



NATIONAL TAXPAYER ADVOCATE  
2004 ANNUAL REPORT TO CONGRESS  
EXECUTIVE SUMMARY

## THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS

Internal Revenue Code § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to describe at least 20 of the most serious problems encountered by taxpayers. This year's report describes 21 problems and designates the complexity of the Internal Revenue Code as the most serious problem facing taxpayers and the IRS alike. The report illustrates the effects of tax law complexity through its discussion of the remaining 20 problems, which are grouped into five categories: (1) customer service; (2) tax return preparation; (3) IRS processing issues; (4) tax law enforcement and the tax gap; and (5) taxpayer rights.

In each case, the report describes the problem, includes a statement submitted by the appropriate IRS officials providing the IRS' response to the problem, and sets forth the National Taxpayer Advocate's analysis of the IRS' response. This format provides a clear picture of which steps have been taken to address the most serious problems – and which additional steps are required. The 21 problems, in sequence, are as follows:

**The Confounding Complexity of the Tax Code:** This year's report identifies the complexity of the Internal Revenue Code as the most serious problem facing taxpayers and the IRS alike. The Code contains well over a million words, bedeviling individual taxpayers with provisions such as the alternative minimum tax (AMT) and the earned income tax credit (EITC). Business taxpayers must grapple with a patchwork of rules that cover the depreciation of equipment; numerous and overlapping filing requirements for employment taxes; and vague factors that govern the classification of workers as either employees or independent contractors. The IRS must find a way to digest and explain the Code in a way that taxpayers can understand, and enforce it. Indeed, most of the other top problems cited in the report result from the complexity of the Code.

### **A. CUSTOMER SERVICE**

**Taxpayer Access to Face-to-Face Interaction with the IRS:** The IRS is working to expand the electronic delivery of services to taxpayers, and reducing some of the face-to-face services available at Taxpayer Assistance Centers (TACs). The IRS is also shifting the focus of the TACs from pre-filing services to compliance activities, further diluting taxpayers' access to face-to-face interaction with IRS employees. The National Taxpayer Advocate recommends that the IRS conduct research to determine whether it is offering services to taxpayers through the appropriate means and ensure that taxpayers who do not utilize electronic services are receiving assistance elsewhere, including through face-to-face service.

**Taxpayer Access to Remote Interaction with the IRS:** As the IRS encourages more taxpayers to access customer service remotely, the agency faces significant challenges in providing taxpayers with the level and type of service that they require. While the IRS has significantly improved the toll-free telephone service, taxpayers still struggle with the menu system. The Kiosk program has given out old and incorrect information, and despite clear demand for the Electronic Tax Law Assistance (ETLA) program, the IRS has virtually hidden the ETLA link on its website. The National Taxpayer Advocate recommends that the IRS conduct research on why taxpayers

perceive the need to make multiple phone calls; how taxpayers navigate the phone system; their experiences with the Referral Mail program; the use of artificial intelligence technology for ETLA; and the experience of other organizations with kiosks.

**Accuracy of Tax Law and Accounts Assistance:** The toll-free telephone system experienced a decline in accuracy rates between fiscal years 2002 and 2004. During this time, the IRS increased the range of topics assigned to customer service representatives (CSRs) to reduce customer wait times and call transfers, but this occurred at the expense of accuracy. Another contributing factor was the failure of some CSRs to follow required scripts. The IRS has now increased the number of topics covered and reduced specialization. To devise a long-term solution, however, the National Taxpayer Advocate recommends that the IRS research the comparative effects of accuracy rates, call wait times, and call transfers on taxpayer compliance.

