential collection alternatives and resources available,

62 The House of Representatives included a provision to exclude taxpayers whose incomes are less than 250 percent of the federal poverty level from referral to a PCA in the bipartisan Taxpayer First Act, H.R. 5444, which passed the House with a recorded vote of 414-0 on April 18, 2018. A recent proposal in Congress would exclude taxpayers whose incomes are at or below 200 percent of the federal poverty level from having their debts assigned to a PCA. See House Amendment to the Senate Amendment to H.R. 88, Division B, § 1205 *Taxpayer First Act of 2018* (Nov. 26, 2018). The IRS should also continue to take steps to incorporate using TAS's retirement income calculator for FPLP. See National Taxpayer Advocate 2018 Objectives Report to Congress 80-87 (Area of Focus: *The IRS Has Improved Its Internal Guidance for Retirement Levies But More Can Be Done*).

63 IRM 5.16.1.6 (Dec. 8, 2014) (describing the two-year review process for CNC cases).

64 In FY 2018, the IRS placed 155,186 taxpayers in CNC-Hardship status in FY 2018. Custom analysis by TAS Research, IRS, IMF, Collection Activity Report NO-5000-149 (Oct. 11, 2018). About 60 percent of these cases involved taxpayers with income less than ALEs and no indication of an asset, which could have been flagged by the economic hardship algorithm at the outset of case scoring. TAS Research analysis of the IMF and Individual Returns Transaction File on IAs established in FY 2018. While taxpayers can be placed in CNC-Hardship even with income above ALEs, this data indicates that using ALEs as a filter can be an effective baseline indication of taxpayers likely to experience economic hardship.

65 See Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*; see also IRS, *Behavioral Insights Toolkit* 13, 27 (2017) (“Feedback and reminders highlight a specific piece of information to increase the chances that recipients will act on or respond to the information in a desired way.”).

including TAS and the Low Income Taxpayer Clinic (LITC).⁶⁶ The letter should encourage taxpayers to call the Hardship Help Line, and clearly list the number to do so.

This type of communication would show a willingness by the IRS to work with the taxpayers to meet their needs and circumstances, fulfilling taxpayer *rights to be informed* and *to quality service*, and could improve taxpayer trust in the agency.⁶⁷

These communications should be *resolution-oriented*, explaining to taxpayers the risks of neglecting a tax liability and how penalties and interest can continue to accrue. To better serve taxpayers at risk of economic hardship, the IRS should partner with TAS and the LITCs to develop regular, annual training focusing exclusively on economic hardship to prepare collection employees for how to work with these taxpayers. The training should cover how to help taxpayers develop a plan to resolve the liability through collection alternatives, and highlight the appropriate use of OICs. In drafting IRC § 7211, Congress directed the IRS to make OICs more available to taxpayers to “enhance taxpayer compliance.”⁶⁸ The Committee Report reflects the belief that the IRS should be “flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system” and “make it easier for taxpayers to enter into offer in compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.”⁶⁹ Pursuing collection alternatives with taxpayers suffering economic hardship would benefit those taxpayers by helping them to resolve their liability in a way that meets their financial situation and fulfills the taxpayer *right to finality*.

TAS’s research shows that an algorithm using internal data about a taxpayer’s income and assets, and comparing that information to Allowable Living Expenses (ALEs), can be a reliable way to predict taxpayers at risk of economic hardship.

Flagging Economic Hardship During Case Scoring Will Allow the IRS to Avoid Rework Caused by Defaulting Installment Agreements

TAS’s economic hardship algorithm can be an important indicator that a taxpayer *is* able to pay: in a research study by TAS, 93 percent of the payments received by the IRS in our sample group came from taxpayers with income in excess of their ALE or with an indication of an asset.⁷⁰ In a time of limited resources, focusing on more productive cases rather than IAs likely to default or to produce no payment

66 For additional discussion on the impact of sending collection alternative notices, see Research Study: *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,”* *infra*. See also Most Serious Problem: *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.,* *infra*.

67 The National Taxpayer Advocate believes the IRS should assign one ACS employee to a taxpayer’s case who is located in the same geographic region as the taxpayer so that the employee can better understand and relate to the taxpayer’s facts and circumstances. 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*.

68 S. REP. No. 105-174, at 88 (1998).

69 *Id.* at 88-89.

70 See Research Study: *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,”* *infra*.

could help the IRS avoid unnecessary rework, including time and resources to obtain an updated financial statement, reroute the case, or even issue a Notice of Federal Tax Lien determination with additional periods. Thus, proactively flagging taxpayers at risk of economic hardship would benefit taxpayers and the IRS alike. When coupled with the offer of a dedicated phone line to those taxpayers, the resulting future voluntary compliance will increase those benefits.

CONCLUSION

The IRS must have a different approach to address taxpayers who are *unable*, as opposed to *unwilling*, to pay their tax liabilities and bring them back into compliance. The Congressional mandates for the IRS to consider whether taxpayers can meet basic living expenses in CDP hearings and OICs show a recognition of the need to protect taxpayers who are experiencing economic hardship to prevent collection actions from exacerbating that hardship further. When taxpayers enter into payment agreements they cannot afford, it violates their *right to a fair and just tax system*. Similarly, neglecting taxpayers experiencing economic hardship by simply shelving their case or potentially routing them to a PCA violates the *rights to quality service* and *to finality*.

Using internal data to compare a taxpayer's financial status to their ALEs would allow the IRS to identify taxpayers at risk of economic hardship and shield those taxpayers from potentially harmful collection actions without further financial analysis. The IRS could use this algorithm to identify cases with higher collection potential and identify taxpayers that may be suited for collection alternatives. A notice detailing the options available to the taxpayer would help make the tax liability seem less of an insurmountable obstacle, and could prompt the taxpayer to reach out to the IRS to resolve their liability. In addition, a dedicated phone line for taxpayers at risk of economic hardship would help a taxpayer determine which option is most appropriate and answer any questions. Proactively working to identify and engage taxpayers experiencing economic hardship would be an important step in developing a taxpayer-focused approach to tax administration.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Develop and utilize an algorithm to compare a taxpayer's financial information to ALEs during IDS case scoring and as a template made available to Revenue Officers and telephone assistants responding to taxpayer inquiries.
2. Apply this algorithm before sending any cases to PCAs, and exclude any case involving a taxpayer at risk of economic hardship from potentially collectible inventory.
3. 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 LITCs.
4. 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.
5. Partner with TAS and LITCs to develop issue-focused training for IRS employees who interact 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****RESPONSIBLE OFFICIAL**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

Field Collection works cases² that have not been resolved through the notice stream or through the Automated Collection System (ACS).³ 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. Often these cases are aged and generally involve resolution of tax debts with complex financial circumstances, the investigation and assertion of trust fund liabilities related to employment taxes, finding collection alternatives that cannot be resolved by mere levy or seizure of assets, and ensuring taxpayers are in full compliance with filing tax returns and paying taxes. In fiscal year (FY) 2018, the average age of cases with at least one unpaid assessment assigned to Field Collection was 1,203 days.⁴ Revenue Officers are supposed to make field visits to taxpayer locations to gain a better understanding of taxpayers' financial circumstances and the economic conditions in their geographic area.⁵ They meet with taxpayers face-to-face and assess their ability to pay the tax.

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 In Field Collection, Revenue Officers work cases, which consist of various delinquent and balance due modules. See Internal Revenue Manual (IRM) 5.1.20, *Field Collecting Procedures, Collection Inventory* (Nov. 2, 2016).

3 For an overview of the IRS collection process and information about each Collection function, see the Introduction to Collection, *infra*.

4 IRS, Compliance Data Warehouse (CDW), Individual and Business Module Accounts Receivable Dollar Inventory. Small Business/Self-Employed (SB/SE) could not confirm the reported average age of a case due to limited information provided regarding the methodology. However, the Strategic Analysis & Modeling (SAM) team came up with a similar average age of 1,353 days by conducting a series of queries for the same time frame of Individual Master File (IMF) and Business Master File (BMF) cases assigned to Status 26 during fiscal year (FY) 2018 using data from CDW's Masterfile Status History and Accounts Receivable Dollar Inventory tables.

5 See IRM 5.1.10.3, *Initial Contact* (Dec. 11, 2018); Field Compliance Embedded Quality FC Job Aid (Sept. 2017), Attribute 401, Field Visitation.

Notwithstanding their responsibility to collect tax, Revenue Officers must adhere to taxpayers' right to privacy and right to a fair and just tax system, which means, respectively, the Revenue Officer must balance the government's interest in collecting the tax with the taxpayer's interest that the collection action be "no more intrusive than necessary," and the Revenue Officer must consider the taxpayer's specific "facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely."⁶ The current state of Field Collection has impaired the ability of Revenue Officers to fulfill their mission in accord with the TBOR.

The National Taxpayer Advocate has the following concerns:

- Revenue Officer staffing has declined by 45 percent since 2011⁷ and therefore is not as accessible to taxpayers, and is less able to assess economic conditions on the ground;
- IRS procedures do not provide for early intervention by Revenue Officers;
- Revenue Officers are not given the appropriate tools (*e.g.*, ability to enter into offers in compromise (OICs); reduced training) to effectively collect revenue; and
- IRS metrics for evaluating the effectiveness of Field Collection are incomplete; they do not properly measure the value of first contact resolution, future voluntary compliance, prevention of economic hardship, or the education of taxpayers.

ANALYSIS OF PROBLEM

Background

If taxpayers do not voluntarily pay taxes assessed, the IRS may initiate collection action. The IRS will send a series of letters issued early in the life of the debt, notifying the taxpayer of the balance due and requesting payment of the full amount (this is called the "notice stream"). If the taxpayer does not pay in full or otherwise respond to the notice stream, the IRS issues a final notice of intent to levy via certified mail.⁸ If the taxpayer does not pay within 30 days of that notice, the IRS sends a collection due process (CDP) notice that provides a taxpayer the opportunity to appeal the filing or issuance of liens or levies.⁹

⁶ See IRS Pub. 1, *Your Rights as a Taxpayer* (rev. Sept. 2017).

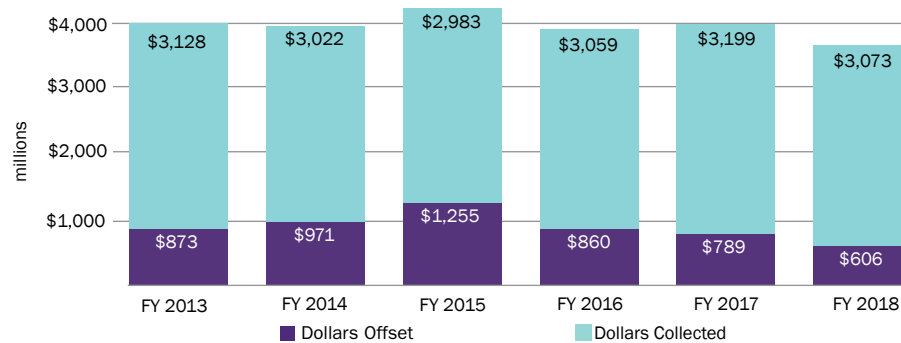
⁷ The number of Revenue Officers declined from 4,817 at the end of FY 2011 to 2,639 at the end of FY 2018. IRS Human Resources Reporting Center (Sept. 24, 2011 and Sept. 29, 2018). Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

⁸ See IRC § 6331(d).

⁹ See IRC §§ 6320 and 6330. For an in-depth discussion of the Collection Due Process (CDP) process, 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*, *supra*.

FIGURE 1.16.1¹⁰

Dollars Collected (including Offset) by Field Collection by Fiscal Year



The chart above shows the amounts collected by Field Collection (including via offsets from taxpayer refunds) for the five-year period from FY 2013 to FY 2017. The dollars collected by Field Collection has been relatively steady, despite the significant reduction in Revenue Officer staffing that we had mentioned. The IRS brought in over \$3 billion in FY 2018 from Taxpayer Delinquent Accounts (TDAs) assigned to Field Collection.¹¹ Additionally, nearly \$1.3 billion was collected from installment agreements attributable to Field Collection.¹²

Field Collection issued 439,001 levies in FY 2018.¹³ This is a 47 percent decrease when compared to FY 2011. In FY 2018, Field Collection completed 275 seizures, down 65 percent from 776 in FY 2011.¹⁴ Field Collection filed 225,852 liens in FY 2018, down 60 percent from 566,889 liens filed in FY 2011.¹⁵

10 See FY 2018: IRS, Collection Activity Report 5000-2, Taxpayer Delinquent Accounts (TDAs) (Sept. 30, 2018); FY 2017: IRS, Collection Activity Report 5000-2, TDA Report (Oct. 1, 2017); FY 2016: IRS, Collection Activity Report 5000-2, TDA Report (Oct. 2, 2016); FY 2015: IRS, Collection Activity Report 5000-2, TDA Report (Oct. 4, 2015); FY 2014: IRS, Collection Activity Report 5000-2, TDA Report (Sept. 28, 2014); FY 2013: IRS, Collection Activity Report 5000-2, TDA Report (Sept. 29, 2013).

11 The exact amount collected by Field Collection in FY 2018 was \$3,073,180,944. IRS, Collection Activity Report 5000-2 (Sept. 30, 2018); IRS, Collection Activity Report 5000-6 (Sept. 30, 2018).

12 \$1,294,794,616 was collected from installment agreements (IAs) in FY 2018. IRS, Collection Activity Report 5000-2 (Sept. 30, 2018); IRS, Collection Activity Report 5000-6 (Sept. 30, 2018).

13 IRS, Collection Activity Report 5000-24 (Oct. 9, 2018). In FY 2011, Field Collection issued 882,751 levies; IRS, Collection Activity Report 5000-C23 (Oct. 11, 2011).

14 IRS, Collection Activity Report 5000-24 (Oct. 9, 2018); IRS, Collection Activity Report 5000-C23 (Oct. 11, 2011).

15 This includes liens filed by Advisory and lien refiles. IRS, Collection Activity Report 5000-25 (Oct. 1, 2018).

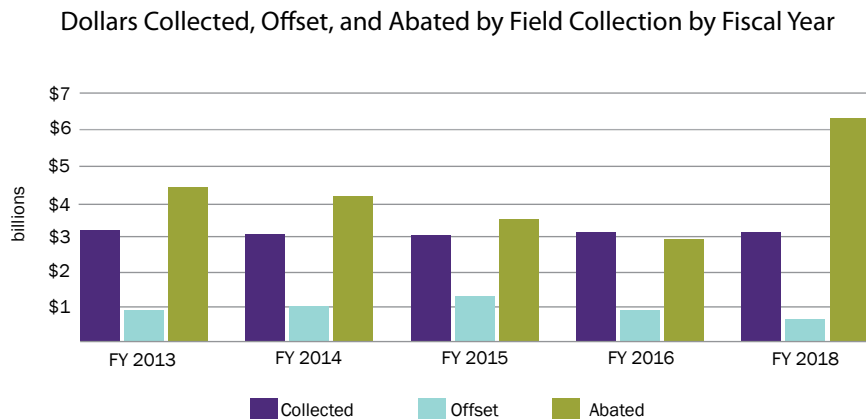
FIGURE 1.16.2¹⁶

Figure 1.16.2 shows the amounts abated by Field Collection from FY 2013 to FY 2018.¹⁷ An abatement is a decrease in the amount of penalties or tax that is imposed upon a person.¹⁸ The figure above includes partial and full abatements. Examples of abatements include abatement of the failure to file penalty, abatement of estimated tax penalty, abatement of the failure to deposit penalty, or abatement of the failure to pay penalty, and abatement of the IRS’s substitute for return assessment under IRC § 6020(b). Interestingly enough, Field Collection abated more than it collected in many years.

The Role of Field Collection

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. Revenue Officers are charged with collecting delinquent taxes and securing unfiled tax returns from individual and business taxpayers. Aspects of a Revenue Officer’s responsibilities include education, research and investigation, and, when necessary, appropriate enforcement.

One of the important roles Revenue Officers play is to educate taxpayers on their tax filing and paying obligations. Taxpayers have the right to be informed and the right to know what they need to do to comply with tax laws. They are entitled to clear explanations of the law and IRS procedures and IRS decisions about their tax accounts and to receive clear explanations of the outcomes. During their interaction with taxpayers, Revenue Officers have an opportunity to provide guidance on a wide range

16 See FY 2018: IRS, Collection Activity Report 5000-2, TDA Report (Sept. 30, 2018); FY 2016: IRS, Collection Activity Report 5000-2, TDA Report (Oct. 2, 2016); FY 2015: IRS, Collection Activity Report 5000-2, TDA Report (Oct. 4, 2015); FY 2014: IRS, Collection Activity Report 5000-2, TDA Report (Sept. 28, 2014); FY 2013: IRS, Collection Activity Report 5000-2, TDA Report (Sept. 29, 2013).

17 The National Taxpayer Advocate discusses abatements of tax in the 2016 Annual Report to Congress, recommending that the IRS determine and mitigate the factors causing such a large percent of the tax to be abated, so that resources are not wasted on assessments not due. See National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 81-102 (Research Study: *Collecting Business Debts: Issues for the IRS and Taxpayers*). The “dollars collected” only includes dollars collected from TDAs assigned to Field Collection it does not include revenue from IAs or secured returns. FY 2017 data is omitted from the graph because of a few large outliers. In FY 2017, Field Collection abated more than six times the amount it collected. IRS, Collection Activity Report 5000-2 (Oct. 1, 2017).

18 BLACK’S LAW DICTIONARY (Free Online Legal Dictionary 2nd Ed.).

of financial matters and help taxpayers take actions to resolve their tax issues. That interaction should include public outreach to provide information about the Revenue Officers' role in the collection of taxes and the policy, process, and procedures of field collection. Yet, there is no outreach function for Field Collection, or even within the SB/SE division. As of April 1, 2017, the IRS moved the Stakeholder Liaison function out of SB/SE and into headquarters Communications & Liaison.

As part of the investigative process, Revenue Officers in Field Collection are expected to meet with taxpayers (individual taxpayers and business taxpayers, or their representatives) in person to discuss and establish collection alternatives.¹⁹ Such meetings may be held at the taxpayer's place of business, the taxpayer's residence, or at the representative's office.²⁰ Revenue Officers will also obtain and analyze financial information to determine the taxpayer's ability to pay the tax bill.

The majority of Field Collection cases are related to business taxpayers. At the end of FY 2018, business taxpayers comprised 53 percent of Field Collection cases.²¹ Business cases are often more complicated, requiring time and resources to properly assess and address the business's unique compliance circumstances. This includes investigation and assertion of the trust fund recovery penalty (TFRP) on persons involved in the activities to collect, account for, and pay over taxes held in trust of employment tax.²² Active businesses with employees are called in-business-trust-fund (IBTF) taxpayers. IBTF taxpayers require personal contact and, in most circumstances, a field visit.²³ These accounts cannot be simply resolved in the notice stream or the ACS when the issues involve more than one tax period, unfiled employment tax returns, or late federal tax deposits.

The IRS Has Been Entrusted With Powerful Collection Powers

Congress has given the IRS some very powerful tools to bolster its collection efforts. For example, if a taxpayer has outstanding tax liabilities and has not responded to the notices to pay, the IRS may file a Notice of Federal Tax Lien or levy assets or income without first going to court and obtaining a judgment.²⁴ These are awesome collection powers granted to the IRS. For a private creditor to garnish a paycheck or attach a lien to assets, generally it would need to first go to court and obtain a judgment, while the IRS may take these actions administratively.

Using its lien and levy authorities are drastic measures that can have significant negative impact on taxpayers. Thus, before taking these measures, Revenue Officers are to check whether taxpayers are not suffering economic hardship from circumstances that would make their account "currently not collectible."²⁵

19 See IRM 5.1.10.3.2, *Effective Initial Contact* (Nov. 20, 2017); IRM 5.1.10.3(3), *Initial Contact* (Dec. 11, 2018) ("In most cases, you should try to make initial contact with taxpayers in the field.")

20 IRM 5.15.1.2(4), *Overview and Expectations* (Aug. 29, 2018).

21 IRS, Collection Activity Report 5000-2 (Dec. 3, 2018).

22 IRC § 6672. See IRM 5.7.3, *Establishing Responsibility and Willfulness for the Trust Fund Recovery Penalty* (Aug. 6, 2015); IRM 1.2.14.1.3, *Policy Statement 5-14 (Formerly P-5-60)* (June 9, 2003); IRM 5.17.7, *Legal Reference Guide for Revenue Officers, Liability of Third Parties for Unpaid Employment Taxes* (July 18, 2012).

23 See IRM 5.1.10.3, *Initial Contact* (Dec. 11, 2018); Field Compliance Embedded Quality Field Collection (FC) Job Aid (Sept. 2017), Attribute 401, Field Visitation.

24 See IRC § 6321; IRC § 6331.

25 See IRM 5.11.1.3.1, *Pre-Levy Considerations* (Nov. 9, 2017). "Revenue Officers must exercise good judgment in making the determination to levy... If the revenue officer has sufficient information and verified that the levy would cause an economic hardship, the levy should not be issued." See also Most Serious Problem: *Economic Hardship: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*, *supra*.

If a Revenue Officer determines that a taxpayer is unable to pay the tax bill in full, the Revenue Officer may consider alternative means of resolving the tax debt. Such collection alternatives may include:

- Setting up an installment agreement that would allow the taxpayer to pay the bill over time;
- Recommending relief from penalties imposed when the tax bill is overdue (*e.g.*, if there is reasonable cause) or recommending adjustment or abatement if the tax debt is in doubt;
- Evaluating whether the taxpayer is a good candidate for an offer in compromise, where the IRS would accept less than the full amount of the tax liability; or
- Suspending collection due to currently not collectible accounts, which could include IBTF taxpayers.²⁶

Because Revenue Officers 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.²⁷ For example, there may be circumstances unique to that community that should be taken into consideration. Having IRS employees with a geographic presence in the local community can pay dividends by making the IRS seem more relatable. TAS research studies have shown that personal contacts produce better response, resolution, and agreement rates, and result in better-educated taxpayers.²⁸

As of December 6, 2018, there were 2,639 Revenue Officers nationwide.²⁹ Figures 1.16.3 and 1.16.4 reflect the number of Revenue Officers by state in FY 2011 and, again, in FY 2018.³⁰

26 Accounts may be reported currently not collectible (CNC) using closing code 13 when an operating corporation, exempt organization, or limited liability partnership can pay current taxes but cannot pay its back taxes and enforcement cannot be taken because the business has no distrainable accounts receivable or other receipts or equity in assets. See IRM 5.16.1.2(1), *Currently Not Collectible Procedures, Closing Code 13* (Sept. 18, 2018); IRM 5.16.1.2.7, *In-Business Corporations, Exempt Organizations, Limited Liability Partnerships, or Limited Liability Corporations* (Aug. 25, 2014).

27 See National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, 245 (Literature Review: *Fostering Taxpayer Engagement Through Geographic Presence*).

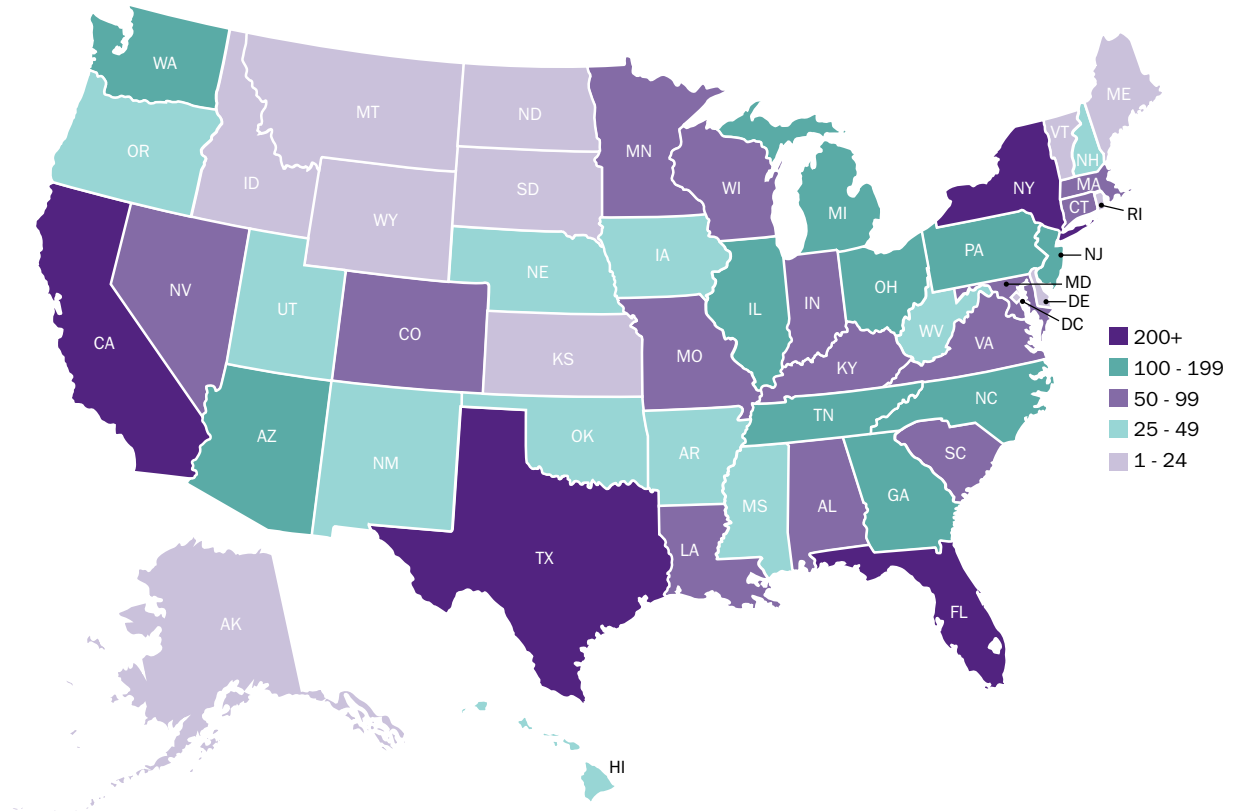
28 See, *e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 15 (Research Study: *A Comparison of Revenue Officers and Automated Collection System in Addressing Similar Employment Tax Delinquencies*).