**Education and Outreach Efforts:** Complexity in the tax law and its administration can easily baffle taxpayers and lead to compliance problems. The National Taxpayer Advocate is concerned that inadequate planning for taxpayer education and outreach may significantly impact compliance in an ever-changing, complex tax environment. With the IRS placing more emphasis on enforcement, and shifting resources from pre-filing to post-filing activities, taxpayers may not receive the education and assistance they require to comply with their tax obligations. The National Taxpayer Advocate believes that the IRS must set forth identifiable and quantifiable objectives, actively utilize available sources of research, and provide for a method of measuring the effectiveness of its initiatives.

## **B. TAX RETURN PREPARATION**

**Oversight of Unenrolled Return Preparers:** Taxpayers' views on the fairness of the tax system are largely shaped by the totality of their interaction with the system, including their experiences with return preparers. If the IRS does not police the return preparation and filing profession, taxpayers are more likely to have bad experiences with unscrupulous or incompetent preparers, unquestionably tainting their impression of the system. The National Taxpayer Advocate continues to recommend the establishment of a Federal program to regulate unenrolled tax preparers. The IRS has an obligation to research the scope of the problem and the regulatory experience of other states to design the most effective way to administer such a program.

**Electronic Return Preparation and Filing:** The IRS needs an effective strategy to overcome obstacles such as cost and security that prevent taxpayers and return preparers from filing returns electronically. E-filing benefits both taxpayers and the IRS in many ways, including reduced transcription errors, faster refunds and lower processing costs. The IRS has not sufficiently planned for those paper filers who resist all efforts to convert them to e-file. The agency's plan to discontinue the TeleFile program will only increase this taxpayer population. The National Taxpayer Advocate recommends that the IRS explore the creation of an electronic return template and a direct filing portal, which would enable taxpayers to prepare and file their returns electronically without cost. To obtain some e-file benefits in the case of taxpayers who prepare their returns using software but are die-hard paper filers, the IRS should consider using bar-code technology on individual tax returns.

**Problems in the Volunteer Return Preparation Program:** The Volunteer Income Tax Assistance (VITA) Program provides an invaluable service – offering free tax return preparation services to low income taxpayers. Concerns are growing over VITA, the quality of the returns it prepares, and the relationship between the IRS and the volunteers and partners who carry out the program. Many of these concerns stem from ambiguity over the structure of the program and how

it is run. The National Taxpayer Advocate recommends that the IRS engage in an open discussion about who bears ultimate responsibility for the program and clarify the IRS relationship with the volunteer organizations that operate VITA sites, including the extent and nature of support the IRS will provide to these organizations.

### **C. IRS PROCESSING ISSUES**

**Inconsistent Campus Procedures:** The Internal Revenue Service Restructuring and Reform Act of 1998 reorganized the IRS into an agency comprised of business units and campuses, in part because the previous structure did not promote consistency and accountability. Although the IRS has instituted nationwide procedures for its campuses (formerly called service centers), TAS has identified areas where varying campus procedures can result in different treatment of similarly situated taxpayers. These include: (1) taxpayers whose Social Security numbers have been stolen, (2) taxpayers who demonstrate that a levy should be released due to economic hardships but have new levies imposed before the original ones are released; and (3) the treatment of some taxpayers who file a delinquent tax return only after the IRS' Automated Substitute for Return unit files a substitute return on the taxpayer's behalf.

**Processing ITIN Applications and Amended Income Tax Returns:** The IRS faces systemic problems in processing two types of taxpayer submissions: applications for Individual Taxpayer Identification Numbers (ITINs) and amended tax returns. With respect to the processing of ITIN applications, the IRS has implemented a new two-step process that has caused a number of hardships to taxpayers, including delayed refunds, and resulted in conflicting procedural guidance. With respect to the processing of amended returns, a review of TAS cases suggests that there are systemic problems in this area, particularly relating to delayed refunds. The IRS needs to do a better job of tracking amended returns through the different stages of processing.