29 IRS Human Resources Reporting Center (Sept. 29, 2018). Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

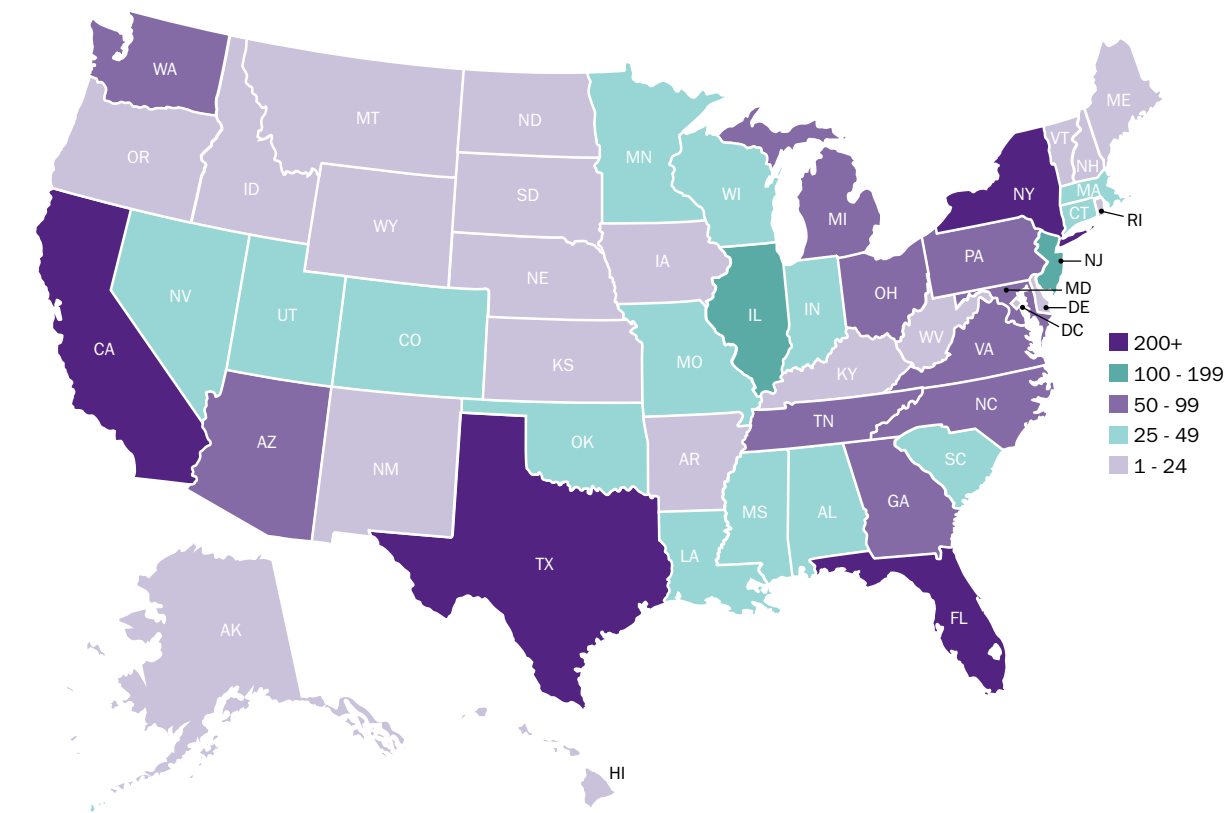
30 Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

FIGURE 1.16.3³¹

Revenue Officer (RO) by State and US Possession, 2011



31 U.S. Possessions with no Revenue Officers include Armed Forces Pacific (AP), American Soma (AS), Guam (GU), Marshall Islands (MH), Northern Marinana Islands (MP) and Palau (PW). Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

FIGURE 1.16.4³²**Revenue Officer (RO) by State and US Possession, 2018**

Field Collection has plans to hire up to an additional 750 Revenue Officers (budget permitting) in FY 2019,³³ but note that nearly a quarter of the current Revenue Officer cadre is eligible to retire.³⁴

Revenue Officers Need to Be More Accessible to Taxpayers

As Figure 1.16.5 reflects, there has been a significant reduction in the staffing of Revenue Officers over the past several years. As of the end of FY 2018, there were 2,639 Revenue Officers, down 45 percent from 4,817 Revenue Officers in FY 2011. One negative consequence of this decline in staffing is that it makes it more difficult for taxpayers to have face-to-face interaction with Revenue Officers. In less populated states, a taxpayer may be required to drive hundreds of miles to meet with the nearest Revenue Officer. Moreover, the decrease in IRS offices staffed with Revenue Officers makes it more

³² U.S. Possessions with no Revenue Officers include AP, AS, GU, MH, MP, PW and Virgin Islands, U.S.

³³ IRS response to TAS information request (Oct. 5, 2018). Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

³⁴ As of January 5, 2019, 606 Revenue Officers will be eligible for retirement. Data obtained from the IRS Human Resources Reporting Center (Dec. 11, 2018). Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

difficult for individual Revenue Officers to understand the economic conditions in the taxpayer’s geographic area or industry—conditions that influence the taxpayer’s ability to pay the tax debt.³⁵

In recent conversations TAS held with stakeholder groups, practitioners expressed a common frustration with the lack of responsiveness of the Revenue Officers.³⁶ 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.

According to the 2019 National Agreement between the IRS and the National Treasury Employees Union (NTEU), Revenue Officers are among the positions eligible for “frequent telework”—meaning that they have regular and recurring duties that may be performed at an approved site other than the official post of duty for more than 80 hours each month.³⁷ Frequent teleworkers are still required to report to their assigned post of duty at least two days each pay period for their full tour of duty.³⁸ However, since Revenue Officers are considered “mobile workers,” they can meet that reporting requirement by performing field work in their assigned post of duty at least twice during each pay period, in lieu of coming into the office. In other words, there is no minimum amount of time required for a Revenue Officer to spend in his or her office.

With the trend of frequent teleworking and “hoteling” (a hoteling arrangement is one where teleworking employees share a single workstation on a rotating basis, rather than have a dedicated office, allowing the government to save resources), taxpayers and practitioners may continue to have difficulty reaching their assigned Revenue Officer by phone, or receiving a callback.

FIGURE 1.16.5, “Hoteling” by Revenue Officer Groups, Calendar Year (CY) 2014 to CY 2018³⁹

	CY 2014	CY 2015	CY 2016	CY 2017	CY 2018 (thru June)
Revenue Officer Groups Allowing “Hoteling”	3	9	13	22	37

Field Collection has not conducted formal analysis on the impact of hoteling on Revenue Officers’ performance of duties and their interaction with taxpayers.⁴⁰ The trend toward more frequent hoteling of Revenue Officers may lead to reduced face-to-face office meetings, a reduced ability to accommodate walk-in or last-minute appointments, more difficulty in scheduling appointments (because of the need to adjust to the Revenue Officer’s hoteling schedule), delays in posting payments made by taxpayers,

35 Some IRS offices offer Virtual Service Delivery (VSD), where a taxpayer may interact with IRS employees via webcam. This VSD option seems like a good idea in theory, particularly for taxpayers in rural areas that may be hours away from the nearest IRS office. However, the only IRS business units that currently offer VSD capability are Field Assistance, TAS, and Appeals—and uptake has been disappointing. The technology is also challenging. With decreased Revenue Officer staffing, expanding some form of user-friendly virtual face-to-face technology to Field Collection would make it easier for taxpayers to get face-to-face contact with Revenue Officers. However, even if there is a demonstrated demand for VSD or alternative digital solutions, Field Collection should not diminish the option for traditional face-to-face interaction—there is no need for the IRS to make taxpayers choose one over the other.

36 TAS telephone calls with practitioners (Oct. 3, 2018; Oct. 10, 2018).

37 2019 National Agreement Between IRS and NTEU, Article 50, § 1.B.1, § 2.F.3.

38 2019 National Agreement Between IRS and NTEU, Article 50, § 1.A.4.

39 IRS response to TAS information request (Oct. 5, 2018).

40 *Id.*

and delays in posting tax returns. (The IRS did indicate that many offices have an “Revenue Officer of the Day” assigned to ensure that a Revenue Officer is available for unscheduled visits and to accept payments and tax returns, but such a designation would not be feasible in offices where there is just one Revenue Officer.)⁴¹ The IRS recognizes that there could be issues arising from teleworking Revenue Officers and lag time in accepting payments and financial information from taxpayers. For example, IRM 5.1.2, *Field Collection Procedures, Remittances, Form 809, and Designated Payments* (Nov. 26, 2014), discusses how teleworking employees should safeguard and timely post payments and OIC receipts from taxpayers. Offices that share secretaries will face additional hurdles in ensuring there is not a significant lag time in processing such that it burdens taxpayers and infringes on their right to quality service.

While there may be a resource savings to the government for increased hoteling of its Field Collection employees, we do not know the true cost—whether there is a negative impact on taxpayer service. The IRS may offer reduced customer service by delaying some administrative duties (such as posting payments, posting returns, inputting pending installment agreements, inputting bankruptcy indicators, etc.) because Revenue Officers spend less time in the office or because support staff is shared.

Assignment of Field Collection Cases Should Allow for Early Intervention

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. This risk of “pyramiding” taxes and interest is especially high in IBTF cases, which account for 15 percent of Field Collection’s modules in inventory as of the end of FY 2018.⁴² Thus, it is imperative that a Revenue Officer quickly assess the taxpayer’s situation and take early intervention measures, as appropriate

Recognizing the importance of early intervention, in June 2015, the IRS formed a Field Inventory Process Improvement Team (FIPIT) that looked at the impact of how inventory was assigned to Revenue Officers.⁴³ The “Fresh Inventory” pilot limited the assignment of inventory to Collection cases that had recent liabilities on tax periods less than three years old. The pilot applied to all individual and business tax liabilities. The goal was to have in-person contact with taxpayers as early as possible to educate them regarding compliance requirements and reduce the risk of pyramiding further, which is costly to the taxpayer.

For this Fresh Inventory pilot, cases were compared to control groups and the pilot groups generally had a higher number of full pay cases and a lower number of currently not collectible closures. The pilot groups also closed substantially more cases per Revenue Officer. This suggests that early intervention is a benefit to the taxpayer and makes it easier for the IRS to collect or otherwise resolve the case.

There are no plans to immediately implement any of the FIPIT pilots.⁴⁴ The results from the Fresh Inventory pilot suggest that the IRS could modify its case selection and assignment methodologies for Revenue Officers to encourage early intervention. This, in turn, would reduce taxpayer burden and increase the likelihood of the taxpayer becoming compliant in the future. The IRS should implement the approach utilized in the Fresh Inventory pilot, and explore other approaches to older inventory.

41 IRS response to TAS information request (Oct. 5, 2018).

42 IRS, Collection Activity Report 5000-2, TDA Report (Sept. 30, 2018).

43 IRS response to TAS information request (Oct. 5, 2018).

44 *Id.*

In 2014, Employment Tax engaged the Office of Research, Analysis, and Applied Statistics (RAAS) to examine the effectiveness of several potential expansions of the Federal Tax Deposit (FTD) Alert program, as part of the Early Interaction Initiative Pilot. The purpose of this initiative was “to determine the right treatment, at the right time, for the right taxpayer.”⁴⁵ The pilot studied the effectiveness of earlier interaction with taxpayers by first sending “soft letter notices” earlier in the quarter, to remind businesses of their obligation to make timely FTDs. The overall outcome of the FTD Early Interaction Initiative was an increase in the number and frequency of Alerts issued per quarter, and an expansion of the FTD Alert treatments into new taxpayer segments. The new taxpayer segments were businesses who needed early interaction, education, and Revenue Officer intervention.

The Early Interaction Initiative Pilot concluded in September 2016, showing some positive results. They indicated Revenue Officer field visits on IBTF taxpayers and early interaction were effective in ensuring businesses complied with FTD depository requirements. Based on the results of the pilot, Revenue Officer visits are estimated to have generated additional payments compared to a control group with no early interaction in 2017.⁴⁶ RAAS’s analysis is currently under review.

Properly Evaluating the Effectiveness of Field Collection Is Difficult But Achievable

As a general rule, the IRS assigns the “easier” collection cases to Campus Collection—high volume, “fresh” cases that the IRS thinks will not involve much personal contact—while it reserves the more problematic collection cases for Field Collection. Thus, it is not possible to make an apples-to-apples comparison of the effectiveness of Campus Collection versus Field Collection by looking strictly at the revenue collected.⁴⁷

The IRS measures quality through two systems—the Embedded Quality Review System (EQRS) and the National Quality Review System (NQRS).⁴⁸ EQRS is used to evaluate employee performance on cases and rate case actions against quality attributes.⁴⁹ NQRS provides independent case review information that is used to determine organizational performance. Many of the same quality attributes are used to review employee performance and assess organizational quality. The quality measurement systems evaluate Field Collection performance relative to the actions taken by Revenue Officers specific to the IRM, Collection policy, and statute, but it does *not* measure the outcome or impact of those actions to taxpayers, including if those actions resulted in undue harm or burden to taxpayers.⁵⁰

Although Field Collection measures quality, it does not include such results in its Monthly Assessment of Performance (MAP) and Business Performance Review (BPR). Only the metrics shown on the MAP and BPR are used to evaluate the effectiveness of the Field Collection program.⁵¹

45 IRS response to TAS information request (Oct. 5, 2018).

46 *Id.*

47 For an in-depth look at the Automated Collection System (ACS) function, 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*.

48 IRM 5.13.1, *Embedded Quality Field Organizations Administrative Guidelines* (Oct. 4, 2018).

49 See Field Compliance Embedded Quality FC Job Aid (Sept. 2017).

50 See IRM 21.10.1.7.12, *EQRS/NQRS Standard Reports* (Oct. 1, 2013); IRM 21.10.1.7.12.1, *Standard EQRS Reports* (May 17, 2018); IRM 21.10.1.7.12.2, *Standard NQRS Reports* (Sept. 11, 2018).

51 IRS response to the TAS information request (Apr. 26, 2018).

The Collection managers' manual has a very cursory section on taxpayer rights.⁵² This is the section of the IRM that lists the ten rights and instructs managers to ensure rights are “always observed.” Yet there is nothing in the managers' manual discussing specific ways to uphold these rights, such as meeting with taxpayers to hear any objections that they may have.

Revenue Officers have a number of important responsibilities as they interact with taxpayers, including:

- **Identifying economic hardship.** When a taxpayer states he or she is suffering from economic hardship, has the Revenue Officer taken all the appropriate steps to protect the taxpayer from further collection action? Has the Revenue Officer been proactive about identifying economic hardship and responded promptly to taxpayers' claims of experiencing economic hardship?⁵³
- **Preserving taxpayer rights.** Has the Revenue Officer advised the taxpayer of the Taxpayer Bill of Rights or merely handed (or mailed) the taxpayer Publication 1? The IRS should track whether these rights are being communicated from the outset of any collection case.⁵⁴
- **Evaluating collection alternatives.** After the Revenue Officer obtains the taxpayer's financial information and analyzed the situation, has the Revenue Officer seriously explored all of the collection alternatives?⁵⁵ Has the Revenue Officer explained each of the applicable options to the taxpayer in terms the taxpayer can understand? Has the Revenue Officer seriously considered the taxpayer's objections to the proposed collection action?⁵⁶
- **Taking timely actions.** While cycle time is one measurement, Revenue Officers also should be evaluated on whether they took timely actions. While timely actions are part of case quality review process, overall program metrics do not track the average timeliness of Revenue Officer actions.⁵⁷
- **Impacting taxpayers' future compliance behavior.** Revenue Officers have an opportunity to make a real impact on the future compliance behavior of taxpayers with whom they interact. If the IRS tracked this behavior, even by pulling nationally representative samples annually, Revenue Officers may be more invested in making an effort to ensure that taxpayers understand the process and are aware of what is expected of them.⁵⁸ Taxpayers have the right to be informed of IRS decisions about their tax accounts and are entitled to clear explanations of the laws and IRS procedures. One way to fulfill this right is for Revenue Officers to conduct and participate in outreach events to inform and educate taxpayers and practitioners about the collection process.
- **Receiving proper training.** Revenue Officers should regularly receive training, not only on the technical aspects of the job but on how to effectively interact with taxpayers. Courses on financial analysis should be required of all Revenue Officers. In addition, Revenue Officers should be offered communications and psychology workshops, enhancing Revenue Officers' skills in having conversations with taxpayers when collection action is imminent. Field Collection

52 IRM 1.4.50.3.2, *Protecting Taxpayer Rights* (Aug. 21, 2018).

53 See IRM 5.11.1.3.1, *Pre-Levy Considerations* (Nov. 9, 2017).

54 See Field Compliance Embedded Quality FC Job Aid, Attribute 607 Taxpayer Rights (page 21). Also, the Integrated Collection System (ICS) contact history screen allows you to select 'Taxpayer Rights Publications.' A pick list allows for verification of Pub 1, Pub 594 and Pub 1660; at least one publication must be selected to verify this selection.

55 See Field Compliance Embedded Quality FC Job Aid, Attribute 203 Requested/Secured Financial Information 5; Attribute 432 Verify/Analyze Ability to Pay 11; Attribute 434 Research & Technical Analysis 12.

56 See IRC § 7803(a)(3)(D).

57 Field Collection has Embedded Quality metrics which cases are reviewed. See Field Compliance Embedded Quality FC Job Aid 2; Attribute 200 Timely Initial Contact 4; Timely Follow-up Actions 16; Attribute 505 Timely Employee Actions.

58 See Field Compliance Embedded Quality FC Job Aid, Attribute 437 Compliance 14; Attribute 800 Customer Impact (National Review Only) 27.

should require a course that teaches ways to balance collection with taxpayer education regarding their rights as taxpayers and their responsibilities in tax compliance and awareness of other collection alternatives—and bring in external presenters from Low Income Taxpayer Clinics or private practitioners, as well as TAS, to give Revenue Officers a sense of the taxpayer perspective.

Organizational goals can drive behavior, but only when performance metrics are aligned with those goals. By emphasizing measures such as cycle time and percent of time spent in the field,⁵⁹ Collection sends a message to Revenue Officers that case closures and rates of performance are more important than balancing their role in the collection of taxes and tax returns and informing taxpayers of their rights, the IRS collection process and procedures, and the importance of voluntary compliance.

Virtual Training of Revenue Officers Is No Substitute for In-Person Training

In the National Taxpayer Advocate’s 2017 Annual Report to Congress, we reported that the IRS cut its training budget from a high of \$170 million in FY 2010 to just under \$40 million in FY 2017.⁶⁰ Not only has it slashed three-quarters of its training budget, but the IRS is moving away from face-to-face training and focusing its training efforts on virtual learning.

The IRS provided data on the number of training sessions it delivered over the past five fiscal years.⁶¹ We reviewed what was provided and found that much of Field Collection’s training is completed virtually. In the past, Field Collection regularly delivered face-to-face training, especially for new hires. However, this is no longer the case.⁶² In FY 2018, there were 14 times as many virtual training sessions as there were in-person training sessions.⁶³

FIGURE 1.16.6, Field Collection Training Sessions, FY 2014 to FY 2018⁶⁴

Fiscal Year	In-Person Sessions	Attendees	Total Hours	Virtual Sessions	Attendees	Total Hours
2014	105	2,151	15,579	1,464	78,627	201,991
2015	110	19,108	102,880	1,127	59,547	94,822
2016	10	461	16,199	137	704	1,390
2017	73	1,355	13,310	952	63,450	95,920
2018	74	20,897	58,685	1,058	47,158	45,926

59 SB/SE Business Performance Report (4th Qtr FY 2018); SB/SE Business Performance Report (3rd Qtr FY 2018).

60 National Taxpayer Advocate 2017 Annual Report to Congress 86.

61 IRS response to TAS information request (Oct. 5, 2018); IRS response to TAS information request (Nov. 7, 2017).

62 In-person attendees: FY 2014 43 new hires; FY 2015 280 hires; FY 2016 0 new hires; FY 2017 6 new hires; FY 2018 184 new hires. Virtual attendees: FY 2014 226 new hires; FY 2015 58 new hires; FY 2016 0 new hires; FY 2017 91 new hires; FY 2018 135 new hires. IRS response to TAS information request (Oct. 5, 2018); IRS response to TAS information request (Nov. 7, 2017); IRS response to TAS fact check (Jan. 30, 2019).

63 SB/SE disagreed. In its January 30, 2019, response, SB/SE asserted that there were eight times as many virtual training sessions as there were in-person training sessions. In FY 2018, there were 74 in-person person training sessions and 1,058 virtual sessions reported. Upon review of the virtual classes, 452 are Skillsoft online developmental courses. These courses are voluntary in nature and have inappropriately skewed these results. Excluding the voluntary Skillsoft developmental courses and utilizing a virtual class count of 606 (1,058 – 452).

64 IRS response to TAS information request (Oct. 5, 2018); IRS Human Capital Office response to TAS information request (Nov. 7, 2017). Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

We appreciate that there are substantial cost savings that the IRS may achieve by driving its employees to undergo virtual learning. However, the work of Revenue Officers requires the exercise of judgment and discretion. Discussions of case studies, partaking in role playing, practicing interviewing and negotiating techniques—these are skills that are vital for Field Collection employees and do not lend themselves to the virtual learning environment.

For example, TAS recommends the Financial Analysis series become a core competency course taught face-to-face.⁶⁵ This core competency will strengthen Revenue Officers' ability to more effectively work complex business cases⁶⁶ and provide them the tools to better identify and work their own OIC case versus shipping the case to an OIC Specialist who would not be familiar with the taxpayer's economic situation or geographic location.⁶⁷ Also, TAS recommends a new course be created, using the case study technique, on how to make an economic hardship determination including pre- and post-levy situations⁶⁸ and incorporating training on placing businesses into CNC status.⁶⁹

CONCLUSION

Revenue Officers have a difficult task. They are assigned collection cases that are aged and often require a great deal of legwork. Yet the trend is for Revenue Officers to receive less in-person training. Field Collection can help Revenue Officers become more effective by assigning them more recent cases (so Revenue Officers can make more of an impact via early intervention measures, as demonstrated by several recent pilot programs), by making them available to meet taxpayers face-to-face or respond timely to taxpayer calls, by encouraging Revenue Officers to conduct educational programs in their communities, and by changing how it evaluates Revenue Officers.

65 Financial Analysis series would include the following courses: (1) Basic Financial Analysis for Wage Earners; (2) Basic Financial Analysis for the Self-Employed (schedule C filer; emphasis on understanding bank statement info, P&L statement with comparison to Schedule C); (3) Financial Analysis for Flow-through Entities (emphasis on understanding the income statement and balance sheet); and (4) Financial Analysis of C-corporations and consolidated entities.

66 Field Collection reported that only 37 Revenue Officers in FY 2018 attended a financial analysis course. See IRS response to the TAS information request (Oct. 5, 2018).

67 IRM 5.8.5, *Offer in Compromise, Financial Analysis* (Mar. 23, 2018); IRM 5.1.2.5.6.2, *Processing Offer in Compromise Receipts* (Sept. 26, 2014).

68 IRM 5.1.12.20.1.1, *Make an Economic Hardship Determination* (Aug. 5, 2014); IRM 5.11.1.3.1, *Pre-Levy Considerations* (Nov. 9, 2017); IRM 5.11.2.3.1.4, *Economic Hardship* (Apr. 15, 2014). See also IRM 5.16.1.2.9, *Hardship* (Sept. 18, 2018).

69 IRM 5.16.1.2.7, *In-Business Corporations, Exempt Organizations, Limited Liability Partnerships, or Limited Liability Companies* (Aug. 25, 2014), specifically that accounts can be reported CNC using closing code 13 if such organizations can pay current taxes but cannot pay back its back taxes and enforcement cannot be taken because the business has no distrainable accounts receivable or other receipts or equity in assets. Only 3,273 cases were closed as CNC using closing code 13 (hardship for businesses) in FY 2018. IRS, CDW, Business Master File.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Formally evaluate the impact on taxpayers of hoteling Revenue Officers—for example, is there any quantifiable harm to taxpayers due to the lag time in responding to taxpayer or practitioner calls or appointments, or in posting payments and tax returns, installment agreements, and OICs?
2. Implement lessons from the “Fresh Inventory” pilot to modify its case selection and assignment methodologies for Revenue Officers to focus on early intervention that educate taxpayers on compliance, resolve cases timely, and promote future voluntary compliance.
3. Implement the Early Interaction Initiative to ensure business taxpayers are in compliance with and educated on the federal tax deposit requirements for employment taxes.
4. Issue a policy for a “Revenue Officer of the day” in all field offices, except offices with only one Revenue Officer, so every taxpayer, wherever they are located in the country, receives the same quality service. Such a policy would help ensure that payments and tax returns are posted timely, correspondence and questions are responded to timely, and face-to-face meetings are available.
5. Promote taxpayers’ future compliance by Revenue Officers conducting and participating in outreach events that provide information on policy and procedures of Field Collection and the role of Revenue Officers in the collection of taxes and voluntary tax compliance.
6. 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.
7. 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****RESPONSIBLE OFFICIAL**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to Confidentiality*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The Automated Collection System (ACS) is a major IRS computerized collection inventory system used to send notices demanding payment, and to issue notices of federal tax liens (NFTLs) and levies. ACS employees also answer taxpayer telephone calls to resolve balance due accounts and delinquencies. ACS relies on mailed notices to generate taxpayer contact. In fiscal year (FY) 2018, this approach resulted in ACS only collecting about seven percent (\$3.4 billion) of the \$47 billion placed in its inventory.²

Just as important as the dollars collected is the process followed by the IRS collection function, including ACS. The dollars collected are the byproduct of the compliance work that ACS employees *should* be doing—namely, understanding the cause of the current tax debt, curing the current tax debt by looking at appropriate collection alternatives, and ensuring that these collection alternatives enable the taxpayer to be compliant going forward.

However, ACS is drifting from this philosophy by suppressing the systemic issuance of ACS taxpayer notices and by considering redesigned notices that place a heavy emphasis on self-service channels and, in some circumstances, enforcement action as well. This undermines four cardinal taxpayer rights: *the*

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 IRS, Small Business/Self-Employed (SB/SE), Collection Activity Report (CAR) NO-5000-2, Taxpayer Delinquent Account (TDA) Cumulative Report, Part 1 - TDA's, Automated Collection System (ACS)/CS, Receipts (line 11.19), Credits (Line 13.0) (Sept. 2018). The amount collected in fiscal year (FY) 2018 is from TDAs received in FY 2018 as well as from the dollars remaining in ACS inventory at the end of FY 2017.

right to be informed, the right to privacy (IRS action be no more intrusive than necessary); *the right to a fair and just tax system* (considering the specific facts and circumstances); and *the right to challenge the IRS's position and be heard* (which means to talk with and listen to taxpayers).

As a result, the National Taxpayer Advocate continues to have a number of concerns regarding ACS operations, including:

- Despite a recent study that shows monthly notices are productive in generating contact with the taxpayer, ACS has suppressed the issuance of taxpayer notices to prevent a poor level of service (LOS) on its phone lines and is considering redesigned notices that push taxpayers towards self-service channels.
- ACS routinely enters taxpayers into streamlined installment agreements (IAs) which do not require any financial analysis, thereby missing opportunities to have discussions with taxpayers about their financial situations and assist them in finding the best collection alternatives for their particular facts and circumstances. This is evident by the 22 percent overall default rate for streamlined IAs in FY 2018,³ and the 42 percent default rate for streamlined IAs of taxpayers whose income was at or below 250 percent of the federal poverty level (FPL) for the same time period.⁴
- ACS employees still do not properly observe the holding in *Vinatieri v. Commissioner*,⁵ even though it is nearly ten years old.
- When taxpayers raise economic hardship, these discussions may be unfruitful because taxpayers do not have one single point of contact in ACS, and taxpayers may be speaking to ACS employees who are not familiar with the geographic region in which they reside.
- ACS may not be identifying the most productive cases to work but, instead, may be addressing cases that are better suited for field collection.

3 IRS CAR, *Installment Agreement (IA) Default Report*, FY 2018.

4 TAS Research used the following source to analyze ACS and installment agreement accounts for FY 2018: IRS CAR, *Installment Agreement (IA) Default Report*, FY 2018.

5 *Vinatieri v. Comm'r*, 133 T.C. 392 (2009).

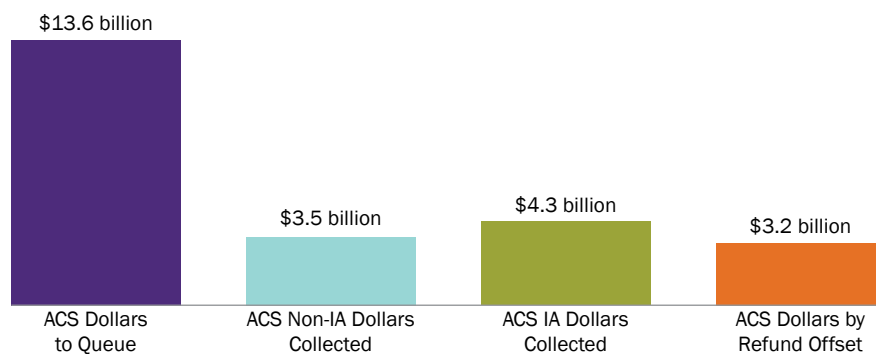
ANALYSIS

Background

At the end of 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, or about seven percent.⁶ About \$4.3 billion was collected through IAs.⁷ In FY 2018, ACS transferred \$13.6 billion, or 29 percent of inventory placed with ACS in FY 2018, in unresolved cases to the Queue.⁸ Figure 1.17.1 shows dollars collected through full payment, IA, refund offset, and dollars transferred to the Queue for FY 2018.

FIGURE 1.17.1⁹

Automated Collection System (ACS) Dollars Collected by Source and Dollars Transferred to the Queue for FY 2018



As Figure 1.17.1 shows, ACS transfers about twice as many dollars to the Queue as it collects, and collects about half as many dollars through refund offsets as it does through IAs or other payments.

One possible response to ACS's performance may be to increase the use of its collection authority, namely, the issuance of liens and levies. However, Figure 1.17.2 shows there is little correlation between total revenue collected by the IRS and an increase in notices of federal tax liens and levies issued.

6 CAR 5000-2 (Oct. 1, 2018).

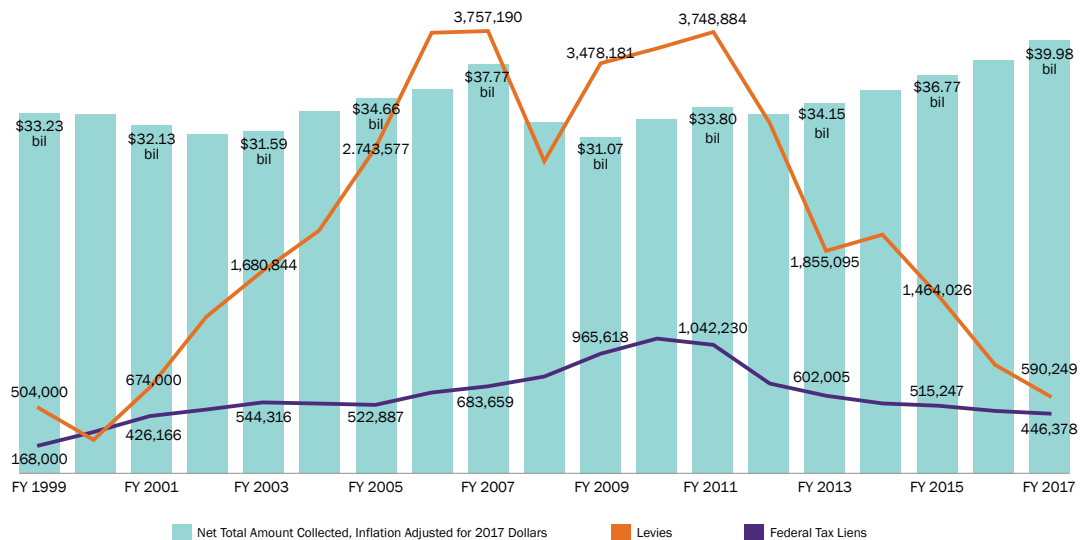
7 CAR 5000-6 (Oct. 1, 2018). IRS response to TAS fact check (Dec. 13, 2018). This amount is limited to accounts in taxpayer delinquent account (TDA) status and that are placed in ACS inventory.

8 CAR 5000-2 (Oct. 1, 2018). The Queue is an electronic holding area for accounts that will not be worked immediately. See Internal Revenue Manual (IRM) 1.4.50.8.3 (Sept. 12, 2014).

9 CAR 5000-2 (Sep. 30, 2018); CAR 5000-6 (Sep. 30, 2018).

FIGURE 1.17.2¹⁰

ACS Liens and Levies and IRS Dollars Collected From Fiscal Years 1999-2017



What Figure 1.17.2 demonstrates is that taxpayers tend to pay their tax debts, irrespective of the level of enforced collection actions. Thus, rather than focusing solely on increasing enforcement actions, ACS should focus on how to best reach taxpayers, how to get taxpayers into the most appropriate collection alternatives, and what are the best cases to focus these efforts on. However, as the discussion below shows, ACS appears to be moving in the opposite direction.

Despite a Recent Study That Shows Monthly Notices Are Productive, ACS Has Suppressed the Issuance of Taxpayer Notices to Prevent a Poor Level of Service on Its Phone Lines and Is Considering Redesigned Notices That Push Taxpayers Towards Self-Service Channels

Despite a recent study that shows monthly notices are productive in generating contact with the taxpayer, ACS has suppressed the issuance of taxpayer notices to prevent a poor LOS on its phone lines and is considering redesigned notices that push taxpayers towards self-service channels.

An IRS study regarding NFTLs found that regular monthly notices to taxpayers regarding their liabilities were generally more effective than any other reminder notices included in the study as an effective collection mechanism.¹¹ Specifically, a monthly notice brought in more money than any

10 IRS Data Book, Table 16, *Delinquent Collection Activities FYs 1999-2017*. Note that the dollars collected in this figure are IRS-wide dollars collected, and not just dollars collected by ACS. This does not include FY 2018 dollars because the FY 2018 IRS data book with this data is not yet published.

11 See Research Study: *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"*, *infra*. This study compares the monthly notice to other reminder notices sent but does not compare the monthly notice to the Notice of Federal Tax Lien. See also Consumer Financial Protection Bureau, *Quarterly Consumer Credit Trends, Public Records* (Feb. 2018). Recently, the three major credit reporting agencies—Equifax, TransUnion, and Experian—announced they would no longer report tax liens on a taxpayer's credit report.

other reminder notice included in the study. Sending a monthly notice that shows tax due plus accrued penalties and interest would be more reflective of a private company's collection practices and more in line with tax collection approaches in other countries.¹² However, rather than adding additional notices, ACS has recently suppressed the systemic issuance of the LT16, *Request for Taxpayer to Contact ACS*. This suppression was done to decrease the number of taxpayers calling ACS, to prevent a projected LOS of 31 percent for FY 2018¹³ (although better than projected, the LOS on ACS phone lines was still a dismal 63 percent during filing season (FS) 2018).¹⁴ Nevertheless, improvements to LOS should not be achieved by taking steps that discourage taxpayers from contacting the IRS.

Two recent IRS studies considered whether redesigned notices would be more effective than notices either currently or previously used by ACS.¹⁵ These studies, however, were largely focused on how notices can push taxpayers to use self-service channels such as the Online Payment Agreement (OPA) or Voice Balance Due (VBD).¹⁶ In fact, the redesigned notices emphasized the availability of self-service channels while reducing the visual prominence of the telephone contact number. Not surprisingly, these notices resulted in a reduction in the number of taxpayers calling that number when compared to the LT16, which was the Control notice. However, taxpayers who received the redesigned notices were more likely to call an IRS number that they found through other means, such as using a phone book or the Internet. Specifically, even though the Control group notice resulted in the greatest number of total inbound calls, the redesigned notices all resulted in a greater number of inbound calls using phone numbers found through other means, when compared with the Control notice.¹⁷

Similar to the LT16 study, a study conducted on the CP14 Notice, *Balance Due of \$5 or More, No Math Error*, placed a high emphasis on pushing taxpayers towards self-service channels and limiting the cost to the IRS by reducing the number of inbound calls the notices generate. However, the study correctly acknowledges that different types of notices may be appropriate for different types of taxpayers. The study further points out that when taxpayer responses to notices are markedly different depending on the size of their balance or the age of their debt, the IRS could use this information to treat different taxpayer groups with specific notices. Tailoring notices to unique taxpayer characteristics could increase

12 *Introduction to Behavioral Economics for CDM Applications and Best Practices for Bill Design*, BEWorks (2016), beworks.com/assets/pdfs/BEworks_Energy_Sector_Report.pdf; OECD, Tax Administration, *Insights from Innovations In Tax Debt Management* 158 (2017), http://dx.doi.org/10.1787/tax_admin-2017-en; FORBES, *A Better Way to Collect Bills From Customers Without Alienating Them* (Mar. 31, 2017), <https://www.forbes.com/sites/elizabethharris/2017/03/31/a-better-way-to-collect-bills-from-customers-without-alienating-them/#21aca8162c2f>.

13 IRS response to TAS fact check (Dec. 13, 2018).

14 ACS CFO Financial Management, *Office of Cost Accounting, Cost-Based Performance Measures FY 2012-2017*, 2. This level of service was due in part to the eight million telephone calls that ACS assumed from Accounts Management in 2016.

15 However, the Urgent notice still resulted in fewer calls than the Control notice. IRS, *ACS Optimization/Research, Applied Analytics, and Statistics (RAAS) ACS LT16 Notice Redesign Test Pilot Report 23-24* (Sept. 27, 2017).

16 IRS, *ACS/RAAS ACS LT16 Notice Redesign Test Pilot Report 20* (Sept. 27, 2017). Online Payment Agreement (OPA) is a portal on the IRS.gov website where taxpayers can login and establish an IA. Voice Balance Due (VBD) is an interactive telephone system that allows taxpayers to use a touchtone keypad to take action. Both OPA and VBD are self-service channels that taxpayers can use independently without the assistance of an IRS employee.

17 IRS, *ACS Optimization/RAAS ACS LT16 Notice Redesign Test Pilot Report 22-23* (Sept. 27, 2017). For example, taxpayers who received the Control notice made 980 calls to the phone number printed on the notice (Kansas City ACS site) and 934 calls to other IRS telephone numbers—yielding a total of 1,914 phone calls, the most of any notice. While all of the redesigned notices resulted in fewer total phone calls, with reductions of 12 percent to 33 percent relative to the Control Group, they all resulted in more telephone calls to numbers not printed on the notice compared to the Control Group.

compliance and dollars collected.¹⁸ Going forward, IRS should further explore what types of notices generate the best result for particular taxpayers.¹⁹

Both of the redesign studies discussed above omitted two significant characteristics that should be included in IRS collection notices. First, notices should include the name and phone number of an individual ACS employee. Taxpayers are more likely to respond to notices when they feel like the notice is coming from an actual person whom they can contact regarding their tax problem.²⁰

A second element that should be present is a focus on taxpayer rights. Notices should be designed within a taxpayer rights framework and identify the taxpayer rights relevant to the particular notice. For example, a monthly reminder notice about a taxpayer's outstanding liability could start out by saying, "Under the Taxpayer Bill of Rights, you have the *right to quality service* and *the right to be informed*. In an effort to observe these rights, we want to keep you informed of the amount you currently owe the IRS. You also have the *right to a fair and just tax system*, where all the facts and circumstances of your situation are considered, so if you are unable to pay the amount due because of a financial hardship, please contact us at" Designing notices within a taxpayer rights framework will educate taxpayers as to what rights are relevant to their current situation and will ensure taxpayers are informed about what rights they can exercise during this particular IRS interaction.

ACS Routinely Enters Taxpayers Into Streamlined Installment Agreements Which Do Not Require Any Financial Analysis, Thereby Missing Opportunities to Have Discussions With Taxpayers About Their Financial Situations and Assist Them in Finding the Best Collection Alternatives for Their Particular Facts and Circumstances

Beginning in 2012, the IRS expanded the availability of streamlined IAs,²¹ which do not require financial analysis. More specifically, these IAs are based purely on mathematical equations. For instance, the liability is divided by as many as 84 months (seven years), which establishes the taxpayer's monthly payment.²² Over the last six years, 4,285,773 IAs has been arranged for cases assigned to ACS and about 84 percent of those IAs were streamlined.²³ In FY 2018, 40 percent of ACS taxpayers who entered into streamlined IAs had income that fell below the allowable living expenses (ALE) threshold, meaning they agreed to pay on their tax liability while likely jeopardizing their ability to pay their basic

18 IRS, *Small Business/Self-Employed SB/SE Collection & RAAS CP14 Notice Redesign Test Pilot Report 15-20* (April 12, 2018).

19 *Id.* at 29 (April 12, 2018). Future research should attempt to isolate the impact of specific behavioral elements by designing notices that test a smaller number of discrete changes.

20 See American Bar Association, *Nudging and Educating Taxpayers to Comply: Reevaluating Traditional Approaches to Taxpayer Compliance 20, 22, 29-40* (May 2018), https://www.americanbar.org/content/dam/aba/events/taxation/meetingmaterials/18may_materials/18may-ift-nudgingandeducationg-villalobos-slides.authcheckdam.pdf.

21 IRS, IR-2012-31, *IRS Offers New Penalty Relief and Expanded Installment Agreements to Taxpayers under Expanded Fresh Start Initiative* (Mar. 7, 2012). See also National Taxpayer Advocate 2012 Annual Report to Congress 358-357 (*Introduction to Collection Issues: The IRS "Fresh Start" Initiative Has Produced Significant Improvements in Some Collection Policies; However, Significantly More Emphasis on Service Delivery Is Necessary to Realize the Full Benefits of These Important Changes*).

22 IRS, *Streamlined Processing of Installment Agreements*, <https://www.irs.gov/businesses/small-businesses-self-employed/streamlined-processing-of-installment-agreements> (last visited Nov 15, 2018).

23 There are instances where installment agreements may be arranged by other collection units than ACS.

Improvements to the level of service should not be achieved by taking steps that discourage taxpayers from contacting the IRS.

living expenses.²⁴ Thirty-two percent of these also had income at or below 250 percent of the FPL for FY 2018.²⁵

Unsurprisingly, while the overall default rate for streamlined IAs in FY 2018 was 19 percent,²⁶ the default rate for streamlined IAs of taxpayers whose income did not exceed their ALEs, was 39 percent.²⁷

Despite having various pieces of information indicating that a taxpayer is low income, and having a low income indicator that is placed on accounts with gross income at or below 250 percent of the FPL,²⁸ the IRS generally does not initiate a discussion about economic hardship with the taxpayer.²⁹ The IRS should create a template that ACS employees can use which would fill in the Information Return Program (IRP) income, and utilize the family size from the last tax return, and then compare the information to the ALE standard. If there is no recent return on file, the ACS employee could complete the template by asking the taxpayer for their income and family size, then based on this information, could determine how to proceed. If the taxpayer is in fact experiencing economic hardship as determined by completing the template, the ACS employee should open up a discussion regarding

24 See IRS, *Collection Financial Standards*, <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards> (last visited Dec. 19, 2018). The allowable living expenses (ALEs) are guidelines that “establish the minimum a taxpayer and family needs to live.” The IRS may allow additional amounts for basic living expenses if the taxpayer substantiates the need to deviate from the standards. IRM 5.15.1.8 (6), *Allowable Expense Overview* (Aug. 29, 2018). Allowable expenses include transportation expenses, which may consist of ownership expenses (loan or lease payments) and operating expenses (maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking, and tolls). Unless otherwise indicated, in calculating taxpayers’ ALEs, we allowed operating expenses (two allowances in the case of joint filers and one allowance for all other taxpayers), and all taxpayers were allowed one vehicle ownership expense.

25 CAR, *IA Default Report, FY 2018*. See also Most Serious Problem: *Private Debt Collection: The IRS’s Expanding Private Debt Collection Program Continues to Burden Taxpayers Who Are Likely Experiencing Economic Hardship While Inactive PCA [Private Collection Agency] Inventory Accumulates*, *supra*. Forty-four percent of taxpayers who made payments while their debts were assigned to PCAs had incomes below 250 percent of the federal poverty level. One possible explanation as to why this figure is higher than the 29 percent ACS figure is that ACS is making the decision to not work cases where the taxpayer has low income but rather places them in the Queue where they will later be shelved and sent to the PCAs.

26 CAR, *IA Default Report, FY 2018*.

27 IRS CAR, *IA Default Report, FY 2018* for the default rate information for streamlined IAs, and TAS Research analysis of the ACS and IA accounts, FY 2018, for results on percentage of streamlined IAs whose income did not exceed their ALEs who defaulted.

28 According to IRM 5.14.1.2, *Installment Agreements and Taxpayer Rights* (July 16, 2018), taxpayers entering into IAs are eligible for a reduced or waived user fee if they meet a certain income level. Eligibility is based on the Low-Income Indicator (LII) and Reduced User Fee Indicator (RUF). The LII is placed on the IRS’s internal Masterfile system, and is determined by reviewing the taxpayer’s income and exemptions on the taxpayer’s most recent tax return and comparing them with the poverty level charts created by the Department of Health and Human Services (HHS). If the taxpayer is low income according to HHS standards, a LII will be placed on Masterfile showing that they are eligible for a reduced user fee. A LII can also be placed on the taxpayer’s account if a review of Form 13844, *Application for Reduced User Fee*, reports such a designation. See also IRS response to TAS information request (Sept. 14, 2018). An income-based LII is placed on accounts that are at or below 250 percent of the federal poverty level depending on household size and state of residence.

29 IRM 5.19.13.2, *Securing Financial Information* (June 23, 2017). ACS employees will only take financial information if the taxpayer raises one of the following issues: Payment amount requested is insufficient based on current Streamlined Installment Agreement (SIA) criteria and the balance is over a certain amount; Follow paragraph (17) below if the amount is over a certain amount; Aggregate Assessed Balance (AAB) (Command Code (CC) SUMRY) is over \$25,000 (and taxpayer does not meet SIA Over \$25,000 criteria); Partial Payment Installment Agreement (PPIA) is being considered, or Cannot Pay Any Amount Currently Not Collectible (CNC).

offers in compromise or Currently Not Collectible (CNC)/hardship status. If the ACS employee and the taxpayer cannot agree on a resolution, the ACS employee should refer the taxpayer to TAS.

Further, if the completion of the template shows that the taxpayer's income is at or below 250 percent of the FPL, the ACS employee should refer the taxpayer to a Low Income Taxpayer Clinic (LITC).³⁰ Currently, the Internal Revenue Manual (IRM) instructs employees to advise taxpayers that they might be eligible for LITC assistance in completing a financial statement.³¹ This guidance should be expanded to advise customer service representatives (CSRs) to inform all low income taxpayers of the existence of LITCs in their state (or nearby if there is not one in their state).³²

ACS Employees Still Do Not Properly Observe the Holding in *Vinatieri v. Commissioner*, Even Though It Is Nearly Ten Years Old

Not only does ACS fail to start conversations about taxpayers' financial situations, or specifically refer them to an LITC, but TAS has learned that, in some instances, ACS does not even properly observe the spirit of the Tax Court holding in *Vinatieri v. Commissioner*, which held that when the IRS sustains even a *proposed* levy on a taxpayer it knows is in economic hardship, it abuses its discretion.³³ For example, TAS was recently made aware of a situation where the ACS CSR refused to place a welfare recipient into CNC hardship status because the taxpayer had an unfiled return from a previous year.³⁴ The *Vinatieri* case, in which the Tax Court held that it was an abuse of discretion for the IRS to proceed with a levy against a taxpayer who has unfiled returns if the taxpayer has demonstrated economic hardship, is now nearly ten years old. Thus, there is no reasonable explanation for why any ACS employee should be unwilling to place a taxpayer in CNC hardship because of unfiled returns. The IRS has had nearly a decade to develop adequate, regular training that clearly educates its employees on this vital Tax Court holding.

When Taxpayers Raise Economic Hardship, These Discussions May Be Unfruitful Because Taxpayers Do Not Have One Single Point of Contact in ACS, and Taxpayers May Be Speaking to ACS Employees Who Are Not Familiar With the Geographic Region in Which They Reside

Taxpayers are not assigned one ACS employee to their case, and will likely speak to a different person each time they call in. This can waste taxpayers' valuable time and needlessly tie up IRS phone lines. Furthermore, miscommunication can cause even more problems down the road, yet again forcing both the IRS and the taxpayer to commit more time to resolving this particular issue. In 1998, Congress directed that the IRS develop a procedure "to the extent practicable and if advantageous to the taxpayer"

30 See Most Serious Problem: *Economic Hardship: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*, *supra*.

31 IRM 5.19.17.1.7(4), *Campus Procedures for Currently Not Collectible and Offers in Compromise* (Sept. 18, 2018).

32 These bills grant IRS employees the authority to refer taxpayers' information regarding low income taxpayer clinics. H.R. 5438, 115th Cong. § 1 (2017-2018); S. 3278, 115th Cong. § 503 (2017-2018).

33 *Vinatieri v. Comm'r*, 133 T.C. 392 (2009). IRC § 6343(a)(1)(D) requires the IRS to release a levy when it would create an economic hardship due to the financial condition of the taxpayer. Treas. Reg. § 301.6343-1(b)(4) specifies that an economic hardship exists if a taxpayer cannot pay his or her basic living expenses. See also Most Serious Problem: *Economic Hardship: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*, *supra*.

34 On June 7, 2018, the Low Income Taxpayer Clinic Listserv had a post regarding ACS employees being unaware of the holding in *Vinatieri*.

to assign one IRS employee to handle a taxpayer's matter until it is closed.³⁵ One concern surrounding the adoption of a single-point-of-contact approach for ACS may be that is not feasible because the employee may be unavailable. However, if the IRS provided effective “first contact resolution”, which would include using the auto-populated economic hardship template discussed above, the number of repeat callers needing to speak to the same ACS employee would be reduced. Further, if the taxpayer calls back and the employee isn't available, the taxpayer can be given a choice: would you like to receive a callback from your assigned ACS CSR, or wait for the next available CSR? Implementing Congress' guidance in IRS Restructuring and Reform Act of 1998 (RRA 98) would enhance taxpayer's communication with ACS by improving continuity, quality taxpayer service, and effective tax administration.

Another significant problem with the design of how ACS manages its cases is that there is no coordination between where the taxpayer resides and the location of the ACS site to which the taxpayer's account is assigned. For instance, a taxpayer who resides in the mid-Atlantic may have his or her case assigned to the ACS site in Des Moines, Iowa. This is problematic because the ACS employee is likely unaware of the particulars of that region, such as cost of living, local industry, and the effect of local natural disasters. For example, ACS employees located in Des Moines, Iowa, may be unfamiliar with and unaware of the long-lasting effects of a natural disaster such as Hurricane Sandy.

ACS May Not Be Identifying the Most Productive Cases to Work but Instead May Be Addressing Cases That Are Better Suited for Field Collection

ACS cases are prioritized by categories high, medium, and low based on modeling scores and a collection potential calculation that calculate the probability of case resolution and compliance. High-priority cases are pushed to the top of the rankings to be worked first by ACS customer service representatives in the “next case” process. However, previous studies have shown that flaws in ACS case prioritization models may exist, and cases it deems low priority may actually yield a higher return on investment (ROI) than cases deemed high priority.³⁶ During the 2006-2009 IRS private debt collection program, the IRS repeatedly stated that it would not choose to work the private collection agency (PCA) inventory if it had additional resources because the “next best case” criteria it used prioritized other cases, such as older cases with higher balances due.

However, a TAS study that compared the two years that PCAs worked cases to the subsequent two years that ACS worked the same cases showed that the IRS was significantly more effective than the PCAs in collecting tax liabilities in all but the first six months after case receipt.³⁷ Specifically, the IRS collected about 62 percent more than the PCAs (\$139.4 million compared to \$86.2 million).³⁸ In addition to

35 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206 § 3705(b), 112 Stat. 685, 777 (1998). Additionally, Congress has recently endorsed a single-point-of-contact customer service approach by requiring that one IRS employee be assigned to each identity theft case. H.R. 5439, 115th Cong. § 1 (2018).

36 IRS response to TAS information request (Sept. 14, 2018). Since the time of these studies, the IRS has implemented a different prioritization system. It ranks cases by high-medium-low in a prioritization process. Defaulted IAs are not a prioritized inventory.

37 We compared PCA and IRS collections during four consecutive six-month intervals following case receipt. See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, *A Comparison of Revenue Officers and the Automated Collection System in Addressing Similar Employment Tax Delinquencies* 97-107.

38 National Taxpayer Advocate 2013 Annual Report to Congress vol. 2 97-107 (Study: *A Comparison of Revenue Officers and the Automated Collection System in Addressing Similar Employment Tax Delinquencies*). Since the time of this study, ACS has changed its method for prioritizing cases. Thus, the IRS should conduct a study similar to that cited here, applying its new case prioritization method.

demonstrating that hiring PCAs is an ineffective way to collect outstanding tax liabilities,³⁹ this study also shows that the IRS's assumptions as to what cases are more or less productive was flawed. Another TAS study showed that the cases that are in ACS might yield better results if placed elsewhere in the IRS's collection function. For example, a TAS research study pertaining to employment tax liabilities showed that the Collection Field Function (Cff) collected more dollars and resolved delinquencies more quickly than ACS, regardless of the size of the delinquency. Further, ACS transferred more tax modules, particularly medium- and high-dollar modules (over \$1,500), to the queue and Cff, reducing the IRS's speed and effectiveness in addressing them,⁴⁰ thus indicating these employment tax cases may be best suited for initial placement in Cff rather than in ACS.

As mentioned above, ACS prioritizes its cases using modeling scores and a collection potential calculator that calculates the probability of the case resolution and compliance. Surprisingly, however, these modeling scores do not prioritize cases where the taxpayer has previously entered into an IA but have since defaulted on the installment payment.⁴¹ Logically, the IRS should rank cases where there is a defaulted IA as high priority since the taxpayer has previously engaged with the IRS to make arrangements to settle his or her outstanding tax liability. The IRS could categorize these cases as high priority and quickly contact the taxpayer after he or she has defaulted on the IA, stating something to the effect of, "We noticed you recently stopped making payments on your installment agreement and the agreement has been defaulted. We wanted to see if your financial circumstances have changed and if your prior installment agreement could be modified to bring you back into compliance." Since the IRS knows that such taxpayers have the desire to resolve the outstanding liability, it only makes sense that their cases should be moved to the top of the heap.⁴² Accordingly, ACS likely can collect more revenue by taking a closer look at how it prioritizes cases and the assumptions on which this prioritization is based.

CONCLUSION

ACS's emphasis on pushing taxpayers towards self-service channels in its redesigned notices risks alienating taxpayers who either do not have access to such channels, or do not feel comfortable using such channels. When a taxpayer contacts ACS, it should use all the information at its fingertips to consider the taxpayer's unique situation and to suggest resolution options that may best suit that individual taxpayer. Taxpayers are further frustrated when talking to ACS because they may be talking to an employee who is unfamiliar with their geographic circumstances, and because they may have to explain the conditions in their region over and over since ACS provides no single point of contact. Finally, it is critical that ACS use its resources effectively by ensuring it is working the most productive cases. These changes would result in better experiences for taxpayers and better collection outcomes for the IRS.

39 For a more in-depth discussion of the problems facing the IRS's current PDC program, see Most Serious Problem: *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*, *infra*.

40 National Taxpayer Advocate 2013 Annual Report to Congress vol. 2 16-31.

41 IRS response to TAS information request (Sept. 14, 2018).

42 See OECD, *Working Smarter in Tax Debt Management* 42 (2014), http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/working-smarter-in-tax-debt-management_9789264223257-en#page1.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Assign one ACS employee to a taxpayer's case, provide this employee's contact information on each notice that is sent to the taxpayer, and assign the case to an ACS employee who is located in the same geographic region as the taxpayer.
2. Send out monthly notice reminders to taxpayers regarding their tax liabilities and accrued penalties and interest.
3. Revise ACS notices using a Taxpayer Bill of Rights framework that conspicuously informs taxpayers of the rights impacted by a given notice.
4. 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.
5. Revise ACS's Internal Revenue Manual and scripts to instruct employees when a taxpayer has an economic hardship indicator placed on their account, to consider all possible avenues for resolution, including Partial Payment Installment Agreements, offers in compromise, or placement into Currently Not Collectible hardship status.
6. Conduct a research study to determine if IRS's modeling scores and collection potential calculator are truly identifying the cases that are most likely to be resolved.
7. Reorder ACS protocols to give high priority to cases where a taxpayer has defaulted on a prior installment agreement.

**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****RESPONSIBLE OFFICIALS**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division
Donna Hansberry, Chief, Office of Appeals

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

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. Congress grants the IRS the authority to accept offers pursuant to Internal Revenue Code (IRC) § 7122.² To its credit, the IRS has engaged in an outreach campaign to make the OIC a more visible collection tool. For instance, it has worked to develop electronic newsletters, IRS Tax Tips, and social media for both taxpayers and tax professionals to use.³

With a robust and flexible OIC program, the IRS receives money that it might not have collected through other means and achieves voluntary tax compliance from the taxpayer (at least for the next five years, which is long enough to create a long-term change in noncompliant behavior).⁴ If the taxpayer does not follow the terms of the agreement, the OIC defaults and the debt is reinstated.⁵ The taxpayer benefits by reaching finality with his or her tax debt sooner in the collection process and paying what he or she can afford to pay, while the IRS benefits by creating a segment of noncompliant taxpayers who become more compliant.

A 2017 study by TAS Research found that individual taxpayers (Individual Master File (IMF)) with accepted OICs were significantly more likely (58 percent compared to 42 percent) to timely file their subsequent income tax returns for the next five years when compared to taxpayers whose OICs the IRS did not accept. For the first five years after the OIC, IMF taxpayers with accepted OICs were also much

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 Treas. Reg. § 301.7122-1(b).