**Lack of Notice Clarity:** Too many of the more than 100 million IRS notices sent to taxpayers annually do not satisfy the standard set forth by Congress – that notices must be sufficiently clear to enable a taxpayer to understand an IRS question about a tax return or any adjustments or penalties applied to a return. The IRS has made many positive strides toward improving notices and has worked closely with external stakeholders to improve EITC notices, in particular. However, some notices are confusing *per se* and should not be used. Others are of vital importance to taxpayers but do not contain sufficient information for the taxpayer to make an informed decision. The IRS must try harder to provide the taxpayer with the *why* of its notices – to explain why a notice has been sent – the *what's next* of its notices – to explain to the taxpayer what is going to happen – and the *how* of its notices – to set forth the taxpayer's options.

**Erroneous and Miscalculated Collection Statute Expiration Dates:** Generally, the IRS has 10 years from the date of assessment to collect a tax. With certain exceptions, when the 10-year collection period expires, the IRS can no longer legally enforce collection of the debt. The expiration of the 10-year collection period is referred to as the "collection statute expiration date" (CSED). Recent changes to the tax laws affecting CSEDs and misinterpretations of other tax laws have caused the IRS to miscalculate CSEDs on thousands of taxpayer accounts. These miscalculations can lead to unlawful collection on these accounts. The IRS is now aware of the problem and is devoting resources to identify and correct taxpayer accounts with incorrect CSEDs.

**Application and Filing Burdens on Small Tax-Exempt Organizations:** Tax-exempt organizations must go through a long, complex process to apply for tax-exempt status. With current IRS procedures and staffing levels, this sometimes takes six months or longer. Once they receive tax-exempt status, these organizations must file complex annual information returns.

These complexities and delays can place significant burdens on small organizations, which typically have very limited resources and do not have personnel who can capably navigate the tax system. The National Taxpayer Advocate notes that the IRS is taking steps to reduce these burdens. She also believes the IRS should more accurately measure application processing times to help reduce delays, further simplify the information return filing process, and better target outreach and education for tax-exempt organizations.

#### **D. TAX LAW ENFORCEMENT AND THE TAX GAP**

**IRS Examination Strategy:** The IRS estimates that the annual net tax gap is about \$255 billion. If examinations (audits) are to reduce the gap, the IRS must allocate its limited examination resources to most effectively promote compliance. Studies show that examinations reduce the tax gap primarily through an indirect effect on voluntary compliance rather than direct collection from the taxpayer under audit. However, the IRS does not know whether its current examination strategy is maximizing voluntary compliance and minimizing the tax gap. The IRS should research how the indirect effect of examinations on voluntary compliance varies by taxpayer population, issues examined, and type of examination, and should use this research to determine which returns and issues to examine and what type of examination to use.

**IRS Collection Strategy:** Our tax administration system faces two serious threats: expansion of the tax gap (the amount of tax imposed by law for a given tax year but not paid voluntarily or timely) and the decline in voluntary compliance by taxpayers. The IRS collection strategy has shifted in emphasis many times, but the IRS has not incorporated the best practices of the private collection industry with strategies to enhance tax compliance. The National Taxpayer Advocate believes the IRS must focus not just on today's delinquent tax dollars but also on tomorrow's tax obligations. An effective collection strategy must: (1) be based on research; (2) understand the *why* of noncompliance; (3) identify the appropriate collection touch for each particular cause of noncompliance; (4) reduce opportunities for noncompliance; and (5) ensure prompt human contact with delinquent taxpayers.

**Federal Contractors and the Federal Payment Levy Program:** The GAO reported that in 2002, more than 27,000 Department of Defense contractors owed more than \$3 billion in Federal taxes, yet many of these noncompliant contractors continued to receive Federal contract awards and payments. This noncompliance contributes to the tax gap, unfairly disadvantages compliant contractors, and allows the noncompliant to reap the benefits of contracts while refusing to fulfill tax obligations. Although the tax law contains provisions aimed at preventing such noncompliance by Federal contractors, the IRS and other responsible agencies are not effectively implementing these provisions. IRS problems include a breakdown in the information return filing process, failing to effectively utilize available information, and problems employing the Federal Payment Levy Program against noncompliant contractors. The National Taxpayer Advocate understands that the IRS is taking steps to remedy these problems, and recommends that the IRS work to solve the remaining problems and implement a system that will more effectively use Federal contract and payment information to curb future noncompliance.