3 IRS response to TAS information request (Aug. 20, 2018).

4 IRS, Form 656-B, *Offer in Compromise* 6 (Jun. 2018).

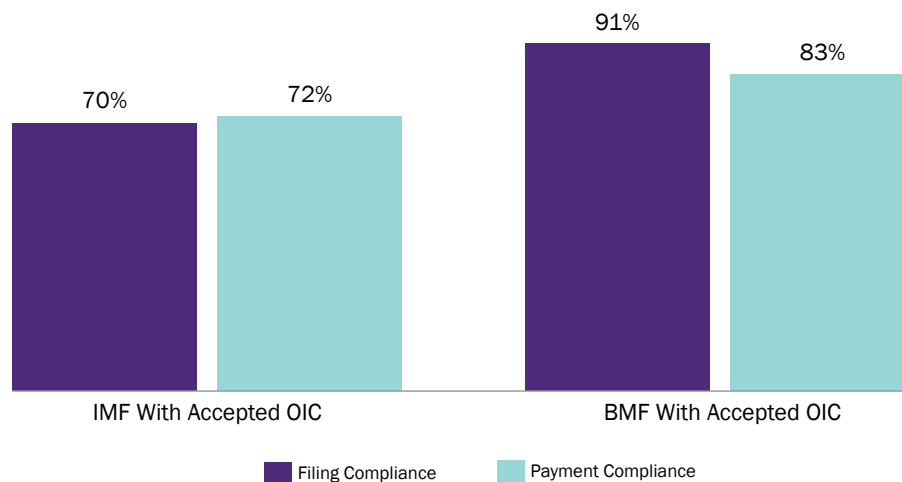
5 Internal Revenue Manual (IRM) 5.8.9.4, *Potential Default Cases*, (Jan. 12, 2017).

more likely to pay their subsequent income taxes than taxpayers whose OICs the IRS did not accept (72 percent compared to 52 percent).⁶

In 2018, TAS Research studied business taxpayers (Business Master File (BMF)) with OICs. It found that BMF taxpayers with accepted OICs have a better filing rate than IMF taxpayers five years out. Figure 1.18.1 shows that while 70 percent of IMF taxpayers with an accepted OIC file their returns five years after an accepted OIC, 91 percent of BMF taxpayers with an accepted OIC do so five years out.⁷ BMF taxpayers also have better future payment compliance. Approximately 72 percent of IMF taxpayers with accepted OICs had no balance due five years after an accepted OIC compared to 52 percent of IMF taxpayers without an accepted OIC.⁸ Approximately 83 percent of BMF taxpayers had no balance due five years after an accepted OIC compared to 75 percent of BMF taxpayers with no accepted OIC.⁹

FIGURE 1.18.1

**IMF and BMF Filing and Payment Compliance for Five Years
After an Offer in Compromise Is Accepted**



6 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, 43 (Research Study: *A Study of the IRS Offer in Compromise Program*).

7 *Id.*; Research Study: *A Study of the IRS Offer in Compromise Program for Business Taxpayers* vol. 2, *infra*. For the purposes of the Business Master File (BMF) study, TAS Research focused on partnerships, corporations, or sole proprietors.

8 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, 55; See Research Study: *A Study of the IRS Offer in Compromise Program for Business Taxpayers*, *infra*.

9 Research Study: *A Study of the IRS Offer in Compromise Program for Business Taxpayers* vol 2, *infra*.

The IRS is also losing revenue collection opportunities because it uses inflated projections of reasonable collection potential (RCP). In about 40 percent of the BMF OICs that were not accepted, the OIC amounts offered are much higher than the amounts ultimately collected through other means.

Notwithstanding the clear benefits of entering into OICs, the National Taxpayer Advocate is concerned that the IRS is not doing enough to help BMF taxpayers file successful OICs. Additionally, the IRS has made changes that create barriers to all taxpayers from submitting successful OICs:

- The IRS moved away from having revenue officers (ROs) available to work OICs in each state;
- OICs submitted by taxpayers who had not filed all necessary tax returns are returned to the taxpayers as not processable, rather than holding them for a period to allow for return filing;
- The IRS will keep the payments sent with OICs it returns for lack of filing compliance;
- OICs returned to the taxpayer in error are not subject to the 24-month deemed acceptance period in IRC § 7122(f); and
- The time it takes to process OICs, including any appeals, may lead to multiple years of refund offsets.

ANALYSIS OF PROBLEM

Background

Treasury Regulations provide three grounds for an OIC:

- Doubt as to liability;¹⁰
- Doubt as to collectibility;¹¹ and
- Effective tax administration.¹²

The law requires two things before the IRS can deem an OIC processable. First, an OIC submission must include a partial payment (referred to as a Tax Increase Prevention and Reconciliation Act or “TIPRA” payment).¹³ Second, the taxpayer must pay any applicable user fee.¹⁴ Additionally, Treasury Regulations require taxpayers to make the OIC in writing, sign the OIC under penalty of perjury, and include all of the information “prescribed or requested by the Secretary.”¹⁵ If an OIC meets the

10 Treas. Reg. 301.7122-1(b)(1). Doubt as to liability exists where there is a genuine dispute as to the existence or amount of the correct tax liability under the law. Doubt as to liability does not exist where the liability has been established by a final court decision or judgment concerning the existence or amount of the liability.

11 Treas. Reg. 301.7122-1(b)(2). Doubt as to collectibility exists in any case where the taxpayer’s assets and income are less than the full amount of the liability.

12 Treas. Reg. 301.7122-1(b)(3). There are two grounds for effective tax administration offers: 1) If the Secretary determines that, although collection in full could be achieved, collection of the full liability would cause the taxpayer economic hardship within the meaning of Treas. Reg. § 301.6343-1 and; 2) If there are no grounds for an offer under the other offer in compromise (OIC) criteria, the IRS may compromise to promote effective tax administration where compelling public policy or equity considerations identified by the taxpayer provide a sufficient basis for compromising the liability. Compromise will be justified only where, due to exceptional circumstances, collection of the full liability would undermine public confidence that the tax laws are being administered in a fair and equitable manner.

13 IRC §§ 7122(c)(1), 7122(d)(3)(C). For lump sum offers, the partial payment must be 20 percent of the OIC amount. For a periodic payment OIC, the partial payment must consist of the first installment payment. IRC § 7122(c)(1)(A)–(B).

14 IRC § 7122(c)(2)(B). The application fee is currently \$186. If an individual taxpayer qualifies for the low income waiver, he or she will not be required to send any payment with the OIC. IRS, Form 656-B, *Offer in Compromise* (Jun. 2018).

15 Treas. Reg. § 301.7122-1(d)(1).

minimum criteria for consideration, the IRS deems it processable.¹⁶ Prior to April 13, 2016, IRS procedures dictated that if any of the following criteria were present, the IRS would determine an OIC as not processable:

- The taxpayer is in bankruptcy;
- The taxpayer did not submit the application fee with the OIC;¹⁷
- The taxpayer failed to submit the initial payment with the OIC;¹⁸
- All liabilities have been referred to the Department of Justice;¹⁹
- The OIC is filed for an unassessed liability and internal information does not indicate that a return has been filed;
- The OIC is filed solely with respect to liabilities for which the statutory period for collection has expired; and
- The taxpayer marks the total amount of the payment as a deposit.²⁰

When the IRS determines that an OIC is not processable, it returns the OIC to the taxpayer with a letter explaining the reason for the IRS's determination.²¹ With a not-processable returned OIC, the IRS *may* return the application fee and initial payment to the taxpayer.²² A rejected OIC differs from a returned OIC in that the IRS has reviewed the facts of the case prior to rejection, and the taxpayer receives appeal rights when the OIC is rejected.²³ The IRS will keep payments made on rejected OICs.²⁴

Every Revenue Officer Should Be Able to Process an OIC

Taxpayers submitting an OIC today can expect that the IRS will work their OIC at one of two Centralized OIC sites or in one of two OIC field territories. The revenue officers (ROs) in the field groups are spread across 22 states.²⁵ ROs who work OICs are referred to as OIC Specialists.²⁶ Previously, the Special Procedures Function investigated all OICs. As OIC receipts increased, Field ROs worked OICs for a short period time prior to the establishment of specialized Field OIC groups in fiscal year (FY) 1996.²⁷

OICs have gone from being something worked by all ROs to something worked in two territories. This consolidation of work is not beneficial to the analysis of OICs, which often must take particular facts and circumstances into account, much of which can be affected by the taxpayer's geography. The IRS

16 IRM 5.8.2.4.1 (May 25, 2018). Centralized OIC employees make the initial determination of processability. *Id.*

17 In lieu of the application fee, a taxpayer may check the low income waiver box on Form 656, which would allow him or her to submit the offer without payment.

18 If the OIC includes part of the initial payment, the OIC may be perfected during the case building process. IRM 5.8.2.4.1 (May 25, 2018).

19 The IRS does not have authority to accept an OIC that is controlled by the Department of Justice. IRM 5.8.1.6.1 (Nov. 8, 2018).

20 This does not include instances where the taxpayer checks the low income waiver box. IRM 5.8.2.3.1(1) (July 28, 2015).

21 IRM 5.8.2.5, *Not Processable* (May 25, 2018).

22 *Id.*; IRM 5.8.7.2, *Returns* (Oct. 07, 2016).

23 IRM 5.8.7.7, *Rejection* (Oct. 7, 2016).

24 IRS, Form 656, *Offer in Compromise 5* (Mar. 2018).

25 Territory 1 has OC Specialists in 10 states and Territory 2 has OC Specialists in 12 states that are not covered in the ten by Territory 1. IRS, *Human Resources Reporting Center*, <https://persinfo.web.irs.gov/> (last visited Oct. 17, 2018).

26 IRS response to TAS information request (Apr. 26, 2018).

27 IRS response to TAS information request (Aug. 20, 2018). In 2005 the Field OIC groups were consolidated into three Areas. *Id.*

should revert back to having a greater geographic presence for OIC Specialists and have at least one OIC Specialist (if not more) in each state. One benefit of having a Field RO work an OIC is that the RO is knowledgeable and familiar with the particular community, its economy, and related issues in which he or she works. However, between FYs 2013 and 2018 there was a ten percent decrease in OIC Specialists (there were 145 OIC Specialists in FY 2013 and 131 as of FY 2018.)²⁸ The National Taxpayer Advocate previously discussed the issue of decreasing numbers and lack of geographic dispersion of OIC Specialists.²⁹

The IRS Is Not Doing Enough to Help Business Taxpayers File Successful OICs

The National Taxpayer Advocate is concerned that the IRS is not doing enough to accept OICs from BMF taxpayers.³⁰ In 2018, TAS Research built on a previous study of IMF OICs by focusing on BMF OICs. Overall, the acceptance rate for BMF OICs (24 percent) is lower than the rate for individual OICs (44 percent).³¹

While the IRS may be concerned that IMF and BMF taxpayers use the OIC process to delay collection action, data from TAS research indicates that BMF taxpayers generally want to submit a successful OIC. Of the BMF taxpayers who submitted an OIC, approximately 11 percent churned (churning occurs when a taxpayer submits another OIC within 180 days after the IRS rejects the prior OIC or returns it as not processable).³² Of the BMF taxpayers that churned, approximately 33 percent ultimately had an OIC accepted.³³ Figure 1.18.2 shows the churning rate based on business type.

FIGURE 1.18.2, Average Churning and Accepted OICs for BMF Taxpayers by Business Type Between 2007 and 2017³⁴

BMF Type	Total OICs	Percent Churning	Percent Churning With Accepted OIC
Corporation	20,963	11%	23%
Sole proprietor	12,009	12%	44%
Partnerships	4,283	11%	28%

28 IRS response to TAS information request (May 25, 2018).

29 See National Taxpayer Advocate 2014 Annual Report to Congress 211; National Taxpayer Advocate 2002 Annual Report to Congress 15.

30 See, e.g., 2014 National Taxpayer Advocate Annual Report to Congress 206-217.

31 Research Study: *A Study of the IRS Offer in Compromise Program for Business Taxpayers* vol. 2, *infra*.

32 *Id.* Additionally, the National Taxpayer Advocate believes the word “churn” has negative connotations for taxpayers trying to perfect their OICs. Instead, such taxpayers should be viewed as “curing” a defect in the OIC.

33 *Id.*

34 *Id.* The entity type of 7,965 businesses is unknown. Corporations filed 20,963 OICs between 2007 and 2017 with 2,386 churned OICs. Of those churned OICs, the IRS ultimately accepted 548 OICs. Sole proprietors filed 12,009 OICs between 2007 and 2017 with 1,482 OICs churning. Of those churned OICs, the IRS ultimately accepted 640 OICs. Partnerships filed 4,283 OICs between 2007 and 2017 with 501 churned OICs. Of those churned OICs, the IRS ultimately accepted 138 OICs. Because sufficient time has not elapsed to determine if all 2017 OICs churned, churning percentages do not include OICs submitted in 2017.

In the 2017 OIC study, TAS Research looked at rejected OICs by individual taxpayers between 2009 and 2013 and determined that the IRS frequently overestimated RCP.³⁵ The RCP is calculated by the IRS after reviewing the taxpayer's financial information and in many instances will serve as the basis for an acceptable OIC amount.³⁶

In 2018, TAS Research looked at BMF OICs and again determined that the IRS is losing some revenue collection opportunities because of inflated RCPs connected to rejected OICs and OICs that were returned due to an imperfection. Overall, the OIC amount offered for returned or rejected BMF OICs was often less than what was ultimately collected. However, in about 40 percent of the BMF OICs that were not accepted, the OIC amounts offered are much higher on average than the amounts ultimately collected through other means. For instance as seen in Figure 1.18.3, for the 4,347 returned or rejected corporation OICs, the average amount offered was \$34,695, but the IRS ultimately collected an average of \$53,990.³⁷ However, 1,766 (over 40 percent) of those returned or rejected corporation OICs offered *more* than what the IRS ultimately collected. In those 1,766 OICs, the average amount offered was \$49,920 and the average amount ultimately collected was just \$16,189.³⁸ This trend is consistent across all business types.

FIGURE 1.18.3, Amounts Offered and Collected for All Returned or Rejected Offers From Corporations Compared to Returned or Rejected Offers From Corporations Where the Offer Amount Was Greater Than Payment³⁹

All Returned/Rejected Corp. Offers				
	Count	Mean	Median	Total
Offered	4,347	\$34,695	\$48,000	\$150,818,185
Collected		\$53,990	\$11,084	\$206,024,907
Returned/Rejected Corp. Offers with Offer > Payment				
	Count	Mean	Median	Total
Offered	1,766	\$49,920	\$12,000	\$88,159,029
Collected		\$16,189	\$1,766	\$28,589,014

Furthermore, Figure 1.18.4 focuses on businesses that submitted OICs greater than the amount collected. The table shows that the RCP for each of the entities is overestimated. In fact, depending on business entity type, the RCP is overestimated about seven to ten times greater than the amount that is offered and about 20 to 30 times what has been collected.

35 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, 59.

36 IRM 5.8.1.2.3, *Policy* (May 5, 2017).

37 Research Study: *A Study of the IRS Offer in Compromise Program for Business Taxpayers* vol. 2, *infra*.

38 *Id.*

39 *Id.* The value for amount collected is calculated through August 2018.

FIGURE 1.18.4, Business Rejected OICs Which Exceeded Payments by Business Type⁴⁰

Business Type	Count	Average Amount Offered	Average Amount Collected	Percentage of Amount Offered	Average RCP	Percentage of Amount Collected
Partnership	107	\$28,882	\$7,787	27%	\$210,744	2,706%
Corporation	617	\$53,911	\$21,066	39%	\$414,590	1,968%
Sole Proprietor	178	\$16,345	\$5,794	35%	\$171,005	2,951%

The IRS should study what occurred in the financial analyses of these cases to determine how it can improve the RCP calculation. Since the RCP plays such a large role in OIC analysis, having an accurate RCP will improve the taxpayers' ability to submit successful OICs.

The IRS Has Made Recent Policy Changes That Discourage All Taxpayers From Submitting Successful Offers

OICs Submitted by a Taxpayer Who Has Not Filed All Necessary Tax Returns Are Returned to the Taxpayer As Not Processable

In 2016, the IRS announced that it would return OICs submitted by a taxpayer who had not filed all necessary tax returns (based on internal research) to the taxpayer as not processable.⁴¹ Prior to this change, if the IRS determined that a taxpayer was not in filing compliance, the IRS would process the OIC and contact the taxpayer to discuss any late tax returns and allow the taxpayer time to file them within a specified period of time.⁴²

The IRS decided to return OICs as not processable due to lack of filing compliance as part of an OIC Future State Initiative, explaining “[the new policy] changes the current COIC practice to sign in offers from non-compliant taxpayers and attempts to bring them current.”⁴³ With this initiative, the IRS will return such OICs to the taxpayer with instructions to become compliant and then resubmit his or her OIC. A TAS review of the data relied on by the IRS indicates that the IRS considered the time saved by not working these OICs any further; however, it did not consider the time to work a resubmitted OIC or conduct any analysis to compare the time saved by returning these OICs versus keeping them open and achieving filing compliance in the future and resolving outstanding tax liabilities.

40 Research Study: *A Study of the IRS Offer in Compromise Program for Business Taxpayers* vol. 2, *infra*. The value for amount collected is calculated through August 2018.

41 Memorandum from Director, Collection Policy to Director, Specialty Collection Offers, Liens & Advisory (Apr. 13, 2016) (on file with the author).

42 IRM 5.8.3.6(1), *Perfecting Field Cases* (July 28, 2015); IRM 5.8.3.7(1), *Perfecting COIC Cases* (Dec. 7, 2015).

43 IRS response to TAS information request (Sept. 20, 2017). For an in-depth discussion of the IRS's Future State, see National Taxpayer Advocate 2015 Annual Report to Congress 3-13.

During FY 2017 and the first three quarters of FY 2018, the IRS returned 2,767 IMF OICs because of unfiled returns. Of those returned OICs, 947 taxpayers (approximately 34 percent) resubmitted an OIC.⁴⁴ The IRS returned 561 OICs to BMF taxpayers because of unfiled returns in FY 2017. Of those returned OICs, 266 taxpayers (approximately 47 percent) resubmitted OICs.⁴⁵

The IRS Will Keep the Payments Sent With OICs That Are Returned for Lack of Filing Compliance

In February 2017, the IRS announced a change in practice in which the IRS will keep the payments sent with OICs that are returned for lack of filing compliance.⁴⁶ The payments are applied to the liability; however, the taxpayer cannot have these funds applied to subsequent OICs. In many instances, the OIC funds may be borrowed or are from sources not generally available to the taxpayer. By not processing these OICs (see above) *and* keeping the payments, the IRS creates a major obstacle to submitting a successful OIC.

Prior to 2006, sums submitted with an OIC were considered deposits and were not applied to the liability until the IRS accepted the OIC, unless the taxpayer provided written authorization for application of the payments.⁴⁷ Subsequently, the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) required taxpayers to submit a partial payment with the OIC package (hence, the “TIPRA payment”).⁴⁸ In lieu of updated regulations, the IRS issued Notice 2006-68 in July 2006. Under Notice 2006-68, the IRS treats the TIPRA payment as a payment of tax rather than a refundable deposit, as the regulations do. Of all the IMF OICs that the IRS returned for lack of filing compliance during FY 2018, 554 taxpayers made a TIPRA payment with their original OIC. Of those 554 taxpayers, IRS kept the TIPRA payment in approximately 18 percent of the cases and did not reopen the original OIC, causing the taxpayer to come up with another TIPRA payment for any subsequent OIC.⁴⁹ Likewise, 190 BMF taxpayers made a TIPRA payment with their original OIC. Of those taxpayers, 64 percent had their TIPRA payment retained without the OIC being reopened by the IRS. Since the IRS has taken the legal position in Notice 2006-68 that the IRS must keep TIPRA payments because they are viewed as payments and not deposits, the IRS should provide taxpayers with an opportunity to cure any defect prior to considering the OIC not processable. The IRS impedes compliance by keeping OIC payments without first offering an opportunity to cure OICs it would otherwise deem not processable.

44 For the purposes of this analysis, TAS Research considered the OIC to be a resubmission if it was more than four weeks after the date indicated by the Small Business/Self-Employed (SB/SE) division as the return date. IRS response to TAS information request (Aug. 20, 2018); Individual Master File for the Taxpayer Identification Numbers (TINs) provided by SB/SE where an OIC was returned in FY 2017 as unprocessable because of unfiled returns.

45 IRS response to TAS information request (Aug. 20, 2018); Individual Master File for the TINs provided by SB/SE where an OIC was returned in FY 2017 as unprocessable because of unfiled returns.

46 Memorandum from Director, Collection Policy to Director, Specialty Collection, Liens & Advisory (Feb. 23, 2017) (on file with the author).

47 Treas. Reg. § 301.7122-1(h).

48 Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), Pub. L. No. 109-22, §509, 120 Stat. 362 (2006).

49 IRS response to TAS information request (Aug. 31, 2018). The IRS may reconsider a returned OIC if doing so would be in the best interest of the IRS and the taxpayer. Generally, in these instances the IRS will not require another application fee or TIPRA payment. IRM 5.8.7.3, *Return Reconsideration* (Oct. 7, 2016).

OICs Returned in Error Are Not Subject to the 24-Month Deemed Acceptance Period in IRC § 7122(f)

Under IRC § 7122(f), which Congress added as part of TIPRA, if an OIC has not been rejected within 24 months of submission, the IRS must deem it accepted.⁵⁰ This legislation occurred as a result of problems first identified with OIC processing during Congressional hearings for the IRS Restructuring and Reform Act of 1998 (RRA 98).⁵¹ The president of the National Society of Accountants (NSA) reported NSA members experienced “inordinate delays” with the processing of OICs.⁵² One woman described her experience getting an OIC in connection with an innocent spouse claim. She reported in part:

I have offered to pay the original assessed amount of \$9,000, but that was flatly rejected. This process of offer in compromise has taken nearly two years to negotiate. At almost every turn, I have hit a wall in terms of requesting information or filing information. It appears to me that the right hand doesn't know what the left hand is doing. I have noticed that in requesting certain information, letters are signed by one person, but questions should be directed to another. This slows the process. An agent in Idaho returned my original offer in compromise because it was submitted on a photocopied form rather than a carbon-copy original. This slows the process.⁵³

In an email dated April 27, 2018, IRS Counsel stated that OICs returned in error are not subject to the 24-month deemed acceptance period in IRC § 7122(f).⁵⁴ Since an OIC will not be deemed acceptable once it is rejected, the 24-month period under IRC § 7122(f) is extinguished once the OIC is rejected. IRC § 7122(f) does not distinguish between a rejection with merit and a rejection made in error by the IRS.⁵⁵ As a result, the IRS will no longer apply the protections of IRC § 7122(f) to OICs returned to taxpayers after an erroneous rejection by the IRS.

Congress created the protections found in IRC § 7122(f) after listening to taxpayers and practitioners describe the situations in which they found themselves. By exempting the time associated with an OIC returned erroneously to the taxpayer, the IRS is going against the Congressional intent in IRC § 7122(f) as well as violating the taxpayer's *right to a fair and just tax system*. This change will also lead to confusion for taxpayers, particularly for those who do not understand the difference between a returned and a rejected OIC. And in totality, all of the changes described above will make it more difficult for taxpayers to get the IRS to accept an OIC.

50 Pub. L. No. 109-222, §509(b)(2), 120 Stat. 363.

51 *Taxpayer Rights Proposals And Recommendations of the National Commission on Restructuring the Internal Revenue Service on Taxpayer Protections and Rights: Hearing Before the H. Subcomm. on Oversight*, 105th Cong. 17 (1997) (statement of Rep. William J. Coyne).

52 *IRS Restructuring: Hearing Before the S. Comm. on Finance*, 105th Cong. 240 (1997) (statement of Douglas C. Burnette, president, National Society of Accountants).

53 *Internal Revenue Service's Methods: Hearing Before the S. Comm. on Appropriations*, 105th Cong. 17 (1998) (statement of Amy Powers).

54 In some instances this will harm taxpayers twice. The IRS believes the 24-month period under IRC § 7122(f) stops to run when an OIC is closed, even if the IRS erroneously returns or withdraws an OIC to a taxpayer and later reopens it. However, the IRS tolls the collection statute expiration date timeframe in such reopened offers, which allows the IRS a longer time to collect the taxpayer's debt if the OIC is not accepted. Treas. Reg. § 301.7122-1(i). So the taxpayer is inconvenienced with an erroneously returned OIC that no longer is protected by a two-year timeframe for processing but is also subjected to a longer collection period.

55 See also IRS, Notice 2006-68, *Downpayments for Offers in Compromise* (July 31, 2006).

The Time It Takes for Appeals to Process OIC Appeals May Lead to Multiple Years of Refund Offsets

As a term of acceptance for the OIC, the taxpayer agrees that the IRS will keep any refund, including interest, that might be due for tax periods extending through the calendar year in which the IRS accepts the offer.⁵⁶ This policy may make sense when the OIC can be processed (including any Appeals action) within a year. However, practitioners report this practice harms their clients because processing OICs takes so long that the IRS takes multiple refunds.⁵⁷ It can be especially difficult for low income taxpayers who rely on their tax refunds to meet their basic living expenses. Figure 1.18.5 shows the cycle time for OICs worked in Appeals from receipt of the case until closure.

FIGURE 1.18.5, Appeals Offer in Compromise Case Closed Cycle Time FY 2016-FY 2018⁵⁸

FY 2016	FY 2017	FY 2018
174.8 days (5.8 months)	193.6 days (6.5 months)	194.7 days (6.5 months)

While Appeals is not the only cause of delayed processing, the average amount of time that Appeals keeps a case has gone from 5.8 months in FY 2016 to 6.5 months in FY 2018. This means if a taxpayer appeals a rejected OIC to Appeals after August of a given year, there is a likelihood that the OIC will be worked into the next calendar year, and the taxpayer will lose an additional refund. The IRS accepted 24,958 IMF OICs in FY 2017 and in 1.5 percent (378 OICs) of those, the taxpayer lost two refunds.⁵⁹ The lost refunds total \$ 945,953.⁶⁰ For BMF OICs, the IRS accepted 1,599 OICs in FY 2017. Of that amount, less than one percent (seven OICs) lost two refunds. The lost refunds total \$20,383.54.⁶¹ This impacts the taxpayer's *right to a fair and just tax system*.

The role of Appeals is not to develop the case. Appeals employees are instructed to “ask the taxpayer for clarifying information if the taxpayer (particularly a *pro se* taxpayer) is unsure of what to provide to clarify a position that is being advanced by the taxpayer. You will primarily rely on the case development that is in the case file at the time of appeal.”⁶² Additionally, Appeals employees are instructed to consider only the items in dispute at the time of the OIC rejection or issues raised by the taxpayer.⁶³ Since OIC analysis is now centralized, Appeals should review its employees’ training and technical experience to ensure it has a sufficient number of employees to work these OIC cases timely.

56 IRS, Form 656, *Offer in Compromise* 5 (Mar. 2018).

57 TAX ANALYSTS, *Offer in Compromise Participation Can Mean Lost Refunds for Some* (June 12, 2018).

58 IRS response to TAS information request (Aug. 6, 2018).

59 Analysis of OIC submission dates and offset refunds from IMF.

60 *Id.*

61 Analysis of OIC submission dates and offset refunds from BMF.

62 IRM 8.23.1.3(2), *Conference and Settlement Practices* (Apr. 18, 2016).

63 IRM 8.23.1.3(3), *Conference and Settlement Practices* (Apr. 18, 2016).

CONCLUSION

As demonstrated by TAS Research, the OIC is a valuable collection tool for both the IRS and taxpayers. It is a cost-effective way to encourage long-term tax compliance. It provides finality to taxpayers who are struggling with a tax liability. It saves money for the IRS by collecting as much as possible early in the process, without expensive enforcement action.

However, the IRS has made several changes to the OIC program which threaten to leave the OIC out of reach for some taxpayers. Instead of returning OICs for lack of filing compliance, the IRS should retain the OIC for a period of time during which the taxpayer can “cure” the defect of missing tax returns. By adopting this approach, the IRS would only retain a TIPRA payment in situations where an OIC defect cannot be cured. The IRS should rethink its analysis of when the 24-month processing limitation applies in cases where it rejects an OIC, especially in cases where the rejection was an IRS error. Refusing to apply this protection to taxpayers compounds the IRS errors to the detriment of taxpayers. Last, the IRS should review its policy of offsetting multiple years of refunds where there are long processing times for OIC appeals. The recent IRS changes to the OIC program could harm taxpayers and may impact the OIC’s viability as a collection tool in the future.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Have at least one OIC Specialist in each state to ensure a more even geographic presence for OIC analysis.
2. 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 obtain missing returns within a specified period of time.
3. Reconsider its determination that OICs returned or withdrawn in error are not subject to the 24-month deemed acceptance period in IRC § 7122(f).
4. Limit the number of refunds that can be offset while an OIC is pending to one refund only.
5. Conduct a study to analyze the OIC amount offered and collected amounts to understand why the IRS is rejecting OICs that have an offered amount greater than the dollars collected. For instance, the IRS should look at how it is applying the Allowable Living Expense standards and where the taxpayer is obtaining the payment for the OIC.

**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 Private Collection Agency Inventory Accumulates****RESPONSIBLE OFFICIAL**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to Confidentiality*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The IRS implemented its current Private Debt Collection (PDC) initiative in April 2017.² 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).³ The IRS initially assigned cases in which the taxpayer did not dispute liability for the debt. However, 2018 assignments included tax assessments, such as those based on substitutes for return, which have high tax abatement rates.

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 IRS News Release IR-2017-74, *Private Collection of Some Overdue Federal Taxes Starts in April; Those Affected Will Hear First From IRS; IRS Will Still Handle Most Tax Debts* (Apr. 4, 2017), <https://www.irs.gov/newsroom/private-collection-of-some-overdue-federal-taxes-starts-in-april-those-affected-will-hear-first-from-irs-irs-will-still-handle-most-tax-debts>.

3 Private Debt Collection (PDC) Program Scorecard for fiscal year (FY) 2018 showing that 621,321 taxpayers' accounts with a dollar value of \$5,115,996,181 were in Private Collection Agency (PCA) open inventory.

PDC program revenues have surpassed program costs, but this surplus has been 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 installment agreements (IAs) while their debts were assigned to PCAs had incomes at or below their allowable living expenses (ALEs), meaning they agreed to pay tax arrears while they could not pay for their basic living expenses;⁴
- 44 percent of taxpayers who made commissionable payments while their debts were assigned to PCAs had incomes at or below 250 percent of the federal poverty level (FPL);⁵
- 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;⁶ 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.⁷

The PDC program is not generating the revenues Congress expected, and only about a third of revenues attributable to PCA activity in FY 2018 made their way to, and remained in, the government's General Fund.⁸ 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 than did PCA activity.⁹

At the end of FY 2018, PCAs' inventories included over 400,000 cases in which there was no payment by the taxpayer and no agreement to pay, even though the case had been assigned for at least 90 days.¹⁰ In fact, these cases had been in PCA inventory for 244 days on average.¹¹ Retaining cases without resolving taxpayers' liabilities allows PCAs to receive commissions on any payments taxpayers happen to make in the future in the absence of any recent PCA collection activity. Had these cases remained

4 This figure reflects allowance of vehicle ownership and operating expenses in calculating allowable living expenses (ALEs). As discussed below, if vehicle ownership expenses are not allowed, 33 percent of taxpayers who entered into installment agreements (IAs) while their debts were assigned to PCAs had incomes at or below their ALEs. For a further discussion of ALEs, see vol. 2, *A Study of the IRS's Use of the Allowable Living Expense Standards*, *infra*.

5 The measure of 250 percent of the federal poverty level is used in tax administration in several contexts. Congress adopted the measure to identify taxpayers who qualify for assistance from low income taxpayer clinics (LITCs) because they cannot afford representation in IRS disputes and are therefore vulnerable to overreaching. See IRC § 7526. The Bipartisan Budget Act of 2018 adopts the measure to determine whether to excuse taxpayers from paying user fees to enter into installment agreements. See Bipartisan Budget Act of 2018, Pub. L. No. 115-123, § 41105, 132 Stat. 64, 157 (Feb. 9, 2018). The IRS uses the measure as a proxy to identify certain retirement income recipients who are likely to be in economic hardship in order to exclude them from its automatic levy program, the Federal Payment Levy Program. See IRM 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (Oct. 20, 2016).

6 Accounts Receivable Dollar Inventory (ARDI), Individual Returns Transaction File (IRTF), Information Returns Master File (IRMF), Compliance Data Warehouse (CDW), reflecting data from inception of the PDC program through FY 2018, discussed below.

7 ARDI, IRTF, IRMF, CDW, reflecting activity on tax modules (the IRS's record of a specific tax liability for a specific tax period), from program inception through FY 2018, discussed below.

8 Congressional Budget Office (CBO) projections; IRS Quarterly Update to Congress, *Private Debt Collection (PDC) Program 1*, for FY 2018, discussed below. According to the Bureau of the Fiscal Service (BFS), "[a]s 'America's Checkbook,' the General Fund of the Government consists of assets and liabilities used to finance the daily and long-term operations of the U.S. Government as a whole. It also includes accounts used in management of the budget of the U.S. Government." BFS, *The General Fund*, <https://fiscal.treasury.gov/general-fund/> (last visited Dec. 18, 2018). Of the \$75.3 million in revenues attributable to PCA activity, a net amount of \$25.8 million, or 34 percent, was generated for the General Fund.

9 As discussed below, in FY 2018 the IRS collected \$37.4 million from taxpayers whose debts were assigned to PCAs, while PCA activity generated a net amount of \$25.8 million for the General Fund.

10 ARDI, IRTF, IRMF, CDW data, showing 408,087 of these cases as of Sept. 30, 2018.

11 *Id.*, reflecting activity since the inception of the PDC program in April 2017 through FY 2018.

in the IRS queue and not assigned to PCAs, the public fisc would be credited with the full amount of collected funds.

ANALYSIS OF PROBLEM

Background

IRC § 6306 was amended in 2015 to require the IRS to enter into “qualified tax collection contracts” for the collection of “inactive tax receivables.”¹² The Congressional Budget Office (CBO) estimated that from FYs 2016-2025, the new PDC program would raise \$4.8 billion in revenues and require \$2.4 billion in spending.¹³ CBO projected that for FY 2017, the PDC program would generate \$374 million in revenues, and for FY 2018 would generate \$470 million in revenues.¹⁴

Prior to the launch of the PDC initiative, the National Taxpayer Advocate voiced her concern that the program as implemented would create or exacerbate taxpayers’ economic hardship.¹⁵ By the IRS’s own estimate, under the proposed legislation that required the IRS to outsource certain tax debts to PCAs, about 79 percent of the taxpayers whose debts would be eligible for assignment to PCAs had incomes below 250 percent of the federal poverty level.¹⁶

On April 23, 2018, about a year after the IRS began assigning tax debts to PCAs, the National Taxpayer Advocate issued a Taxpayer Advocate Directive (TAD) ordering the IRS to exclude from assignment to PCAs the debts of taxpayers whose incomes are below 250 percent of the FPL. The IRS appealed the TAD on May 14, 2018, and the Deputy Commissioner for Services and Enforcement rescinded the TAD on June 20, 2018.¹⁷

In the meantime, the IRS continued to assign tax debts to PCAs. By September 13, 2018, over \$5.7 billion in debts owed by over 730,000 taxpayers had been assigned to PCAs.¹⁸ About \$5 billion in debts owed by more than 600,000 taxpayers was still in PCA inventory on that date.¹⁹ For FY 2018,

12 See Fixing America’s Surface Transportation Act (FAST Act), Pub. L. No. 114-94, Div. C, Title XXXII, § 32102, 129 Stat. 1312, 1733-36 (2015) (adding subsections (c) and (h) to IRC § 6306).

13 Letter from Keith Hall, CBO Director, to Rep. Bill Shuster, Chairman, Comm. on Transportation and Infrastructure, Table 2 (Dec. 2, 2015).

14 *Id.*, projecting that the PDC program would generate \$374 million in revenues and \$187 million in outlays for FY 2017 and \$470 million in revenues and \$235 million in outlays for FY 2018. The projected outlays appear to include amounts retained under IRC § 6306(e), discussed below, equal to 50 percent of revenues attributable to PCA activity.

15 See National Taxpayer Advocate 2016 Annual Report to Congress 172 (Most Serious Problem: Private Debt Collection (PDC): *The IRS Is Implementing a PDC Program in a Manner That Is Arguably Inconsistent With the Law and That Unnecessarily Burdens Taxpayers, Especially Those Experiencing Economic Hardship*).

16 See Letter from Nina Olson, National Taxpayer Advocate, to Sen. Ron Wyden, Chairman, Comm. on Finance; Sen. Orrin G. Hatch, Ranking Member, Comm. on Finance; Rep. Dave Camp, Chairman, Comm. on Ways and Means; Rep. Sander Levin, Ranking Member, Comm. on Ways and Means; Rep. Charles W. Boustany, Jr., Chairman, Subcomm. on Oversight, Comm. on Ways and Means; Rep. John Lewis, Ranking Member, Subcomm. on Oversight, Comm. on Ways and Means (May 13, 2014).

17 The Taxpayer Advocate Directive (TAD), the IRS’s appeal, and the memorandum rescinding the TAD were published in the National Taxpayer Advocate Fiscal Year (FY) 2019 Objectives Report to Congress 68-79.

18 PDC Program Scorecard for FY 2018, showing that since the program’s inception, \$5,707,490,970 of debt of 730,015 taxpayers were assigned to PCAs.

19 *Id.*, showing that 621,321 taxpayers’ accounts with a dollar value of \$5,115,996,181 were in PCA open inventory.

PCA activity generated \$75.3 million of revenue, which is about 16 percent of the \$470 million CBO projection for FY 2018.²⁰

IRS Activity Generated More For the Public Fisc Than PCA Activity Did

As noted, in FY 2018, taxpayers made \$75.3 million in payments as a result of PCA activity.²¹ However, of this \$75.3 million:

- The IRS retained 25 percent, \$18.8 million, as authorized by IRC § 6306(e)(1), to pay for the costs of services performed by PCAs, including commissions;²² and
- The IRS retained an additional 25 percent, \$18.8 million, as authorized by IRC § 6306(e)(2) “to fund the special compliance personnel program account under section 6307.”²³

After subtracting the amounts retained pursuant to IRC § 6306(e), \$37.7 million was paid to the General Fund.²⁴ From the General Fund, an additional \$11.9 million of PDC program costs were paid.²⁵ Thus, of the \$75.3 million attributable to PCA activity in FY 2018, a net amount of \$25.8 million — or 34 percent — was generated for the General Fund.²⁶ Figure 1.19.1 shows the disposition of funds collected from taxpayers as a result of PCA activity.

20 IRS Quarterly Update to Congress, *Private Debt Collection (PDC) Program 1*, for FY 2018, discussed below. Because the PDC program was not launched until April of 2017, it may be appropriate to compare the FY 2018 program performance with CBO’s FY 2017 projections. The \$75.3 million in revenues for FY 2018 generated by PCA activity is 20 percent of the \$374 million CBO revenue projection for FY 2017. In its Quarterly Update to Congress, the IRS reported PDC program revenues of \$82.1 million, which includes, in addition to \$75.3 million in revenues attributable to PCA activity, \$6.8 million of payments received within ten days of assignment of the account to a PCA. These payments are not subject to commissions because they are deemed not attributable to PCA activity. Even including the \$6.8 million in program revenues, the program appears to have fallen short of expectations: \$82.1 million is 17 percent of CBO’s projected FY 2018 revenues and 22 percent of projected FY 2017 revenues.

21 *Id.*, showing taxpayers made \$75,372,679 in commissionable payments (*i.e.*, amounts received more than ten days after the IRS notified taxpayers their debts had been assigned to PCAs. These payments are deemed attributable to PCA activity and are thus subject to commissions).

22 IRC § 6306(e)(1) authorizes the IRS to retain and use “an amount not in excess of 25 percent of the amount collected under any qualified tax collection contract for the costs of services performed under such contract.” Pursuant to this provision, the IRS retained \$18,843,170 for its Cost of Services Fund. The IRS paid commissions to PCAs from this fund. IRS Quarterly Update to Congress, *Private Debt Collection (PDC) Program 7*, for FY 2018.

23 Pursuant to IRC § 6306(e)(2), the IRS retained \$18,843,170 for a Special Compliance Personnel Program (SCPP) fund. IRS Quarterly Update to Congress, *Private Debt Collection (PDC) Program 7*, for FY 2018. IRC § 6307(a) requires the IRS to use amounts retained under IRC § 6306(e)(2) to hire, train, and employ special compliance personnel, defined in IRC § 6307(d)(1) as “field function collection officers or in a similar position, or employed to collect taxes using the automated collection system or an equivalent replacement system.”

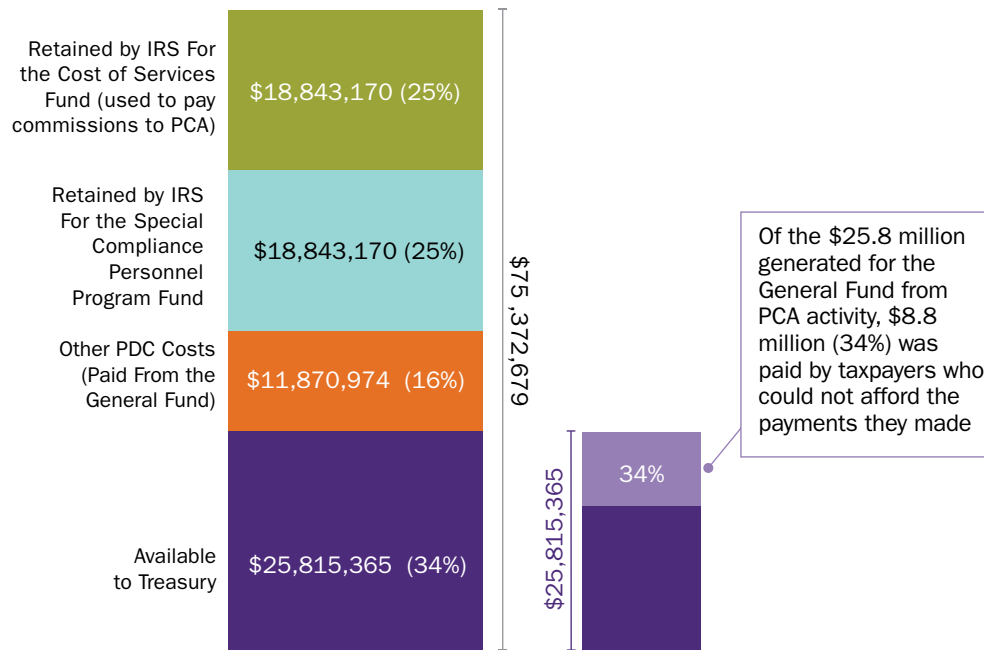
24 IRS response to fact check (Dec. 17, 2018), noting that “[c]ommissionable payments are distributed as follows: 25% (\$19 million) is retained in the Cost of Services fund to pay commissions, 25% (\$19 million) is retained in the SCPP fund to pay for contract administration and SCP [this acronym is undefined] program costs, and 50% goes to the General Fund (\$37 million).” Without rounding, commissionable payments of \$75,372,679 less \$18,843,170 for each special fund authorized by IRC § 6306(e) is \$37,686,339.

25 PDC program costs paid from the General Fund were \$11,870,974. IRS response to TAS fact check (Dec. 17, 2018); IRS Quarterly Update to Congress, *Private Debt Collection (PDC) Program 1*, for FY 2018.

26 Without rounding, \$37,686,339 less \$11,870,974 is \$25,815,365.

FIGURE 1.19.1

Disposition of \$75 Million of Commissionable Payments Made in FY 2018 by Taxpayers Whose Debts Were Assigned to Private Collection Agencies



As discussed in greater detail below, 34 percent of total payments attributable to PCA activity are made by taxpayers whose incomes are at or below their ALEs. Thus, of the \$25.8 million that was ultimately available to the Treasury as a result of PCA activity, \$8.8 million was paid by taxpayers who could not afford the payments they made.²⁷

Moreover, some taxpayers whose debts were assigned to PCAs made payments that were attributable to IRS, rather than PCA, activity:

- The IRS’s initial contact letter advising taxpayers their debt was being assigned to a PCA generated \$6.8 million;²⁸
- Through levies on payments these taxpayers were entitled to receive from federal, state, or local governments, the IRS collected an additional \$16.4 million;²⁹

27 Without rounding, 34 percent of \$25,815,365 is \$8,777,224. As discussed below, if vehicle ownership expenses are not allowed in calculating ALEs, 30 percent of total payments attributable to PCA activity are made by taxpayers whose incomes are at or below their ALEs.

28 IRS Quarterly Update to Congress, *Private Debt Collection (PDC) Program 1*, for FY 2018, showing non-commissionable payments (i.e., those received within ten days after the IRS notifies taxpayers their debts have been assigned to a PCA) of \$6,820,047.

29 ARDI, IRTF, IRMF, CDW data, reflecting activity for FY 2018, showing the IRS collected \$16,400,771 through levies, including pursuant to the State Income Tax Levy Program (SITLP); Municipal Tax Levy Program (MTLP); Alaska Permanent Fund Dividend Levy Program (AKPFD); and the Federal Payment Levy Program (FPLP). These cases were recalled by the IRS from PCA inventory; IRC § 6306(d)(4) provides that a tax receivable may not be assigned to a PCA if it is “currently under examination, litigation, criminal investigation, or levy.”

- The IRS collected \$14.2 million by offsetting these taxpayers' federal tax refunds against their outstanding tax liabilities.³⁰

This total of \$37.4 million is not subject to commissions or retention by the IRS under IRC § 6306(e).³¹ Thus, IRS activity actually generated 1.4 times more dollars for the public fisc than PCA activity did.³²

PCAs do not appear to be particularly effective in generating payments, especially in view of the burden the PDC program places on taxpayers, discussed below. Only a little more than one percent of the dollar value of the debt assigned to PCAs since inception of the program has been collected.³³ By comparison, the Automated Collection System (ACS), the IRS function that issues collection notices and receives calls from taxpayers with delinquent tax liabilities, collects seven percent of the dollar value of tax liabilities assigned to it.³⁴ Taxpayers whose cases are assigned to PCAs enter into IAs six percent of the time.³⁵ In contrast, the ACS function places taxpayers into IAs about ten percent of the time.³⁶

Congress Required the IRS to Develop Allowable Living Expense Standards to Prevent Taxpayers From Being Required to Make Payments They Cannot Afford

The IRS evaluates taxpayers' abilities to pay their tax liabilities by comparing their incomes to their ALEs, a practice that has been in place for decades.³⁷ The ALE standards determine how much money taxpayers need for basic living expenses such as housing and utilities, food, transportation, and health care, based on family size and where they live.³⁸ The amount by which a taxpayer's income exceeds his or her ALEs is the starting point for determining the extent to which a taxpayer can afford to pay the debt immediately in full, or over time in installments. If the ALE standards exceed the taxpayer's income, the taxpayer is unable to pay his or her necessary living expenses. Thus, the taxpayer may

30 Refund offsets do not cause a recall of a case from PCA inventory. In FY 2018, the IRS offset \$14,197,449 of refunds claimed by taxpayers whose debts were assigned to PCAs. ARDI, IRTF, IRMF, CDW.

31 The sum of the non-commissionable payments of \$6,820,047, levied amounts of \$16,400,771, and refund offsets of \$14,197,449 is \$37,418,267.

32 Without rounding, \$37,418,267 million in collections that resulted from IRS activity is 1.4 times greater than the \$25,815,365 generated for the General Fund by PCA activity.

33 PDC Program Scorecard for FY 2018. Since inception of the program, the amount of commissionable payments was \$80,736,597, which is 1.4 percent of the dollar value of the amounts assigned, \$5,707,490,970.

34 IRS, Collection Activity Report NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Sept. 30, 2018) (showing \$47,125,583,881 assigned for collection and \$3,455,267,613 collected, a rate of 7.33 percent).

35 As discussed below, 43,579 of the 730,015 taxpayers whose debts were assigned to PCAs entered into IAs, a rate of six percent.

36 IRS, Collection Activity Report NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Sept. 30, 2018); IRS, Collection Activity Report NO-5000-6, *Installment Agreement Cumulative Report* (Sept. 30, 2018) (showing 4,670,873 individual taxpayers' accounts in Automated Collection Systems (ACS) inventory at the beginning of FY 2018, and an additional 3,197,173 individual taxpayers' accounts assigned to ACS during FY 2018, for total available inventory of 7,868,046 individual taxpayer accounts. Of these, 780,809 taxpayers entered into IAs, a rate of 9.9 percent).

37 See, e.g., IRM 105.1.3, *Collecting Contact Handbook* (Sept. 25, 1996), <http://core.publish.no.irs.gov/irm/p05/pdf/30353i96.pdf>; IRM 57(10)(10).1(4), *Determination of Adequate Offer* (Sept. 22, 1994), cross referencing IRM 5323 on IAs, <http://core.publish.no.irs.gov/irm/p05/pdf/35490e98.pdf>.

38 See IRS, Collection Financial Standards, <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>. The ALEs are guidelines that "establish the minimum a taxpayer and family needs to live." The IRS may allow additional amounts for basic living expenses if the taxpayer substantiates the need to deviate from the standards. IRM 5.15.1.8 (6), *Financial Analysis Handbook, Allowable Expense Overview* (Aug. 29, 2018). Allowable expenses include transportation expenses, which may consist of vehicle ownership expenses (loan or lease payments) and operating expenses (maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking, and tolls). Unless otherwise indicated, in calculating taxpayers' ALEs, we allowed vehicle operating expenses (two allowances in the case of joint filers and one allowance for all other taxpayers), and all taxpayers were allowed one vehicle ownership expense.

qualify for collection alternatives such as an offer in compromise (OIC)³⁹ or to have the account designated as Currently Not Collectible (CNC) - Hardship.⁴⁰

In 1998, Congress amended IRC § 7122, *requiring* the IRS to develop guidelines to determine when an OIC is adequate and should be accepted to resolve a dispute.⁴¹ Specifically, the IRS was required to develop ALEs “designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.”⁴² Essentially, Congress codified in IRC § 7122 the existing IRS practice of taking into account taxpayers’ ALEs in determining the extent to which they can pay, and in considering collection alternatives.

The IRS is not required to consider taxpayers’ ALEs, however, in evaluating proposed “streamlined” IAs (*i.e.*, IAs to repay a tax liability of a specified maximum amount within a specified number of months).⁴³ Taxpayers need not submit financial analysis to qualify for streamlined IAs, and may enter into streamlined IAs online, without interacting with an IRS employee. Nonetheless, taxpayers who seek to resolve their tax liabilities with the IRS have the option of providing financial information that can serve as the basis for collection alternatives, an option particularly relevant to taxpayers whose incomes are exceeded by their ALEs.

In the PDC Initiative as Implemented, the Allowable Living Expenses Guidelines Are Ignored

In contrast, PCAs can *only* propose that the taxpayer fully pay the liability within 120 days, or, alternatively, enter into a streamlined IA, which currently refers to an IA to repay a tax liability of up

39 See IRC § 7122, described below.

40 See IRM 5.16.1.2, *Currently Not Collectible* (Sept. 18, 2018); IRM 5.16.1.2.9, *Hardship* (Sept. 18, 2018), noting that “hardship exists if a taxpayer is unable to pay reasonable basic living expenses.”

41 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3462, 112 Stat. 685, 764 (July 22, 1998), adding subsection (c) (which is now subsection (d)) to IRC § 7122.

42 IRC § 7122(d)(2)(A). However, the ALE standards are not to be used “to the extent such use would result in the taxpayer not having adequate means to provide for basic living expenses.” IRC § 7122(d)(2)(B).

43 Streamlined IAs have been available for many years. See, e.g., 1999 TNT 111-26, *Memo on Streamlined Installment Agreements Released* (June 10, 1999) publishing a Mar. 31, 1998, memorandum from the Assistant Commissioner (Collection) that provided for streamlined IAs where the liability did not exceed \$15,000 (an increase over the previous amount of \$10,000); and 1999 TNT 111-24, *Memo on Streamlined Installment Agreements Released* (June 10, 1999) publishing a Mar. 29, 1999 memorandum from the Director, Office of Collection, Service Center and Appraisal Services that increased the maximum amount of liability for streamlined IAs to \$25,000 and increased the maximum duration of streamlined IAs from 36 months to 60 months.

to \$100,000 within six or seven years (and within the period of limitations on collection).⁴⁴ PCAs do not have the statutory authority to offer any collection alternatives, and in the PDC program as implemented, they do not gather financial information from taxpayers that the IRS could analyze, despite their statutory authorization to gather financial information.⁴⁵ Thus, while a taxpayer's debt is assigned to a PCA, the guidelines that Congress required the IRS to develop for analyzing taxpayers' ability to pay and evaluating collection alternatives will never apply. The National Taxpayer Advocate does not believe this outcome is necessary or appropriate, especially in view of the effect the current PDC initiative has on taxpayers, discussed below. The IRS should ensure that taxpayers whose incomes are at or below their ALEs have direct, unimpeded access to IRS collection alternatives by not assigning their debts to PCAs.⁴⁶

Taxpayers Are Often Entitled to Relief That PCAs Cannot Provide

In the prior iteration of the IRS's PDC initiative, PCAs could refer cases to a Referral Unit consisting of IRS employees.⁴⁷ The current PDC initiative does not include a Referral Unit, but some taxpayers whose debts were assigned to PCAs sought assistance from TAS. The disposition of TAS cases provides useful perspective. In FY 2018, TAS closed 157 cases involving taxpayers whose debts had been assigned to PCAs. Some taxpayers became unresponsive after their cases were opened. However, TAS succeeded in reducing or completely eliminating the balance due through penalty abatements, identity theft procedures, credit transfers, amended returns, or other adjustments 22 percent of the time. The taxpayers' accounts were placed in CNC Hardship status another 24 percent of the time.⁴⁸ Figure 1.19.2 shows the disposition of the 157 TAS cases.

44 Under IRC § 6502, the IRS must generally collect tax within ten years after assessment. See IRM 5.14.5.2, *Streamlined Installment Agreements* (Dec. 23, 2015), providing that streamlined IAs may be approved for taxpayers where the aggregate unpaid balance of assessments is \$50,000 or less and can be paid within 72 months and within the period of limitations on collection. Taxpayers who owe between \$50,000 and \$100,000 may qualify for a streamlined IA payable over 84 months. See IRS, *Streamlined Processing of Installment Agreements*, <https://www.irs.gov/businesses/small-businesses-self-employed/streamlined-processing-of-installment-agreements>. It appears that the duration of IAs offered by PCAs do not always conform to these IRS guidelines. As the Treasury Inspector General for Tax Administration (TIGTA) has noted, “[w]hile it is true that 84 months is the maximum payment arrangement for both IRS and PCA payment plans, the qualifications for obtaining such an agreement are different in that taxpayers who owe less than \$50,000 may not obtain an 84-month installment agreement from the IRS. However, there is no such restriction for PCA payment arrangements.” See TIGTA, Ref. No. 2019-30-018, *Fiscal Year 2019 Biannual Independent Assessment of Private Collection Agency Performance* 26 (Dec. 31, 2019). IRC § 6306(b) authorizes PCAs to offer IAs of a duration not to exceed five years. As discussed below, the PDC program as implemented authorizes PCAs to offer taxpayers IAs of six or seven years if the IRS approves the IA, an outcome the National Taxpayer Advocate views as an “end run” around the statute. See National Taxpayer Advocate 2016 Annual Report to Congress 172 (Most Serious Problem: *Private Debt Collection (PDC): The IRS Is Implementing a PDC Program in a Manner That Is Arguably Inconsistent With the Law and That Unnecessarily Burdens Taxpayers, Especially Those Experiencing Economic Hardship*). TIGTA shares that concern and other concerns expressed by the National Taxpayer Advocate. See TIGTA, Ref. No. 2018-30-052, *Private Debt Collection Was Implemented Despite Resource Challenges; However, Internal Support and Taxpayer Protections Are Limited* (Sept. 10, 2018).

45 IRC § 6303(b) defines a “qualified tax collection contract” as a contract pursuant to which PCAs “obtain financial information specified by the Secretary with respect to such taxpayer,” among other things. PCAs conduct operations according to provisions in the PCA Policies and Procedures Guide (PPG), which does not contemplate the collection of financial information from taxpayers. (References to the PPG are to the Sept. 30, 2018 version unless otherwise noted.)