#### **E. TAXPAYER RIGHTS**

**Independence of the IRS Office of Appeals:** The IRS Appeals division plays a vital role in tax administration by providing taxpayers a forum to resolve tax controversies without litigation. But because Appeals procedures are voluntary, taxpayers will not use Appeals unless they believe that they can reasonably access the Appeals system and that their cases will receive a fair review independent of the IRS enforcement function. Certain Appeals policies limit taxpayers' reasonable

access to Appeals and compromise its independence. These policies include case processing delays, eliminating oral appeals, centralizing appeals in IRS campuses, eroding the prohibition on *ex parte* communications, and actively participating in the planning of IRS tax shelter initiatives. The National Taxpayer Advocate recommends that the IRS revise any policies that lead taxpayers to believe their cases will not receive fair consideration, and take steps to ensure that all taxpayers have reasonable access to Appeals.

**IRS Mediation Programs:** The IRS mediation programs, Fast Track Mediation and post-Appeals mediation, are rarely used. Unless these programs are utilized in every appropriate case, the IRS will not reap the full benefits of mediation identified by Congress, including: (1) reducing the time and costs required to resolve disputes, (2) improving the outcomes of the dispute resolution process, such as reducing the dispute inventory or improving the rate at which disputes are resolved, and (3) improving participants' satisfaction with the process and outcomes. If these potential benefits are to be realized, the IRS must minimize the number of taxpayers and issues excluded from the programs, effectively communicate their existence and utility to taxpayers and IRS employees, and eliminate potential concerns about confidentiality and conflict of interest.

**Offers in Compromise:** Since August 2001, when the IRS began centralized processing of offers in compromise (OICs), it has reduced inventory and processing time primarily by returning more offers to taxpayers, rather than by fully evaluating them and then accepting or rejecting them. In addition, the number and percentage of offers rejected by the IRS have been increasing. A recent study found that IRS formulas for calculating a taxpayer's reasonable collection potential, and the policy of automatically rejecting offers from taxpayers qualifying for an installment agreement, led to the rejection of many reasonable offers. The IRS should revise these unrealistic policies and reduce the number and percentage of offers it returns. Toward this end, it should increase communication with taxpayers prior to returning any offer.

**Taxpayer Rights Training in a Complex and Changing Tax Environment:** As the IRS intensifies its enforcement efforts, the training of both newly selected and experienced compliance employees is especially critical. Current instructional materials do not fully explore the role of the Taxpayer Advocate Service in assisting taxpayers. The IRS does little to ensure that its employees clearly understand both the concept and application of taxpayer rights as they relate to their enforcement activities. It increasingly relies upon rote formulas that do little to expand the employees' ability to apply both the spirit and meaning of the law. The IRS must revise the content, placement and techniques for training employees about the Taxpayer Advocate Service, and integrate consideration of taxpayer rights into each case study or scenario to emphasize its importance.

**Access to the Taxpayer Advocate Service:** TAS' Case Advocacy function, which helps taxpayers resolve specific problems with the IRS, has seen its caseload consistently and significantly decline since its inception in March 2000. While this may be viewed as a positive development, market research indicates that TAS is reaching just four percent of approximately 5.25 million taxpayers eligible for TAS assistance, and only a small percentage of these eligible taxpayers have ever heard of us. As a consequence, taxpayers are harmed because they do not receive the assistance they need to resolve their IRS problems. The National Taxpayer Advocate urges the IRS to fully commit to formal training of IRS employees each year on TAS case criteria and assist TAS in publicizing itself through external media, to ensure that the almost six million taxpayers eligible for our services actually know that TAS exists and is available.