46 For a legislative recommendation that the debts of taxpayers whose incomes are less than their ALEs should not be assigned to PCAs, see National Taxpayer Advocate 2019 Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration: Amend IRC § 6306(d) to Exclude the Debts of Taxpayers Whose Incomes Are Less Than Their Allowable Living Expenses From Assignment to Private Collection Agencies or, If That Is Not Feasible, Exclude the Debts of Taxpayers Whose Incomes Are Less Than 250 Percent of the Federal Poverty Level*, *infra*.

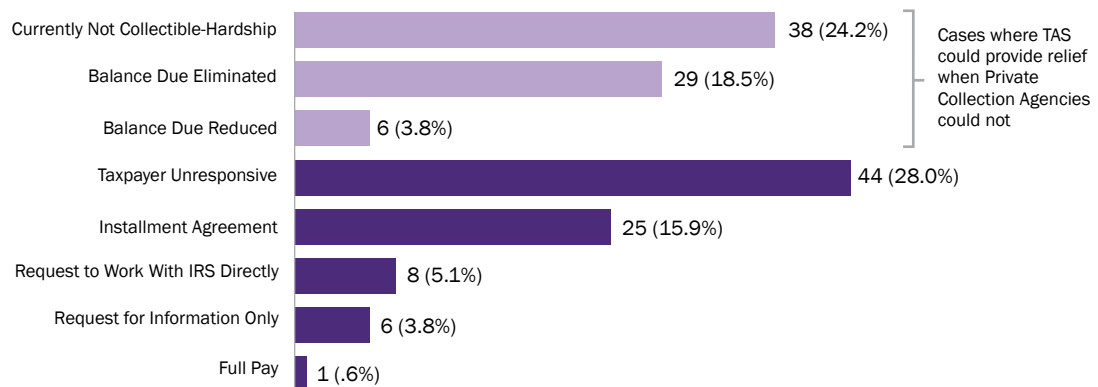
47 See PPG (July 1, 2008 version). The previous PDC initiative was in place from Sept. of 2006 until Mar. of 2009, when the IRS discontinued the program. See *IRS Conducts Extensive Review, Decides Not to Renew Private Debt Collection Contracts, IRS Employees More Flexible, More Cost Efficient* (Mar. 5, 2009), <https://www.irs.gov/newsroom/irs-conducts-extensive-review-decides-not-to-renew-private-debt-collection-contracts>.

48 Data obtained from Taxpayer Advocate Management Information System (TAMIS).

Of taxpayers who entered into installment agreements while their debts were assigned to private collection agencies, 40 percent had incomes at or below their allowable living expenses, meaning they agreed to pay the IRS when they were unable to pay their basic living expenses.

FIGURE 1.19.2

Disposition of TAS Private Debt Collection Cases, FY 2018



PCA Installment Agreements, Often With Taxpayers Whose Allowable Living Expenses Exceed Their Incomes, Have High Default Rates

Taxpayers who enter into IAs outside the PDC program default on their IAs, streamlined or not, at an overall rate of around 14 percent.⁴⁹ Overall, taxpayers who enter into *streamlined* IAs while their accounts are assigned to the IRS’s ACS function default around 19 percent of the time.⁵⁰ Figure 1.19.3 shows the relationship of income to ALEs of taxpayers who entered into IAs while their debts were

49 IRS, Collection Activity Report, *IA Default Report FY 2018 For 12 Month Period Ending Cycle: 201839*, showing a 14.09 percent overall IA default rate and a 14.32 overall default rate for streamlined IAs.

50 *Id.* According to the IRS, “PCAs offer payment arrangements to taxpayers in a manner consistent with IRS installment agreement procedures for similarly situated taxpayers who call the IRS.”

assigned to PCAs and the rate at which they defaulted on their IAs.⁵¹ For purposes of the comparison, income was the amount shown on the taxpayers' 2017 return, or, if no return was filed, the sum of third-party reports of the taxpayer's income for 2017. If no return was filed and there were no third-party reports of income, the taxpayer's income was assumed to be zero. In some cases, taxpayers made no payments on their IAs, yet remain in PCA inventory, a phenomenon discussed below.

FIGURE 1.19.3, Relationship of Income to Allowable Living Expenses of 43,579 Taxpayers Who Entered Into Streamlined Installment Agreements While Their Debts Were Assigned to PCAs and Default Rates⁵²

Income Compared to ALEs	Number of Taxpayers	Percent of Taxpayers	Number of Taxpayers Who Defaulted	Percent of Taxpayers Who Defaulted
Taxpayers With Income At or Below Their ALEs	17,596	40%	6,440	37%
Taxpayers With Income Above Their ALEs	25,983	60%	9,613	37%
Total	43,579	100%	16,053	37%

As Figure 1.19.3 shows, of taxpayers who entered into IAs while their debts were assigned to PCAs, 40 percent had incomes at or below their ALEs, meaning they agreed to pay the IRS when they were unable to pay their basic living expenses.⁵³ Whether or not taxpayers' ALEs exceeded their incomes, the default rate was the same. The difference between these two groups is that according to IRS standards, taxpayers in the former category (those whose ALEs exceed their incomes) agreed to make payments they could not afford.

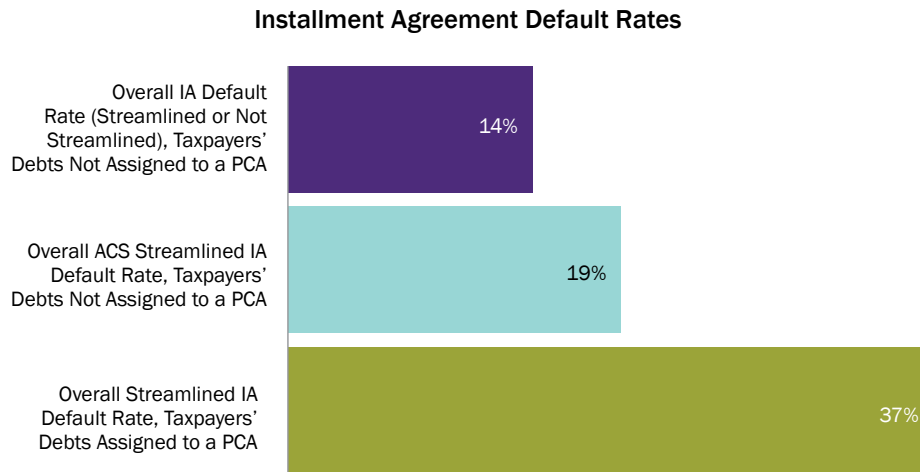
51 ARDI, IRTF, IRMF, CDW data, reflecting activity since the inception of the PDC program in April of 2017 through FY 2018. We identified IAs by searching for modules with a Transaction Code (TC) 971 and Action Code (AC) 63. We identified defaults as IA taxpayers posting a TC 971 AC 163 on any module that entered IA status and that was not fully resolved. The IRS recommended identifying IAs by further restricting the search to taxpayers whose accounts not only bear the TC 971 AC 63, but also have a value in the "Miscellaneous" field of 1, 2, 3, or 4 (corresponding to one of the PCAs). IRS response to fact check (Dec. 17, 2018). When we adopt the IRS's methodology for identifying IAs, we find 7,961 fewer taxpayers who entered into IAs while their debts were assigned to PCAs, 41 percent of whom had incomes at or below their ALEs, and an overall default rate of 23 percent. The difference of 7,961 IAs could represent taxpayers whose debts were assigned to a PCA, but who then entered into an IA with the IRS instead. Because removing these 7,961 IAs reduces the default rate from 37 percent to 23 percent, the question arises whether PCAs always treat IAs as defaulted when appropriate, a concern supported by other data in this report such as the length of time cases remain in PCA inventory with no payment, discussed below. Moreover, when a taxpayer enters into an IA with the IRS, IRS procedures require it to recall the case from the PCA, and the IRS only recalled 4,801 cases due to "Active IA" (leaving 3,160 of the 7,961 cases unaccounted for). The IRS appears to record at least some of these recalled cases as defaulted IAs, while at the same time recording the status of the case as the taxpayer having an IA with the IRS. However, we cannot definitively explain the discrepancy the different methods create. We note that the IRS and TIGTA have encountered similar difficulties in determining the default rate of PCA IAs, but TIGTA found that the overall default rate was 53 percent, which is even higher than the default rate we report here. See TIGTA, Ref. No. 2019-30-018, *Fiscal Year 2019 Biannual Independent Assessment of Private Collection Agency Performance* 4 (Dec. 31, 2018).

52 The values in Figure 1.19.3 reflect the calculation of allowable transportation expenses, described above, in which taxpayers are allowed vehicle ownership and operating expenses. If vehicle ownership expenses are not allowed, and two allowances for vehicle operating expenses are included where the taxpayers filed a joint return and one operating allowance is included for all other taxpayers, then 14,582 taxpayers (33 percent) had incomes at or below their ALEs and 28,997 taxpayers (67 percent) had incomes above their ALEs.

53 Of the 17,596 taxpayers with incomes at or below their ALEs, 3,552 were assumed to have no income because for tax year 2017 they did not file a return and there were no third-party reports of income for them. It is possible that some of these taxpayers may have had unreported income.

Figure 1.19.4 shows overall IA default rates of taxpayers whose debts were not assigned to PCAs, the overall ACS IA default rate for streamlined IAs, and the overall default rate for taxpayers who entered into streamlined IAs while their debts were assigned to PCAs.

FIGURE 1.19.4



Taxpayers, Including Disabled Taxpayers, Make Commissionable Payments They Cannot Afford

Not only do taxpayers whose debts are assigned to PCAs agree to make payments they cannot afford, some taxpayers actually make payments even though their ALEs exceed their incomes. Figure 1.19.5 shows the proportion of commissionable payments overall made by taxpayers according to the relationship between their incomes and their ALEs.

FIGURE 1.19.5, Commissionable Payments Taxpayers Made While Their Debts Were Assigned to PCAs⁵⁴

Income Compared to ALEs	Commissionable Payments	Percent
Taxpayers With Income At or Below Their Allowable Living Expenses	\$29,196,941	34%
Taxpayers With Income Above Their Allowable Living Expenses	\$56,019,574	66%
Total	\$85,216,515	100%

54 ARDI, IRTF, IRMF, CDW, reflecting activity on tax modules with an unreversed TC 971 with an AC 054 from program inception through FY 2018. The total amount of commissionable payments (\$85,216,515) shown on these IRS databases differs from the amount reported in the IRS Quarterly Update to Congress, *Private Debt Collection (PDC) Program 1*, for FY 2018 (\$80,736,597), which was prepared using the Custodial Detail Database (CDDb), part of the Financial Management Information System (FMIS). When vehicle ownership expenses are not allowed, then \$25,503,439, or 30 percent was paid by taxpayers whose incomes were at or below their ALEs and \$59,713,076, or 70 percent, was paid by taxpayers whose incomes were above their ALEs.

Thus, a third of the dollars that were collected as a result of PCA activity were collected from taxpayers who could not afford the payments they made.

As discussed above, the National Taxpayer Advocate ordered the IRS to exclude from assignment to PCAs the debts of taxpayers whose incomes are below 250 percent of the FPL.⁵⁵ As Figure 1.19.6 demonstrates, of taxpayers who *made commissionable payments* while their debts were assigned to PCAs, 24 percent had incomes *at or below the federal poverty level*. An additional 20 percent had incomes above the federal poverty level to 250 percent of the FPL.⁵⁶

FIGURE 1.19.6, Relationship of Income to the Federal Poverty Level of 45,371 Taxpayers Who Made Payments While Their Debts Were Assigned to PCAs and Median Amount Paid⁵⁷

Income Compared to Poverty Level	Number Of Taxpayers	Percent of Taxpayers	Median Amount Paid	Average Income	Median Income
Income At or Below Federal Poverty Level	10,891	24%	\$671	\$3,619	\$890
Income Above Federal Poverty Level up to 250% of Federal Poverty Level	9,119	20%	\$515	\$24,465	\$23,104
Income Above 250% of Federal Poverty Level	25,361	56%	\$780	\$118,640	\$66,351
Total	45,371	100%			

The failure to exclude these low income taxpayers inflicts real harm on vulnerable people.

The 45,371 taxpayers who made payments while their debts were assigned to PCAs shown in Figure 1.19.6 includes 1,031 taxpayers who were Social Security Disability Insurance (SSDI) recipients in 2017.⁵⁸ According to the Social Security Administration (SSA):

- SSDI recipients generally could not earn over \$1,180 per month in 2018 without losing their benefits;⁵⁹ and
- In 2018, the average monthly amount of disability paid was \$1,197.⁶⁰

55 The federal poverty level is based on family size and varies from year to year. The federal poverty level for a single person was \$12,060 in 2017. U.S. Dept. of Health and Human Resources, Poverty Guidelines (2017), <https://aspe.hhs.gov/2017-poverty-guidelines>. 250 percent of \$12,060 is \$30,150.

56 ARDI, IRTF, IRMF, CDW, reflecting activity since the inception of the PDC program in April 2017 through FY 2018.

57 Of the 10,891 taxpayers with incomes at or below the federal poverty level 4,057 were assumed to have no income because for tax year 2017 they did not file a return and there were no third-party reports of income for them. It is possible that some of these taxpayers may have had unreported income.

58 The IRS agreed to exclude from assignment to PCAs the debts of Social Security Disability Insurance (SSDI) and Supplemental Security Income (SSI) recipients. National Taxpayer Advocate 2017 Annual Report to Congress 10, 17 (Most Serious Problem: *The IRS's Private Debt Collection Program Is Not Generating Net Revenues, Appears to Have Been Implemented Inconsistently with the Law, and Burdens Taxpayers Experiencing Economic Hardship*). The IRS has not honored that commitment. If a taxpayer discloses to a PCA that he or she receives SSDI or SSI benefits, the PCA is required to return the case to the IRS. Payments of SSDI benefits (but not SSI benefits) are reported to the IRS on Form SSA-1099.

59 SSA, *Working While Disabled: How We Can Help* 3 (2018), noting "After your trial work period, you have 36 months during which you can work and still receive benefits for any month your earnings aren't 'substantial.' In 2018, we consider earnings over \$1,180 (\$1,970 if you're blind) to be substantial."

60 SSA, *The Facts about Social Security's Disability Program* 1 (2018).

Thus, a taxpayer receiving income of \$1,180 per month (the maximum amount allowed) and the average amount of disability paid in 2018 would earn \$28,524. IRS records show that for the 1,031 taxpayers who received SSDI:

- Median income was \$20,312;
- Average income was \$35,290;⁶¹
- The average amount they paid was \$1,556; and
- The median amount they paid was \$453.⁶²

As discussed above, the IRS has refused to exclude from assignment to PCAs the debts of taxpayers whose incomes are below 250 percent of the federal poverty level, citing lack of statutory authority to do so.⁶³ The National Taxpayer Advocate continues to believe the IRS has the discretion, under IRC § 6306, to exclude these taxpayers' accounts from referral to PCAs.⁶⁴ In addition, the National Taxpayer Advocate believes that in light of Congress's direction that the IRS develop ALE standards, the IRS is authorized to exclude from assignment to PCAs the debts of taxpayers whose incomes are at or below their ALEs.

PCAs May be Improperly Retaining Some Cases, and Procedures Should be Modified to Expand the Types of Cases PCAs Must Return to the IRS to Prevent PCAs From Creating Queues of Inactive Cases

PCAs are required to return cases to the IRS in a variety of situations and to compile reports that categorize the reason for the returns.⁶⁵ In FY 2018, through September 13, 2018, PCAs returned 15,796 cases.⁶⁶ Currently, the IRS does not appear to know the number of returns in each category, except for cases returned because the taxpayer stated he or she received Supplemental Security Income (SSI) *or* SSDI benefits (5,046 cases); or the taxpayer submitted a written request that the PCA cease contacting the taxpayer (2,845 cases).⁶⁷

61 Income includes the spouse's income, where the taxpayer filed a joint return, although the spouse may not have been an SSDI recipient.

62 ARDI, IRTF, IRMF, CDW, reflecting activity since the inception of the PDC program in April 2017 through FY 2018.

63 See June 20, 2018, Memorandum from Deputy Director for Services and Enforcement, rescinding the National Taxpayer Advocate's April 23, 2018 Taxpayer Advocate Directive, published in the National Taxpayer Advocate Fiscal Year 2019 Objectives Report to Congress 75. As discussed above, the IRS has not felt similarly constrained by the temporal limit of IRC § 6303(b), which allows PCAs to offer IAs "for a period not to exceed 5 years," or by the definition in IRC § 6303(b) which defines a "qualified tax collection contract" as a contract pursuant to which PCAs "obtain financial information specified by the Secretary with respect to such taxpayer," among other things.

64 A recent proposal in Congress would exclude taxpayers having "substantially all" of their incomes comprised of SSDI or SSI from having their debts assigned to a PCA. The proposal would also exclude taxpayers whose incomes are at or below 200 percent of the federal poverty level from having their debts assigned to a PCA. See Taxpayer First Act of 2018, H.R. 7227, 115th Cong. § 1205 (2018).

65 Included among the categories of reasons for returning a case are: the taxpayer indicated he or she would send a one-time voluntary payment; the taxpayer indicated he or she is unable to pay; and the taxpayer informs the PCA that he or she is a recipient of SSI/SSDI benefits. PPG § 17.1.3, *Return Tracking Report*. Where the only liability is for the individual shared responsibility (ISRP) and the taxpayer disagrees with the assessment, PCAs are directed to return the case to the IRS, but there is not a separate return category for this type of case. IRS response to TAS information request (Aug. 14, 2018). None of the 3,243 taxpayers whose ISRP debts were assigned to PCAs by FY 2018 were liable solely for the ISRP. Defaulted IA are returned to the IRS but not separately identified or tracked. IRS response to TAS information request (Apr. 10, 2018).

66 PDC Program Scorecard from program for FY 2018 through Sept. 13, 2018.

67 In response to TAS's request for reports from the PCAs that show a breakdown of the reasons the PCAs returned accounts to the IRS, the IRS responded that "RAAS [IRS Research, Applied Analytics, and Statistics] is in the process of analyzing the returned accounts data and it will be another few months before we can provide any accurate and meaningful report on this data." IRS response to TAS information request (Oct. 31, 2018).

PCAs May Be Impermissibly Retaining Cases After Soliciting More Than One Voluntary Payment

One area that raises the concern that PCAs may be improperly retaining accounts is where there appear to be “voluntary payments.” Voluntary payments are payments that do not fully pay the liability and are not made pursuant to an IA. PCAs are permitted to solicit only *one* voluntary payment, and only from a taxpayer who “can make payments, but will not full pay within the Collection Statute Expiration Date (CSED) or seven years, whichever is less.”⁶⁸ After soliciting a voluntary payment, PCAs must return the case to the IRS.⁶⁹

In response to TAS’s inquiry about its oversight in this area, the IRS responded:

Although it is not uncommon for taxpayers to make payments on their accounts without a formal agreement, we asked the PCAs to review these accounts and provide their findings. The PCAs on a regular basis will identify these accounts and include them in their dialing campaigns to attempt to establish payment arrangements.⁷⁰

Thus, it remains unclear from the IRS’s response whether the IRS has developed an adequate mechanism for distinguishing cases in which PCAs solicited more than one voluntary payment from cases in which taxpayers make these payments without any solicitation from the PCAs. Allowing PCAs to secure “voluntary” payments that do not resolve the liability (while interest continues to accrue on the unpaid liability) circumvents the statutory protections of an IA (such as protection against levy) and violates taxpayers’ *right to finality*.

At the end of FY 2018, PCA inventory included the debts of 4,753 taxpayers who had made two or more commissionable payments, yet had not entered into an IA and had not paid their debts in full.⁷¹ This suggests that even if they can afford to make payments, the limited payment alternatives PCAs can offer do not meet their needs. These taxpayers’ debts had been in PCA inventory for 204 days on average.⁷²

PCAs Appear to be Retaining Cases With Defaulted Installment Agreements Without Informing the IRS as Required

An area that raises concern about the IRS’s policy of allowing PCAs to retain inventory involves defaulted IAs. When a taxpayer misses three IA payments within a rolling 12-month period, the PCA is required to terminate the IA and inform the IRS that the IA has been terminated.⁷³ The PCA is not required to return the account to the IRS, however, unless it contacts the taxpayer and the taxpayer states that he or she is unable to restructure the IA to pay the total liability in full within the seven years (or the period of limitations on collection, if earlier).⁷⁴

At the end of FY 2018, PCA inventory included the debts of 3,222 taxpayers who had entered into IAs while their debts were assigned to PCAs and had made *no* payment for more than 120 days after

68 PPG § 10, *Payment Options*.

69 PPG § 10.2.1, *Voluntary Payments*.

70 IRS response to TAS information request (Aug. 14, 2018).

71 ARDI, IRTF, IRMF, CDW, reflecting activity since the inception of the PDC program in April 2017 through FY 2018.

72 *Id.*

73 PPG § 11.5.2, *Missed Payments & Restructuring or Terminating Payment Arrangements*.

74 For example, the PPG § 11.5.2, *Missed Payments & Restructuring or Terminating Payment Arrangements* notes: “Reminder: When unable to contact, three missed payments does not require the PCA to return the account to the IRS. All attempts to contact the taxpayer or representative must be documented.”

entering into the IA, yet IRS records did not reflect termination of the IA. These 3,222 cases had been in PCA inventory for 272 days on average.⁷⁵ Thus, the PCAs do not appear to be providing the required notification to the IRS that these taxpayers missed more than three IA payments in a 12-month period. Moreover, this fact pattern suggests that the taxpayers are interested in resolving their liabilities, but the payment terms they agreed to, or the PCAs can offer, are inadequate to permit them to do so.

As discussed above and shown in Figure 1.19.3, at the end of FY 2018, there were 43,579 taxpayers who had entered into IAs while their debts were assigned to PCAs, of whom 16,053 are shown on IRS records as having defaulted. If the 3,222 taxpayers who entered into IAs and made no payments for more than 120 days are treated as defaulted IAs, the total number of defaulted would be 19,275, which is 44 percent of 43,579. Thus, the 37 percent overall default rate for IA that taxpayers entered into while their debts were assigned to PCAs rises to 44 percent when defaulted IAs that PCAs do not report to the IRS as required are taken into account.

PCAs also appear to be retaining inventory when there is no payment and no IA, even though the cases had been assigned for at least 90 days.⁷⁶ At the end of FY 2018, there were 402,387 of these cases, and they had been in PCA inventory for 244 days on average.⁷⁷

Figure 1.19.7 shows the number of taxpayers whose debts remain in PCA inventory without being resolved.

FIGURE 1.19.7, Number of Taxpayers Whose Debts Are in PCA Inventory And Are Not Being Resolved

	Number of Taxpayers	Average Number of Days Elapsed After Assignment	Median Number of Days Elapsed After Assignment
Two or More Commissionable Payments and No IA or Full Payment	4,753	204	146
IA and No Payment For More Than 120 Days (Excluding Defaults, Recalled Cases, and Returned Cases)	3,222	272	279
No IA or Payment For More Than Three Months After Assignment (Excluding Recalled Cases and Returned Cases)	402,387	244	195
Total	410,362	244	195

75 CDW data, reflecting activity since the inception of the PDC program in April 2017 through FY 2018.

76 The IRS does not require PCAs to return these cases to the IRS, directing only that “The PCA must return an account to the IRS anytime the PCA is unable to collect and has exhausted all reasonable collection efforts.” PPG § 12.3, *Unable to Collect*.

77 CDW data, reflecting activity since the inception of the PDC program in April 2017 through FY 2018.

Allowing PCAs to retain inactive cases defeats the purpose of the PDC program because even where the PCA succeeds in contacting the taxpayer, the liability is not being resolved. Moreover, assignments that effectively become permanent allow PCAs to collect commissions, no matter how much time elapses:

- Between the date the debt was assigned to the PCA and the date the taxpayer makes a payment; and
- Between the date of any PCA activity and the date a taxpayer makes a payment.

The IRS Now Assigns to PCAs More Complex Cases and Those With Increased Risk That the Liability May Not Be Owed

The IRS has assigned to PCAs the liabilities of about 400,000 taxpayers who did not dispute their liability for any year assigned to a PCA.⁷⁸ In FY 2018, this category of cases included, for the first time, liability for the individual shared responsibility payment (ISRP).⁷⁹

As part of “Release 2” of the program, the IRS also assigned cases in which the only tax liability was assessed:

- Based on substitutes for returns;⁸⁰
- Pursuant to the Automated Underreporter (AUR) computer matching system; or
- When the taxpayer did not respond, or stopped responding, to IRS inquiries pursuant to an audit.

By the end of FY 2018, over 150,000 of these cases had been assigned.⁸¹ These cases implicate significant taxpayer rights, particularly the *right to pay no more than the correct amount of tax*, and are subject to additional protections and procedures. For example, taxpayers may seek audit reconsideration with respect to these assessments.⁸² If the IRS refuses, after reconsideration, to abate an assessment, taxpayers are entitled to an appeals conference with the IRS Office of Appeals.⁸³ Moreover, these types of cases have an increased risk that all or part of the liability may not be owed, so that abatement would be appropriate, including penalty abatement.⁸⁴ The IRS instructs PCA employees to refer taxpayers who

78 ARDI, IRTF, IRMF, CDW data, reflecting activity since the inception of the PDC program in April 2017 through FY 2018, showing assignment of 412,535 of these cases. See PPG § 12.22, *Compliance Assessments*, noting that “[i]n the first release of inventory, the IRS provided PCAs with tax accounts where the taxpayer reported and calculated the assessable tax.”

79 As noted above, all the taxpayers who were assessed liability for ISRP also had assessments from another source.

80 If the taxpayer failed to file a timely return, the IRS may make a return, referred to as a substitute for return (SFR), as authorized by IRC § 6020(b), based on information reported to the IRS. The SFR may reflect income reported by third parties, but allows only the standard deduction, one exemption (for returns filed prior to tax year 2018), and a filing status of single or married filing separately. See IRM 4.12.1.25.3, *Itemized Personal Deductions* (Oct. 5, 2010); IRM 4.12.1.24.12, *Married Filing Joint Election for Nonfiler cases* (Oct. 5, 2010). See also *Allowable Expenses in an SFR*, <http://mysbse.web.irs.gov/reflibrary/kts/supparticles/14979.aspx>.

81 ARDI, IRTF, IRMF, CDW data, reflecting activity since the inception of the PDC program in April 2017 through FY 2018, showing assignment of 38,352 SFR-only assessments; 63,989 Automated Underreporter-only assessments; and 51,701 audit default-only assessments, for a total of 154,042 cases.

82 See, e.g., IRM 4.13.1.2, *Definition of an Audit Reconsideration* (Dec. 16, 2015).

83 See IRM 5.1.15.4.6.4, *Appeal Rights on Reconsiderations* (Apr. 16, 2010).

84 See, e.g., National Taxpayer Advocate 2004 Annual Report to Congress, vol. 2 1, (Research Study: *EITC Audit Reconsideration Study*), demonstrating that 43 percent of taxpayers who sought reconsideration of audits that disallowed the EITC in whole or in part received additional EITC as a result of the audit reconsideration. See also National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 74, (Research Study: *Study of Tax Court Cases In Which the IRS Conceded the Taxpayer was Entitled to Earned Income Tax Credit (EITC)*) discussing a TAS study of a random sample of cases in which the IRS denied a claim for EITC but conceded the issue after the taxpayer petitioned the Tax Court for review.

dispute these assessments to the IRS, but the PCAs are not required to return the cases to the IRS.⁸⁵ In contrast, the prior iteration of the IRS's PDC initiative required PCAs to refer cases in which taxpayers disputed their liability to the Referral Unit, which would attempt to resolve the dispute within 30 days.⁸⁶

Release 2 cases also include those in which the taxpayer did not file a return which, according to IRS records, was required to be filed (referred to as a delinquent return). PCAs are instructed that taxpayers must file delinquent returns with the IRS as a condition to entering into an IA. However, IRS records indicating a return was required are not always accurate. For example, in FY 2014, 21 percent of the accounts the IRS identified as delinquent were not actually those of nonfilers (*i.e.*, a return had actually been filed) or there was little or no tax due.⁸⁷ If a taxpayer states the return was filed, the PCA is to monitor the case for 30 days to give a recently-filed return time to post, or, if the return hasn't appeared in IRS records after ten weeks, the PCA is to advise the taxpayer to re-submit the return.⁸⁸ There are no procedures directing PCAs how to handle cases in which the taxpayer asserts he or she was not required to file a return. In any event, once an IA has been created, the failure to file a required return does not cause the IA to terminate.⁸⁹

The IRS held a PDC Engagement Conference on February 14-15, 2018, to train PCA employees how to handle Release 2 cases.⁹⁰ By then, TAS had published data showing that a significant portion of taxpayers whose debts were assigned to PCAs could not afford the payments they made.⁹¹ The training provided to PCAs did not include information about ALEs, even though that instruction might have lessened the impact the PDC program has on taxpayers who appear to be experiencing economic hardship.⁹² This omission demonstrates the IRS does not take seriously the harm imposed on vulnerable taxpayers.

CONCLUSION

With unacceptable frequency, the IRS PDC initiative as implemented continues to burden taxpayers who, according to IRS standards, cannot afford to pay for their basic living expenses. There are insufficient safeguards to prevent taxpayers' debts from remaining with PCAs indefinitely, even where PCA activity does not result in payments by taxpayers. Increasingly, the PCA inventory is simply substituting for the IRS inventory queue, with PCAs receiving commissions on payments that are not attributable to PCA activity.

85 PPG § 12.22, *Compliance Assessments*.

86 PPG § 12.15, *Taxpayer Disputes* (July 1, 2008 version).

87 See National Taxpayer Advocate 2014 Annual Report to Congress 197, 202 (Most Serious Problem: *Federal Payment Levy Program: Despite Some Planned Improvements, Taxpayers Experiencing Economic Hardship Continue to Be Harmed by the Federal Payment Levy Program*).

88 PPG § 11.1, *Delinquent Returns*.

89 *Id.*, noting that “[a] delinquent return indicator received after the account is in a payment arrangement status, as indicated by TRCAT 080, does not create a default or termination of the arrangement.”

90 IRS responses to TAS information request (Aug. 14 and Oct. 10, 2018).

91 National Taxpayer Advocate 2017 Annual Report to Congress 10, 11 (Most Serious Problem: *The IRS's Private Debt Collection Program Is Not Generating Net Revenues, Appears to Have Been Implemented Inconsistently with the Law, and Burdens Taxpayers Experiencing Economic Hardship*, reporting that 44 percent of taxpayers who made payments while their debts were assigned to PCAs had incomes below 250 percent of the federal poverty level, and vol. 2 Research Study: *Study of Financial Circumstances of Taxpayers Who Entered Into Installment Agreements and Made Payments While Their Debts Were Assigned to Private Collection Agencies*, reporting that of taxpayers who entered into an IA and made commissionable payments while their debts were assigned to a PCA, 46 percent had incomes less than their ALEs.).

92 IRS response to TAS information request, providing the training materials (Oct. 10, 2018).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Exclude from assignment to PCAs the debts of taxpayers whose incomes are at or below their allowable living expenses.
2. Work with the Social Security Administration to identify recipients of Social Security Disability Insurance and Supplemental Security Income and exclude those taxpayers' debts from assignment to PCAs.
3. Revise PDC procedures to require IRS review of all PCA cases in which the taxpayer made more than one payment that did not fully pay the liability and was not made pursuant to an IA, to determine whether the PCA requested more than one payment from a taxpayer who can make payments, but cannot fully pay the liability within the Collection Statute Expiration Date (CSED) and if so:
 - a. Recall the case from the PCA;
 - b. Impose a penalty on the PCA for requesting more than one such payment without returning the case to the IRS; and
 - c. Assign an IRS employee to work the case.
4. Revise PDC procedures to:
 - a. Require PCAs to return to the IRS cases in which the taxpayer entered into an installment agreement but made no payments for 120 days thereafter; and
 - b. Assign an IRS employee to work the case.
5. Revise PDC procedures to require PCAs to 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 to the PCA.

**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****RESPONSIBLE OFFICIALS**

William M. Paul, Acting Chief Counsel
 Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division
 Donna Hansberry, Chief, IRS Office of Appeals

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

DEFINITION OF 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.² 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.³

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

1 See Taxpayer Bill of Rights (TBOR), www.taxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 Unlike in the context of criminal cases, litigants in civil cases with limited means have no right to counsel. See *Gideon v. Wainwright*, 372 U.S. 335 (1963). However, Congress has codified the TBOR, including the *right to retain representation* in dealings with the IRS, which includes the right to seek assistance from a Low Income Taxpayer Clinic (LITC) if the taxpayer cannot afford to hire a representative. See IRC § 7803(a)(3) and TBOR, www.taxpayerAdvocate.irs.gov/taxpayer-rights.

3 Rebecca L. Sandefur, *The Fulcrum Point of Equal Access to Justice: Legal and Non-Legal Institutions of Remedy*, 42 *Lox. L.A. L. Rev.* 949, 972-973 (2009); see also Marc Galanter, *Why The "Haves" Come Out Ahead: Speculations on the Limits of Legal Change* (1974) 9 *LAW & Soc'y REV.* 95, 99-100, fn. 11 (suggesting modest income claimants less familiar with litigation will be risk averse and consequently less attracted by uncertain gains and more apprehensive about the potential losses of litigation).

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.

less and the taxpayer elects small tax case (S Case) procedures.⁴ The portion of self-represented litigants in Tax Court is consistent with litigants in civil cases in other state and federal courts.⁵

For over 20 years, Tax Court judges have steadfastly supported programs such as the Clinical, Student Practice & Bar Sponsored Calendar Call Program to bring together unrepresented litigants and representatives offering *pro bono* assistance.⁶ More recently, programs such as *Pro Bono Days* seek to encourage resolution of litigation 30 days or more before the scheduled trial date. Despite broad-based institutional support for 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 OF PROBLEM

Background

Litigating a Controversy in Tax Court

A taxpayer can obtain judicial review of an IRS liability determination by the Tax Court, a district court, the U.S. Court of Federal Claims, or the Bankruptcy Court.⁷ For a taxpayer unable to afford to hire someone for representation, the Tax Court is particularly accessible because it is the only pre-payment forum for judicial review (other than the Bankruptcy Court).⁸ To accommodate the

4 American Bar Association (ABA), Tax Section Court Procedure Committee, Office of Chief Counsel, IRS, fiscal year (FY) 2017 PowerPoint presentation, slides 18, 13. A taxpayer may elect the “small tax case” procedure, known as S case procedures, for cases involving up to \$50,000 in deficiency per year (including penalties and other additions to tax, but excluding interest). S cases have advantages; they are less formal, and can be heard in about 15 more cities than regular cases, https://www.ustaxcourt.gov/taxpayer_info_start.htm.

5 According to *The Justice Index*, a project of the National Center for Access to Justice at the Fordham Law School, as many as two-thirds of litigants appear without lawyers in matters as important as evictions, mortgage foreclosures, child custody and child support proceedings, and debt collection cases in state courts. *The Justice Index 2016*, <http://www.justiceindex.org/> (last visited Sept. 20, 2018). See also Memorandum from Lisa Wood, Chair, ABA Standing Comm. on Legal Aid and Indigent Defendants, to Fin. Comm., Bd. of Dirs., Legal Serv. Corp. 2 (June 2, 2014) (reporting a “trend toward involuntary self-representation”).

6 Keith Fogg, *History of Low-Income Taxpayer Clinics*, 67 *TAX LAW.* 1, 77 (2014).

7 With limited exceptions, taxpayers have an automatic right of appeal from the decisions of any of these courts. See IRC § 7482, which provides that the United States Courts of Appeals (other than the United States Court of Appeals for the Federal Circuit) have jurisdiction to review the decisions of the Tax Court. See also 28 U.S.C. § 1294 (appeals from a United States District Court are to the appropriate United States Court of Appeals); 28 U.S.C. § 1295 (appeals from the United States Court of Federal Claims are heard in the United States Court of Appeals for the Federal Circuit); 28 U.S.C. § 1254 (appeals from the United States Courts of Appeals may be reviewed by the United States Supreme Court).

8 IRC §§ 6212, 6213. The 90-day period becomes 150 days if the notice is mailed to a foreign address. *Id.* The IRS may also assess tax without first sending a notice of deficiency if it determines that collection is in jeopardy. See IRC §§ 6851, 6861, 6862, 6871. The IRS can assess certain “assessable” penalties without sending a notice of deficiency or otherwise triggering the Tax Court’s jurisdiction. For example, the penalties in Subchapter B (i.e., IRC §§ 6671-6725) are expressly excluded from the deficiency process. See IRC § 6671(a); *Smith v. Comm’r*, 133 T.C. 424, 428 n.3 (2009).

numerous unrepresented taxpayers who nonetheless want to exercise their rights, the Tax Court uses rather informal procedures, which are even more relaxed if the disputed issue does not exceed \$50,000.⁹ As a result, the Tax Court hears over 90 percent of all federal civil tax cases.¹⁰

To bring a matter before the United States Tax Court, a taxpayer must act by timely filing a petition with the court. If the IRS proposes a deficiency or seeks to enforce a collection action on a taxpayer and the taxpayer does nothing, the Tax Court will not have jurisdiction over the matter.¹¹ Approximately five months before each calendar call, the Tax Court sends a notice of trial to each petitioner granted a hearing and to the Commissioner of Internal Revenue, indicating the location and time scheduled for the hearing. Generally, Tax Court calendar calls are held one to two times per year in each city where the Tax Court hears cases, although they can occur more frequently, depending on local need.¹²

To efficiently handle cases, the Tax Court typically schedules many hearings on the first day of a calendar call session. Each party is “called” before the judge to set hearings and trials and schedule the court’s “calendar” for the week. Thus, it is known as a “calendar call.” Some Tax Court hearings are resolved in a matter of minutes, while others take longer.

Tax Court Encourages Pro Bono Representation of Pro Se Litigants

To help bring together *pro bono* counsel and unrepresented taxpayers, the Tax Court established the Clinical, Student Practice & Bar Sponsored Calendar Call Program. Since before 1998, judges have allowed approved representatives offering *pro bono* assistance into their court and announced to petitioners that *pro bono* tax lawyers are available to help them.¹³ Under the terms of the program, the Court invites academic and nonacademic tax clinics and state bar sponsored organizations to attend calendar calls, and the presiding judge typically announces the availability of no cost assistance, introduces the group or groups of volunteers, and encourages unrepresented litigants to consult with them. The program has grown and now covers a considerable number of calendar call locations.¹⁴ The majority of organizations participating in the program are Low Income Taxpayer Clinics (LITCs), although other organizations that meet the Court’s eligibility requirements also provide assistance.¹⁵ Students and law graduates working at an LITC may be authorized to represent taxpayers before the IRS.¹⁶

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- 9 IRC § 7463 provides special procedures for small Tax Court cases (where the amount of deficiency or claimed overpayment totals \$50,000 or less) for which appellate review is not available.
- 10 *The Future State of Tax Court Practice and Litigation: An Exploration of Current and Future Issues that Could Affect the Way the Court Does Business*, United States Tax Court Judicial Conference 2 (Chicago, IL Mar. 26–28, 2018) (conference outline).
- 11 The taxpayer must file a timely petition, within 90 days of the deficiency notice’s date (150 days, if the deficiency notice is addressed to a taxpayer outside the U.S.), giving some indication that he contests the deficiency. The taxpayer must attach the deficiency notice to the petition. IRC § 6213(a) and TC Rules 20 – 34. The deficiency notice specifies the deadline for filing the petition. If the deadline is later than 90 days, the later deadline is binding. IRC § 6213(a).
- 12 All 19 Tax Court judges have offices at the court’s Washington, D.C. location. The judges travel to conduct trials in 74 cities nationwide; the Tax Court holds trials only for S cases in 15 of the 74 cities.
- 13 Keith Fogg, *History of Low-Income Taxpayer Clinics*, 67 *TAX LAW.* 1, 77 (2014).
- 14 *Id.*
- 15 See *Requirements for Participation in the United States Tax Court Clinical, Student Practice & Calendar Call Program by Academic Clinics (Law School)*, https://www.ustaxcourt.gov/clinics_academic.htm#SECTION1.
- 16 The LITC must obtain a special appearance authorization for those students and law graduates from the LITC Program Office. Practice under a special appearance authorization issued by the Director of the LITC Program Office is limited to students and law graduates at an LITC or Student Tax Clinic Program working under the direct supervision of an individual authorized to practice before the IRS.

The Tax Court’s primary outreach method for informing petitioners about obtaining legal assistance from local tax clinics and state bar sponsored organizations is the “Stuffer Program.” Taxpayers who indicated in their petition that they did not have representation receive information about legal assistance programs from the Tax Court several times:

- With the letter acknowledging receipt of the petition;
- With the notice of trial; and
- 30 days prior to the trial session.

The Tax Court Clinical Student Practice & Bar Sponsored Calendar Call Program provides an opportunity for an unrepresented taxpayer to interact with a *pro bono* attorney. However, an attorney meeting with a client for the first time on the day the case is scheduled to be heard by a judge is not ideal. Unrepresented taxpayers often show up at the calendar call, or at the trial—which the judge may decide to conduct on the same day—unprepared to try a case, or with documents that the taxpayer is presenting to the IRS for the first time. Furthermore, only 25 of the 74 cities where the Tax Court holds trials have a room reserved for persons admitted to practice before the Court, including attorneys associated with tax clinics and Bar sponsored calendar call programs, to meet privately with petitioners.¹⁷ If the parties establish communication prior to the calendar call, they can avoid a host of logistical issues, such as difficulty finding a space to speak privately, being denied access to a federal building because of missing or unacceptable identification, or lack of interpreters.

Some taxpayers contact an LITC or other organization offering aid prior to the calendar call, but many do not. Most taxpayers eligible to receive assistance from an LITC don’t even know they exist. According to a 2014 TAS survey of a random sampling of taxpayers eligible to receive LITC assistance, only about 30 percent were aware of an organization outside the IRS that helps taxpayers with IRS problems and only about ten percent of those aware (or about three percent of all taxpayers surveyed) knew the LITC name.¹⁸

Litigation Outcomes Show the Importance of Representation as Represented Taxpayers Consistently Fare Better Than Unrepresented

Nearly 27,000 petitions were filed in the Tax Court in Fiscal Year (FY) 2017, and over 22,000 or 83 percent were from unrepresented litigants. Unrepresented taxpayers are more than 2.5 times more likely to have their petition dismissed. For example, in FY 2017, 6,124 *pro se* petitions or about 28 percent were disposed of by default (dismissal) compared to only 411 petitions or less than nine percent of represented taxpayers. Unrepresented taxpayers may have their case dismissed because of a procedural defect and thus are unable to have the court review the merits of their case.¹⁹

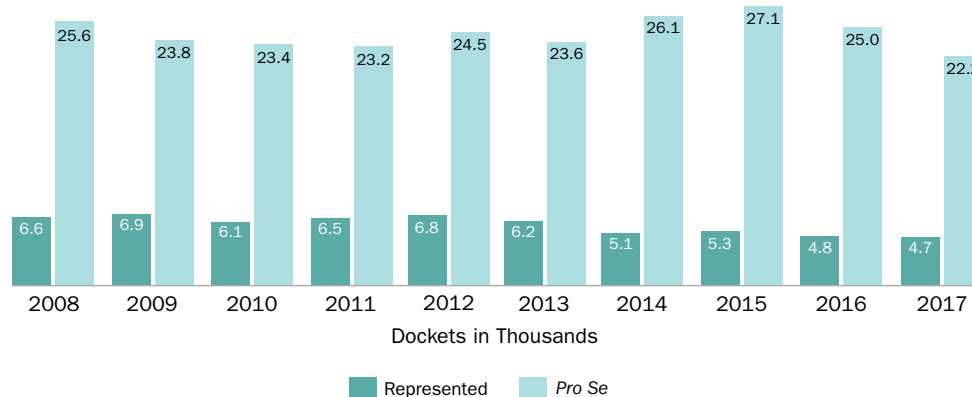
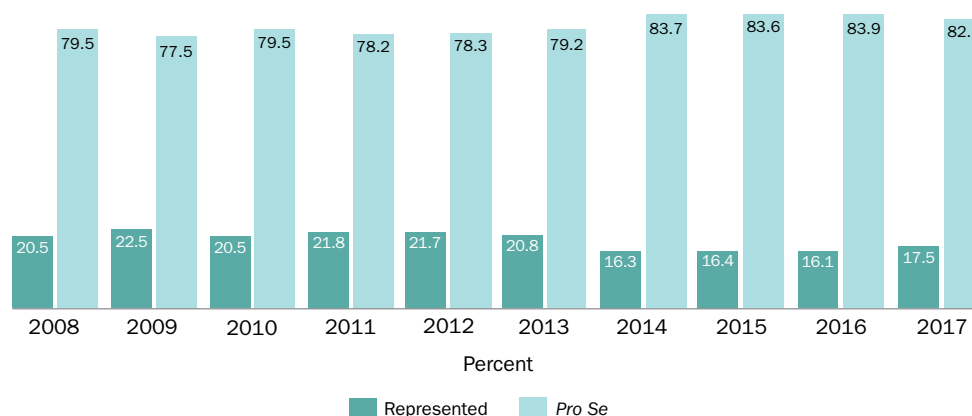
17 See *Requirements for Participation in the United States Tax Court Clinical, Student Practice & Calendar Call Program* by Academic Clinics (Law School), https://www.ustaxcourt.gov/clinics_academic.htm#SECTION1.

18 See National Taxpayer Advocate 2014 Annual Report to Congress vol. 2 2-26 (Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help From the Clinics*).

19 ABA, Tax Section Court Procedure Committee, Office of Chief Counsel, IRS, FY 2017 PowerPoint presentation.

FIGURE 1.20.1²⁰

Tax Court Petitions, FYs 2008-2017

FIGURE 1.20.2²¹Petitions From *Pro Se* and Represented Taxpayers, FYs 2008-2017

Many cases that come before the Tax Court involve a proposed deficiency, however even in cases where the IRS was ready to move forward with collection and had mailed a Collection Due Process (CDP) notice, the rates of dismissals and trials are both disproportionately high among unrepresented taxpayers in FY 2017 CDP cases, compared to represented taxpayers, who had disproportionately high rates of reaching a settlement, as shown on Figure 1.20.3. In FY 2017, more than 53 percent of CDP cases with unrepresented taxpayers were dismissed, and about 39 percent settled; compared to 37 percent dismissed and almost 58 percent settled, for represented taxpayers.²²

20 ABA, Tax Section Court Procedure Committee, Office of Chief Counsel, IRS, FY 2017 PowerPoint presentation, slide 18.

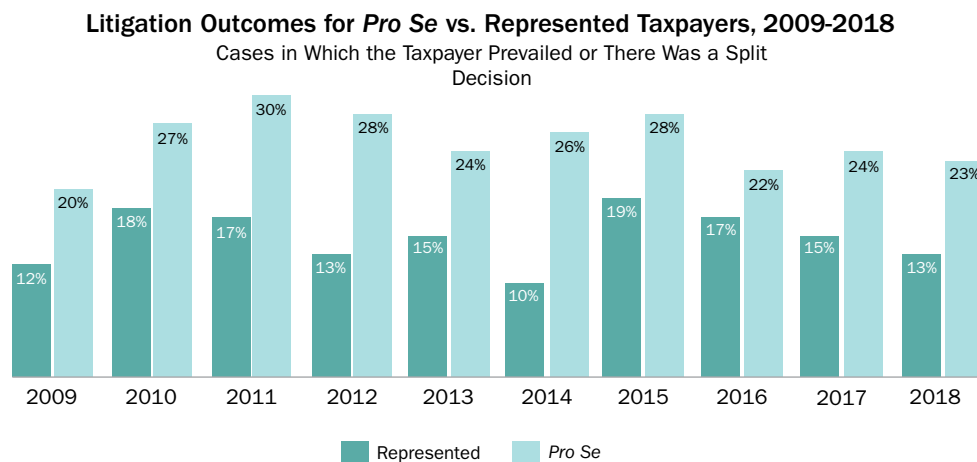
21 *Id.*

22 *Id.*, slide 25.

FIGURE 1.20.3, Collection Due Process Disposals by Category²³

Category	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Settled										
Pro Se	338	451	523	618	617	633	524	483	480	434
Represented	255	353	344	352	455	443	403	338	299	325
Tried-Decided										
Pro Se	111	145	117	137	160	149	87	77	73	83
Represented	33	53	38	37	51	53	38	21	24	28
Dismissed										
Pro Se	454	486	548	615	594	601	611	537	576	595
Represented	108	134	128	132	169	225	213	206	217	211

Even for unrepresented taxpayers that avoid having their petition dismissed, their chances of achieving a favorable outcome aren't as good as taxpayers that are represented. TAS "most litigated issues" analysis shows that unrepresented taxpayers have significantly lesser chances of winning in litigation as shown in Figure 1.20.4.²⁴

FIGURE 1.20.4²⁵

For example, during the 2018 reporting period only 13 percent of unrepresented taxpayers prevailed in full or in part compared to 23 percent of represented taxpayers.²⁶

²³ ABA, Tax Section Court Procedure Committee, Office of Chief Counsel, IRS, FY 2017 PowerPoint presentation, slide 25.

²⁴ This is a sample of cases that involve the top ten categories of issues litigated each year in which the court issued an opinion. See Most Litigated Issues: *Introduction, infra*. Many cases are resolved before the court issues an opinion. Some taxpayers reach a settlement with the IRS before trial, while the courts dismiss other taxpayers' cases for a variety of reasons, including lack of jurisdiction and lack of prosecution. Courts can issue less formal "bench opinions," which are not published or precedential.

²⁵ National Taxpayer Advocate 2005-2017 Annual Reports to Congress, Most Litigated Issues. The annual reporting period is from June 1 of the year preceding the publication to May 31 of the year of the publication.

²⁶ See Most Litigated Issues: *Introduction, infra*.

In FY 2017, more than 53% of Collection Due Process (CDP) cases with unrepresented taxpayers were dismissed, and about 39% settled; compared to 37% CDP cases with represented taxpayers were dismissed and almost 58% settled.

Using *Pro Bono* Days to Facilitate Representation in Tax Court Cases

To ease the pressure of matters that must be resolved at the calendar call, the IRS Office of Chief Counsel (OCC) in collaboration with the Tax Court and LITCs across the country have launched a variety of one-day events, generally known as “*Pro Bono* Days,” that take place 30 days or more before scheduled calendar calls. A *Pro Bono* Day program generally seeks to help unrepresented taxpayers:

- To understand the law applicable to their case;
- Determine the likelihood of prevailing; ease the taxpayer’s reluctance to turn over information the IRS needs in discovery;
- Reach a pre-trial settlement, when possible; and
- Understand the rules of evidence and procedures if a trial is necessary.

A *Pro Bono* Day is a chance for unrepresented petitioners to meet with *pro bono* representatives (such as attorneys, students, and other authorized representatives) in a less chaotic environment than the courthouse at the calendar call. It is also an opportunity for unrepresented taxpayers with a pending petition in Tax Court to meet face-to-face with representatives from IRS Chief Counsel, and sometimes IRS Appeals and IRS Collections.²⁷ Similarly, *Pro Bono* Day events provide an opportunity for unrepresented petitioners to consult with *pro bono* attorneys, and attorneys and paralegals in IRS Counsel’s office to resolve procedural matters, such as preparing and filing motions for matters agreed upon and stipulations of factual matters.²⁸

For IRS attorneys, resolving cases at *Pro Bono* Day events means they do not need to spend time drafting pre-trial memoranda and motions to dismiss for lack of prosecution which they would otherwise have to prepare when they haven’t been able to communicate with the petitioner prior to the scheduled hearing. Attorney involvement on both sides lessens the burden on Tax Court judges, and serves the interests of justice. Even for cases that aren’t resolved at a *Pro Bono* Day that go to trial, the *pro se* petitioners can benefit from a *Pro Bono* Day. For example, in a substantiation case, the volunteers can tell the taxpayer which documents to bring, questions the judge is likely to ask, and facts to get on the record.²⁹

27 The National Taxpayer Advocate requested that TAS participate in *Pro Bono* Days to help resolve issues with years not before the court or collection matters following settlement.

28 Stipulations are facts, opinions, and legal positions on which the parties agree in writing, and thus do not need to be proven at trial.

29 Nathan J. Richman, *Pro Bono Clinic Days Offer New Option to Help Pro Se Petitioners*, TAX ANALYSTS, 2016 TNT 63-2 (Apr. 1, 2016).

Pro Bono Day efforts are heavily dependent upon the support of volunteers, from both the IRS and the local tax practitioner community. Out of 74 cities where the Tax Court holds trials,³⁰ IRS Counsel has helped *Pro Bono* Day efforts with varying success rates in:

- Baltimore, Maryland;
- Chicago, Illinois;
- Los Angeles, California;
- Thousand Oaks, California;
- Miami, Florida;
- Dallas, Texas;
- Charleston, West Virginia; and
- Seattle, Washington.

In one recent *Pro Bono* Day in Thousand Oaks, California, all the taxpayers who attended resolved their cases on the day of the event.³¹

No matter how well the events work for those taxpayers who take advantage of *Pro Bono* Day events, true success cannot be achieved without sufficient taxpayer participation. However, despite broad-based institutional support for *Pro Bono* Day events, and high rates of same-day resolution for attendees, participation rates among the events are inconsistent. One of the greatest challenges to the success of *Pro Bono* Day events is informing unrepresented taxpayers about them while maintaining the confidentiality of each taxpayer's personal information.

Rules to protect the confidentiality of taxpayers' personal information limit the ways in which taxpayers can be contacted.³² The IRS and the court may communicate with unrepresented taxpayers to make them aware of available assistance, however, the independent organizations offering assistance do not have ready access to contact information for the petitioners, and thus cannot contact taxpayers directly. Low income taxpayers tend to be a transient population and change addresses more frequently than other taxpayers, which increases the challenge of establishing communication. Some taxpayers are reluctant to communicate with the IRS, and remain unaware that assistance may be available to help them with their pending case.³³

IRS Counsel attempts to reach unrepresented petitioners by sending out letters informing them about LITC and TAS assistance and by following up with phone calls. The *Pro Bono* Day's sponsors jointly craft a letter for the IRS to send out to *pro se* petitioners, usually four or five weeks before the *Pro Bono* Day.³⁴ Although the letters are not standardized, the format is generally the same. The letter, accompanied by an IRS cover letter, describes the opportunity for free help from volunteer attorneys or law students to review documents and discuss the issues, including the chance to communicate with the IRS about resolving the issues, and directs interested petitioners to contact an LITC to schedule

30 See *United States Tax Court Places of Trial*, https://www.ustaxcourt.gov/dpt_cities.htm.

31 Email from Julie Payne, Assistant Division Counsel, IRS (Sept. 7, 2018) (on file with TAS).

32 See IRC § 6103.

33 See National Taxpayer Advocate 2010 Annual Report to Congress 221 (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*).

34 Nathan J. Richman, *Pro Bono Clinic Days Offer New Option to Help Pro Se Petitioners*, TAX ANALYSTS, 2016 TNT 63-2 (Apr. 1, 2016).

appointments.³⁵ The IRS must mail the letter because it cannot provide the petitioners' addresses to the clinics and volunteer programs under IRC § 6103 disclosure rules. The letter is distinct from the stuffer notices the court sends out informing petitioners about the Tax Court Clinical Program.³⁶

We identified the following challenges affecting *pro se*³⁷ 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 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.

Addressing *Pro Bono* Day Challenges

Increasing Awareness

Pro Bono Day programs could be improved to reach more eligible taxpayers and increase attendance rates. Effective communication with unrepresented petitioners is essential to ensuring they achieve quick and fair resolution of their tax issues. IRS counsel traditionally uses phone calls and mailed letters as the primary methods of communicating with taxpayers that have an upcoming hearing scheduled in the Tax Court. The IRS has attempted several different strategies to improve response rates from attempts to reach unrepresented taxpayers, such as using distinct types of envelopes and sending correspondence at various times between the time the taxpayer files a Tax Court petition and the date of the hearing. However, a taxpayer that has made the decision to take his case to the Tax Court may not be receptive to additional correspondence from the IRS, and may not believe that the IRS is attempting to put the taxpayer in contact with independent counsel. The National Taxpayer Advocate may conduct a study to determine the effectiveness of mailing letters to a representative sample of low income taxpayers who have filed petitions with the Tax Court and who appear to be unrepresented. Such letters would inform the taxpayers about LITCs, and TAS and the assistance they can provide.