## THE NATIONAL TAXPAYER ADVOCATE'S KEY LEGISLATIVE RECOMMENDATIONS

Internal Revenue Code § 7803(c)(2)(B)(ii)(VIII) requires the National Taxpayer Advocate to recommend legislative changes to resolve problems encountered by taxpayers. Four of our previous proposals became law in the 108<sup>th</sup> Congress, and we expect the 109<sup>th</sup> Congress to take up several others that passed either the full House or Senate. This report offers two categories of Key Legislative Recommendations – one dealing with the need for tax simplification and the other dealing with the protection of taxpayer rights.

Summaries of the recommendations dealing with *tax simplification* are as follows:

**Alternative Minimum Tax (AMT):** The AMT, originally designed to prevent wealthy taxpayers from escaping taxation through the use of tax-avoidance transactions, has morphed into a second layer of taxation that increasingly affects middle-income taxpayers and is projected to expand to impact nearly 35 million taxpayers in 2010. Our 2003 report designated the AMT as the most serious problem facing taxpayers. We again recommend that Congress repeal the AMT or revamp it substantially to achieve its original objective.

**Small Business Tax Burdens:** We recommend that Congress adopt a number of proposals to alleviate some of the significant burdens that the tax code imposes on small businesses. Our recommendations include allowing self-employed taxpayers to deduct the costs of health insurance premiums for purposes of self-employment taxes; extending the deadline by which a newly formed corporation must file an election to be treated as an S corporation until the date on which the corporation is required to file its first tax return; and protecting businesses that use payroll service providers from tax deposit fund misappropriation, or even fraud, by requiring payroll services to meet minimum qualifications. We reiterate previous proposals to reduce the maximum penalty for failure to make payroll tax deposits in the manner prescribed and to exempt most husband-and-wife co-owned businesses from the partnership tax filing requirements.

**Education Tax Incentives:** The tax code provides a complex set of incentives to encourage saving for and spending on education, set forth in at least 10 different provisions. The requirements, definitions, and income phase-outs vary from provision to provision. The point of a tax incentive, almost by definition, is to encourage certain types of economic behavior, but taxpayers will only respond to incentives if they know they exist and understand them. Few if any taxpayers are both aware of all the education tax incentives and familiar with their particulars. We offer several specific recommendations to streamline and simplify these provisions.

**Retirement Saving Incentives:** Much like education incentives, retirement planning incentives are numerous and complex. More than a dozen tax-advantaged retirement planning vehicles are available and are subject to different sets of rules governing eligibility, contribution limits, the tax treatment of contributions and distributions, withdrawals, the availability of loans, and portability. We recommend that Congress take a hard look at the confusing array of options. We also suggest guidelines that Congress could consider to streamline them.

Summaries of the recommendations dealing with the *protection of taxpayer rights* are as follows:

**Effective Tax Administration Offers in Compromise:** In 1998, Congress authorized the IRS to compromise tax debts based upon factors such as equity, public policy and hardship in cases where doing so would promote the effective administration of the tax laws (ETA offers). However,

the IRS has interpreted the congressional authorization narrowly so that, for example, the IRS group charged with evaluating such offers accepted only a single ETA offer based upon equity or public policy in FY 2004. We believe that the IRS' reluctance to compromise in inequitable situations may lead taxpayers to disregard the law or erode their faith in the fairness of the income tax system. We recommend that Congress provide more specific guidance to the IRS to ensure that a new "Equitable Consideration" standard be applied in a broader array of cases.

**Collection Due Process Hearings:** We believe that Collection Due Process (CDP) hearings are an important vehicle for ensuring that the IRS follows the appropriate and required administrative and legal procedures and considers all reasonable collection alternatives in the course of collecting outstanding tax liabilities. To keep the focus on collection activity, we recommend that taxpayers continue to be permitted to raise concerns about the underlying liability during the administrative CDP hearing but propose repeal of the ability to have *de novo* judicial review of the underlying liability. We also recommend a number of technical legal and administrative improvements, including proposing forms and notices to help taxpayers navigate and prepare for CDP hearings and create a more accurate administrative hearing record.