Other methods to communicate with Tax Court petitioners might be more effective, but would require the Tax Court to modify its petition form. The Tax Court petition package (available on the Tax Court website)³⁸ contains several check-the-box selections for the petitioner to indicate the choice for small or regular case classification, requested location of the trial, and other critical information. If the Tax Court added a question for petitioners to indicate their consent to being contacted by an LITC, it would allow organizations offering *pro bono* assistance additional opportunities to reach taxpayers without

35 Nathan J. Richman, *Pro Bono Clinic Days Offer New Option to Help Pro Se Petitioners*, TAX ANALYSTS, 2016 TNT 63-2 (Apr. 1, 2016).

36 *Id.*

37 “*Pro se*” means “for oneself; on one’s own behalf; without a lawyer.” BLACK’S LAW DICTIONARY (10th ed. 2014).

38 U.S. Tax Court Petition Kit, https://www.ustaxcourt.gov/forms/Petition_Kit.pdf.

needing to use the IRS as the messenger. Unrepresented taxpayers could indicate their preferred method of communication: phone calls, letters, or email.³⁹

Making Assistance Accessible

Increasing awareness of *Pro Bono* Day events is not the only challenge to their success. Most importantly, the IRS needs to hold the events at locations that offer accessibility and privacy. Taxpayers must be able to get to the event, and once a taxpayer is ready to meet with *pro bono* counsel and the IRS, the locations should provide space for private discussions. In some locales where the Tax Court holds trials there is an LITC nearby that can accommodate hosting the event, however in some parts of the country the nearest LITC might be several hours drive so other locations must be considered. The IRS can and should collaborate with partners to secure such locations. For example, holding the event at a local community center, as opposed to an IRS office in a federally operated building reduces the risk that someone might feel intimidated or be turned away by building security.⁴⁰

Given that many low income taxpayers are not fluent in English, many localities would require the availability of interpreting services to be able to fully assist these taxpayers. The IRS should provide interpreting services to taxpayers unable to communicate in English through over-the-phone interpreters⁴¹ or by partnering with local organizations offering interpretation services.⁴²

Proper scheduling of *Pro Bono* Day events may also maximize attendance. Holding the events during evenings and on weekends can make it easier for petitioners to attend, however the IRS must depend on some employees to agree to work outside of their tour of duty which in turn requires permission from their supervisors. The IRS should adopt a national policy that authorizes employees willing to work at night or on weekends for a *Pro Bono* Day, instead of relying on individual managers to decide. The IRS has a dedicated workforce and may recruit employees for *Pro Bono* events after hours. TAS is offering its assistance to coordinate such events with different IRS functions, such as Collection, Appeals, and Office of Chief Counsel. In a move towards future collaboration, the National Taxpayer Advocate is collaborating with the Chief, Appeals and Deputy Chief Counsel (Operations) to organize a new liaison group with members from TAS, Appeals, OCC, and LITCs to identify and resolve issues that stand in the way of eligible taxpayers being able to receive assistance and other taxpayer rights issues.⁴³

Offering One-Stop Resolution Options for Unrepresented Petitioners

Pro Bono Day events should be organized to provide one-stop resolution of all IRS issues and tax periods. To be most effective, representatives from local IRS Counsel, Appeals, Collection, and TAS should

39 See also 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*, *supra*.

40 See National Taxpayer Advocate 2012 Annual Report to Congress 176. Representatives of LITCs raised concerns about the requirement of many Taxpayer Assistance Centers (TACs) or federal buildings in which some TACs are located to produce a valid, U.S.-issued ID to enter the building. 2013 Annual LITC Grantee Conference, *Recent Developments in IRS Policies and Procedures Related to ITIN Applications*, panel discussion (Dec. 6, 2012).

41 Over the Phone Interpreter (OPI) service is a telephone interpreter-assisted service provided through the IRS by a contractor. OPI affords IRS employees the ability to communicate with taxpayers through interpreters who speak more than 350 languages. OPI Service is available 24 hours per day/7 days per week. It supports the IRS's mission to provide top-quality service for all taxpayers, specifically for those whose native language is not English. This is in compliance with Executive Order 13166, as well as Department of Justice LEP Guidance 67 FR 41455-41472, Department of Treasury LEP Guidance 70 FR 6067, and the TBOR.

42 See IRM 22.31.1, *IRS Language Services* (Oct. 19, 2018).

43 The liaison group held its first meeting on December 4, 2018 at the LITC Annual Conference in Washington, D.C.

attend each *Pro Bono* Day event to resolve disputes pre-trial. Bringing together a broad spectrum of IRS functions allows for resolution of more types of issues, even the many cases where the taxpayer will be unable to pay anything to the IRS, regardless of the outcome of the case. Moreover, many taxpayers with issues before the court also have issues relating to tax years not before the court. By having TAS and other functions available, *Pro Bono* Days can address all the taxpayer's issues, in a face-to-face environment.⁴⁴

We commend the IRS OCC for attempting a variety of formats for helping unrepresented taxpayers resolve cases pre-trial, such as post-petition rolling clinics,⁴⁵ invitations to one-on-one meetings, in-person events in IRS space and in LITC space, and virtual clinics where LITCs equipped with video conferencing allow petitioners to meet virtually with TAS, Collection, and Exam employees using WebEx or other virtual service delivery models. Using technology like WebEx allows a taxpayer to have a virtual face to face interaction from a computer or even a smartphone and eliminates difficulties associated with traveling to the court building or difficulties accessing federal buildings because of missing or unacceptable identification.⁴⁶ Expanding virtual face-to-face digital communication options for taxpayers may improve participation and protect *the right to a fair and just tax system* and to *appeal an IRS decision in an independent forum*.

If implemented holistically, all these measures would tailor services to meet the needs of this discrete group of taxpayers, systemically improving access to representation and future tax compliance.⁴⁷

CONCLUSION

Increasing awareness of available resources for unrepresented taxpayers, such as LITCs and TAS, benefits taxpayers by achieving better case outcomes, and allows the IRS and the Tax Court to resolve cases more efficiently, and pre-trial, whenever possible. Holding *Pro Bono* Days allows the Chief Counsel and IRS to provide a unique opportunity for petitioners to resolve their cases via a face-to-face interaction with the Chief Counsel and IRS employees with the benefit of independent counsel looking out for the taxpayers' interests and ensuring taxpayer rights are protected. Doing that successfully requires cross-functional collaboration across IRS functions and careful planning that meets taxpayer needs for accessibility and privacy.

44 Using a similar model, TAS conducts Problem Solving Day events in communities throughout the country where TAS employees from a local office are available to assist taxpayers in person with tax problems they have not been able to resolve with the IRS. During calendar year 2018, TAS assisted 5,959 taxpayers at 427 Problem Solving Day events.

45 "If the calendar is not filled with cases when scheduled six months before trial, the Tax Court could continue to add cases until five months prior to the start of the trial session or until the calendar is full. A rolling calendar would in many cases give the parties additional time to prepare for trial, while not requiring taxpayers who reside in trial locations that are visited less often to wait the additional time to have their cases heard." ABA, Section of Taxation, *Comments on Tax Court Rules of Practice and Procedure* (Nov. 10, 2015).

46 See Nathan J. Richman, *Pro Bono Clinic Days Offer New Option to Help Pro Se Petitioners*, TAX ANALYSTS, 2016 TNT 63-2 (Apr. 1, 2016); Meeting Minutes, LITC/CC/SBSE Working Group (June 13, 2017).

47 See Thomas Dohrmann & Gary Pinshaw, McKinsey & Company, *The Road to Improved Compliance: A McKinsey Benchmarking Study of Tax Administrations – 2008 -2009* (Sept. 2009).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. 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.
2. 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.
3. Provide staffing at *Pro Bono* Days and other pre-trial resolution events that can provide interpreting services.
4. 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 Additional Progress is Required****RESPONSIBLE OFFICIAL**

Donna Hansberry, Chief, Office of Appeals

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

In several Annual Reports to Congress, the National Taxpayer Advocate has discussed the importance of in-person conferences to both taxpayers and the IRS Office of Appeals (Appeals).² An in-person conference is sometimes essential to properly explaining and settling a controversy. Such is particularly true for cases involving factual or legal complexity, credibility of witnesses, or hazards of litigation settlements.³ Taxpayers whose cases are assigned to Appeals field offices have historically had access to in-person conferences.⁴ By contrast, Appeals campus cases, which typically involve low and middle income taxpayers, were made ineligible for such conferences in October 2016.⁵ This disparity in rights broke down along income lines, as, for example, for fiscal year (FY) 2018 the median adjusted gross income (AGI) of field taxpayers was 33 percent higher than that of campus taxpayers, while the average AGI of field taxpayers was 156 percent higher than that of campus taxpayers.⁶

To its credit, Appeals, taking to heart the urgings of the National Taxpayer Advocate and other stakeholders, has recently changed its policy and reinstated the right of campus taxpayers to transfer their cases to field offices in order to accommodate an in-person conference.⁷ Appeals has also indicated that it will continue to pursue additional strategies aimed at ensuring that taxpayers' requests

1 See Taxpayer Bill of Rights (TBOR), <http://www.taxpayeradvocate.irs.gov/taxpayer-rights>. The rights contained in the TBOR are also codified in the Internal Revenue Code. See IRC § 7803(a)(3).

2 National Taxpayer Advocate 2017 Annual Report to Congress 195-202; National Taxpayer Advocate 2016 Annual Report to Congress 206-210; National Taxpayer Advocate 2014 Annual Report to Congress 46-54; National Taxpayer Advocate 2014 Annual Report to Congress 311-314.

3 Letter from American College of Tax Counsel to Kirsten Wielobob, Chief, Appeals (Oct. 10, 2016), 2016 TNT 197-16. See also Letter from Texas Soc'y of Cert. Pub. Accts. to John Koskinen, Comm'r of IRS (Jan. 24, 2017), 2017 TNT 16-16; ABA Members Comment on Recent Appeals Division Practice Changes, 2017 TNT 89-10 (May 10, 2017).

4 IRS, Interim Guidance Memorandum (IGM) AP-08-1017-0017, Appeals Conference Procedures, (Oct. 13, 2017).

5 Effective October 1, 2016, Internal Revenue Manual (IRM) 8.6.1.2.2, *Transfers for the Convenience of Taxpayers*, was deleted, eliminating the right of taxpayers to transfer cases out of campuses.

6 Appeals response to TAS information request (Oct. 26, 2018). As used here, the term "average" is synonymous with the term "mean."

7 IRS, IRM AP-08-1118-0013, *Appeals Conference Procedures* (Nov. 30, 2018).

for in-person conferences are accommodated, regardless of whether the assigned Appeals Technical Employee (ATE) is located in a campus or in the field.⁸

The National Taxpayer Advocate applauds Appeals for undertaking this significant step with respect to in-person conferences. This progress, however, does not fully address the larger systemic problems attributable to the reality that the cases of low and middle income taxpayers are disproportionately channeled to campus locations. Although somewhat mitigated by Appeals' new transfer policy, this approach continues to limit geographic access to in-person conferences and causes cases to be assigned to less experienced, lower-graded ATEs, who generally lack firsthand familiarity with the local issues and community circumstances that often are at the heart of taxpayers' cases.⁹ Likely unintentionally, Appeals is still systematically perpetuating disproportionate hardships for low and middle income taxpayers.

Accordingly, the National Taxpayer Advocate remains concerned that:

- Appeals has consolidated cases involving smaller dollars and low and middle income taxpayers in campuses;
- Appeals' reliance on campuses presents physical barriers to in-person conferences and makes it difficult for campus taxpayers to have their cases heard by higher-graded, locally based ATEs; and
- Due process issues arise from the disproportionate channeling of low and middle income taxpayers to Appeals campus locations.

ANALYSIS OF PROBLEM

Appeals Has Consolidated Cases Involving Smaller Dollars and Low and Middle Income Taxpayers in Campuses

Beginning in the mid-1990s and then more actively in FY 2004, Appeals reallocated some ATEs out of field offices and into campuses.¹⁰ This incremental shift cannot be precisely tracked, as Appeals did not maintain separate staffing data prior to FY 2012, by which time 29 percent of Appeals personnel had been assigned to campuses.¹¹ This proportion has remained consistent ever since, with campuses containing 30 percent of Appeals personnel in FY 2018.¹² The shift to campuses can be more clearly glimpsed by looking to field offices, which shrank from 93 in FY 2003 to 67 in FY 2018.¹³ The end result is that, as of FY 2017, 53 percent of Appeals cases are assigned to only six campus locations.¹⁴

8 IRS, IGM AP-08-1118-0013, *Appeals Conference Procedures* (Nov. 30, 2018).

9 In this context, "experienced" refers to familiarity with the broad range of issues potentially faced by taxpayers and the contexts in which these cases are resolved.

10 IRS response to TAS information request (May 7, 2018).

11 *Id.*

12 IRS response to TAS information request (Oct. 26, 2018).

13 *Id.*

14 *Id.*

In conversations with TAS, Appeals' primary justification for this shift and the reluctance to transfer cases out of campuses has been the need to accommodate decreased funding.¹⁵ Nevertheless, Appeals' funding rose steadily until FY 2011, when it peaked at \$250 million.¹⁶ By FY 2012, however, when budget decreases began, Appeals had already largely implemented its personnel shift to the campuses.¹⁷

The criteria utilized by Appeals for case assignment cause most small dollar cases, along with low and middle income taxpayers, to be allocated to the campuses. Although the criteria for assigning cases to campus or field locations are treated by the IRS as "official use only," and are therefore not publishable, the data make clear that higher-dollar cases are channeled out of the campuses and to the field.¹⁸ This approach likewise has the impact of providing wealthier taxpayers with direct access to field offices, but initially assigning less affluent taxpayers to campuses. This relationship is illustrated in Figure 1.S1.1:

FIGURE 1.S1.1, Average and Median Adjusted Gross Income Among Appeals Field and Campus Individual Taxpayers, FY 2018¹⁹

Measure	Field	Campus	Percentage Difference – Field Versus Campus
Average	\$294,000	\$115,000	+156%
Median	\$84,000	\$63,000	+33%

Appeals' Reliance on Campuses Presents Physical Barriers to In-Person Conferences and Makes It Difficult for Campus Taxpayers to Have Their Cases Heard by Higher-Graded, Locally Based Appeals Technical Employees

Currently, Appeals has only six campus locations spread throughout the United States: Philadelphia, Pennsylvania; Brookhaven, New York; Fresno, California; Ogden, Utah; Memphis, Tennessee; and Florence, Kentucky.²⁰ Fifty-three percent of Appeals cases are assigned to these campuses.²¹ By contrast, the remaining 47 percent are spread among Appeals' 67 field offices.²² The geographic dispersal of the campuses and field offices is shown in Figure 1.S1.2:

15 Conference call between TAS and Appeals (May 31, 2016). In its response to TAS's information request dated May 7, 2018, Appeals elaborates, "Following passage of the IRS Restructuring and Reform Act of 1998 and the creation of the Collection Due Process workstream, Appeals expanded campus operations to effectively and efficiently manage the workload generated by Compliance campuses." Appeals also explains that there are many reasons for consolidating cases in the campuses, including case complexity, ease case routing, and reduced cycle time. Appeals response to TAS fact check (Nov. 21, 2018).

16 IRS response to TAS information request (May 7, 2018).

17 *Id.*

18 IRS response to TAS information request (Oct. 9, 2018). Appeals clarifies that it does not intentionally assign cases based on taxpayers' adjusted gross incomes (AGI), and instead routes cases based on prior assignments by Compliance or based on the type of case (e.g., Innocent Spouse, Penalty, or Collection Due Process cases). IRS response to TAS fact check (Nov. 21, 2018).

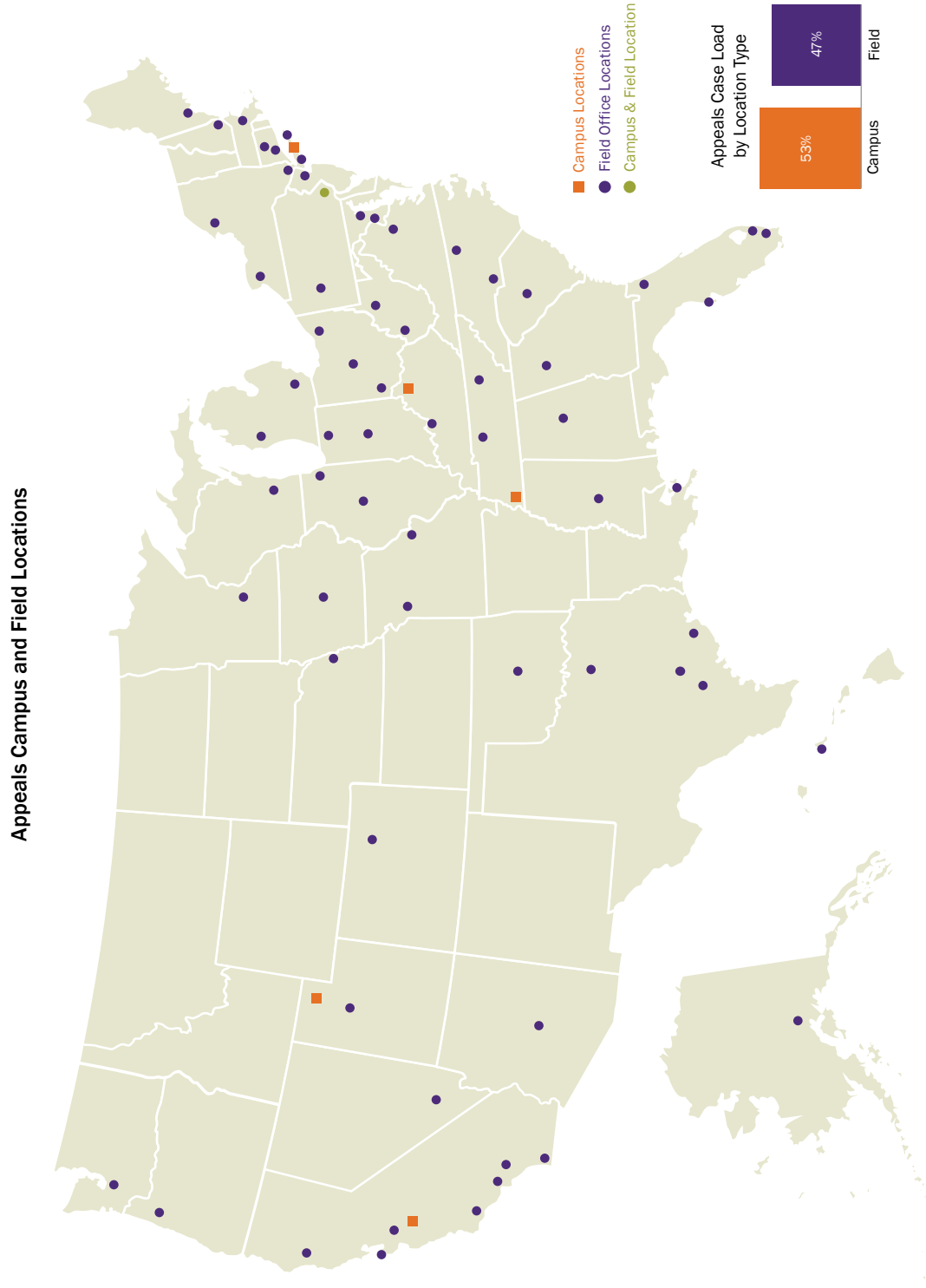
19 IRS response to TAS information request (Oct. 26, 2018). The percentage difference from average campus AGI to average field AGI is calculated by subtracting average campus AGI from average field AGI, then dividing the difference by the average campus AGI. Note that the median AGI calculation helps to adjust for outliers in the dataset. According to Appeals, this data was provided by IRS Research, Applied Analytics & Statistics (RAAS), which drew the information from the Compliance Data Warehouse (CDW). IRS response to TAS fact check (Nov. 21, 2018).

20 IRS response to TAS information request (May 7, 2018).

21 IRS response to TAS information request (Oct. 26, 2018).

22 *Id.*

FIGURE 1.S1.2, Appeals Campus and Field Locations²³



23 This map is developed based on information provided in the IRS response to TAS information request (May 7, 2018).

Thanks to Appeals' reinstatement of campus taxpayers' right to seek a case transfer to facilitate an in-person conference, taxpayers are no longer inextricably bound to campuses. Nevertheless, Appeals' campus-centric approach can make this right difficult to exercise. Appeals states that it will use its best efforts to schedule an in-person conference at a location that is reasonably convenient for taxpayers and Appeals. However, given the geographic scarcity of field offices, which are the primary venues for in-person conferences, and the fact that twelve states and Puerto Rico lack a field office altogether, taxpayers wishing for an in-person conference may well be required to travel substantial distances and incur significant cost in order to attend an in-person conference.²⁴

The circumstance that 53 percent of all Appeals cases are decided out of only six widely scattered offices is problematic because Appeals best serves taxpayers when it has a broad and diverse geographic footprint.²⁵ This presence allows ATEs to negotiate case resolutions based on an understanding of the local economic circumstances and prevailing community issues faced by taxpayers. Similarly, taxpayers are more likely to develop a rapport with, and respect the decisions of, ATEs with whom they share common experiences.²⁶ An Appeals function that is embedded within communities provides a more effective environment for establishing trust and achieving case resolutions.²⁷ This optimal environment, however, is systematically denied to campus taxpayers unless they opt for an in-person conference, which they may or may not need to resolve their cases. Additionally, given Appeals' current staffing model, Appeals may lack any personnel whatsoever located within a taxpayer's vicinity.

Appeals could expand its geographic footprint and minimize its reliance on campuses by using attrition from the campuses to increase staffing in local field offices with ATEs of various grades and designations such that the office could cover cases ranging from the Earned Income Tax Credit (EITC) to itemized deductions to Schedule C controversies.²⁸ Likewise, Appeals could enhance its case assignment flexibility by re-designating technically or factually complex case categories, such as those involving EITC claims, such that they could be assigned to higher-graded ATEs where appropriate.²⁹ These steps would not only expand Appeals' geographic footprint and facilitate the accessibility of in-person conferences, but would lay the foundation for a structure that more effectively and equitably serves both campus and field taxpayers.

24 IRS response to TAS fact check (Nov. 21, 2018).

25 Although 67 field offices would appear ample in comparison with only six campus locations, that number is insufficient to cover the entirety of the U.S., its territories, and the District of Columbia. Currently, 12 states and Puerto Rico lack any Appeals presence offering in-person conferences. IRS response to TAS fact check (Nov. 21, 2018).

26 National Taxpayer Advocate Fiscal Year (FY) 2019 Objectives Report to Congress 138.

27 *Id.*

28 Appeals explains its reluctance to allow case transfers out of the campuses because Appeals concentrates specialized knowledge in particular campuses and because Appeals Technical Employees (ATEs) in campuses are typically lower graded than those in the field and therefore handle less complex cases. Andrew Velarde, *IRS Appeals Confident That In-Person Campus Conferences Will Return*, 2018 TXN 21-63 (May 21, 2018).

29 This step was recommended by the National Taxpayer Advocate to the Chief of Appeals as part of a May 31, 2016, meeting. In that meeting, the then-Chief of Appeals expressed the view that Earned Income Tax Credit (EITC) cases were less complex and therefore best suited for lower-graded ATEs. Given the often challenging factual scenarios and legal issues involved in these cases, however, this perspective should be reevaluated.

Due Process Issues Arise From the Disproportionate Channeling of Low and Middle Income Taxpayers to Appeals Campus Locations

The way in which cases are assigned to campus locations, combined with Appeals' current staffing model, limits the practical ability of low and middle income taxpayers to avail themselves of an in-person conference, while making that right more easily available to most corporations and wealthy taxpayers. Similarly, low and middle income taxpayers face disproportionate difficulty in obtaining review from an ATE who is familiar with the taxpayers' local issues and economic circumstances. Further, because large and complex cases generally are assigned to the field, senior ATEs have remained in field offices. Ninety-four percent of ATEs in field offices are Grade 13 or above, whereas all ATEs in campuses are Grade 12 or below.³⁰ Thus, taxpayers whose cases are channeled to the campuses are initially denied access to the most experienced and highly graded ATEs.³¹

Appeals' reinstatement of the right to transfer cases from campuses to the field provides a path for mitigating the most extreme aspects of differential treatment between low and middle income taxpayers and wealthier taxpayers. Appeals deserves substantial credit for taking steps to partially address this disparity. However, the campus-centric model itself obligates taxpayers initially assigned to campuses to take the additional step of seeking case transfers and, in many cases, requires them to incur travel costs and delays, to which wealthier taxpayers are not subject or are better situated to address. Given the importance of in-person conferences, geographic familiarity, and quality case reviews, Appeals' current design and policy continues to disadvantage the group of taxpayers who can least afford litigation as an alternative to an undesirable Appeals outcome. This situation is problematic because, as explained by the Supreme Court in *Goldberg v. Kelly*, "The opportunity to be heard must be tailored to the capacities and circumstances of those who are to be heard."³²

Regardless of resource constraints or administrative efficiency, such a disparity, albeit unintentionally, presents due process issues that undermine the trust on which the voluntary tax system is based. Appeals has taken a commendable first step toward addressing deeply embedded inequities affecting taxpayers' *right to appeal an IRS decision in an independent forum*.³³ Appeals should continue this progress by expanding its geographic footprint and removing the systemic barriers that make it difficult for low and middle income taxpayers to have the same access to a quality appeal as wealthier taxpayers.

30 IRS response to TAS information request (Oct. 26, 2018).

31 This differential matters for practical as well as philosophical reasons because the relatively smaller cases typically assigned to campus locations are not necessarily simpler or easier to resolve than cases involving larger amounts in controversy. For example, TAS experience indicates that earned income tax credit (EITC) cases and those relating to innocent spouse relief, while often not monetarily large, can be extremely factually and legally complex. See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 240-247.

32 *Goldberg v. Kelly*, 397 U.S. 254, 268-269.

33 IRC § 7803(a)(3)(E).

CONCLUSION

Appeals' reinstatement of the right to transfer campus cases to the field in order to accommodate an in-person conference is a very positive step and removes the worst of the disparity between low and middle income taxpayers on the one hand and wealthier taxpayers on the other hand. Nevertheless, taxpayers whose cases are channeled to the campuses still must apply for a case transfer and, because of Appeals' current staffing model, often will find themselves needing to incur significant cost and other travel-related hardships in order to obtain the same quality appeal to which wealthier taxpayers have more ready access. Appeals has taken an important first step in remedying this disparity but progress remains to be made toward ensuring that all taxpayers have access to a quality appeal.³⁴

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.

34 One aspect of a quality appeal is that a taxpayer's appeals conference should be attended by IRS Counsel or Compliance only with the taxpayer's consent. TAS recently learned, however, that some Appeals managers are seeking out cases that lend themselves to Compliance participation as a means of actively contributing to Appeals' future vision. IRS Appeals, *FY19 Frontline Manager Commitments – Exam Appeals* (on file with TAS). As previously pointed out by the National Taxpayer Advocate, inclusion of either Counsel or Compliance against taxpayers' wishes jeopardizes Appeals' independence and may lead to increased litigation and decreased tax compliance. Accordingly, such performance goals on the part of team managers, which presumably are encouraged by Appeals' leadership, can do significant harm to both Appeals and taxpayers. These goals are also precipitous, as the related pilot program designed to evaluate this initiative has not yet been completed. Nina E. Olson, *When Evaluating its Pilot Program on the Participation of Counsel and Compliance in Conferences, Appeals Should be Transparent and Should Consider Both Objective and Subjective Data*, NTA BLOG (Nov. 7, 2018) [https://taxpayeradvocate.irs.gov/news/nta-blog-appeals-should-be-transparent?category=Tax News](https://taxpayeradvocate.irs.gov/news/nta-blog-appeals-should-be-transparent?category=Tax+News); National Taxpayer Advocate 2017 Annual Report to Congress 203-210.