**Free Basic Electronic Return Preparation and Filing:** In 1998, Congress directed the IRS to work toward a goal of having 80 percent of all returns filed electronically by 2007. This is desirable because e-filing benefits taxpayers and the IRS alike. However, taxpayers who prepare their own returns find that while paper filing is free, e-filing may require them to pay two separate fees to a vendor – one for preparing their return electronically and another for filing electronically. In 2002, the IRS entered into a three-year agreement with the Free File Alliance to provide free e-filing to at least 60 percent of all taxpayers. We recommend that Congress take the next step by requiring the IRS to post fill-in forms on its website and make e-filing free to all taxpayers who prepare their returns themselves. (Taxpayers who prefer to use a sophisticated software program would, of course, remain free to purchase and use one.)

**The Tax Gap:** The final discussion in the section on taxpayer rights relates to the tax gap. The most recent IRS estimate of the net tax gap, for 2001, was \$255 billion. Last year, 128 million taxpayers filed individual income tax returns. Thus, every taxpayer is forced to pay an average of about \$2,000 extra in taxes each year to subsidize noncompliance. At a Senate Finance Committee hearing on the gap last July, virtually all witnesses agreed that the cash economy and other types of income not currently subject to document matching are the biggest sources of the tax gap. The mere fact that honest taxpayers are paying so much extra in taxes due to noncompliance constitutes an extraordinary abridgement of taxpayer rights and raises fundamental issues of fairness. To help alleviate the tax gap's burden, we present an extensive list of options that Congress and the IRS should evaluate. At the same time, any new or enhanced enforcement measure has the potential itself to abridge taxpayer rights. For that reason, we must analyze these options from the perspective of taxpayer rights. In a chart describing possible options, we note the obvious benefits and burdens of each option.

## THE MOST LITIGATED TAX ISSUES

Internal Revenue Code § 7803(c)(2)(B)(ii)(X) requires the National Taxpayer Advocate to identify the ten tax issues most often litigated in the Federal courts and to classify those issues by the type of taxpayer affected. The cases we reviewed were decided during the fiscal year that began on June 1, 2003, and ended on May 31, 2004. Our analysis of issues and cases for this year's report suggests that tax law complexity is a significant cause of tax litigation and constitutes a continuing burden on both taxpayers and the government.

**Collection Due Process:** The Collection Due Process hearing provides taxpayers with an opportunity for independent review of a lien filed by the IRS or a proposed levy action. As in 2003, CDP was the most frequently litigated tax issue in the Federal courts during the period analyzed for the Annual Report to Congress, although the number of cases decreased. Litigation of CDP cases continues to reflect the questions that taxpayers have about CDP hearings and the appeals process, such as: *Which court has jurisdiction to hear the CDP appeal? Has the taxpayer satisfied the CDP appeal filing requirements? Is the taxpayer entitled to a face-to-face CDP hearing? Is the taxpayer entitled to raise issues about the underlying liability at the CDP hearing? Are taxpayers entitled to tape record the CDP hearing?* This procedural uncertainty is made more significant by the anticipated increase in CDP hearings that will likely result from increased IRS collection activity. However, the large decrease (from 52 percent to 23 percent) in frivolous CDP cases demonstrates that the process is beginning to be used in the manner for which it was intended.

**Income Issues:** The issue of what constitutes gross income for purposes of Internal Revenue Code § 61 has been among the Most Litigated Issues since 1998, the first year that the National Taxpayer Advocate was required to report on litigated issues. All of the cases reviewed in this analysis related to income that taxpayers failed to report. Taxpayers prevailed, in whole or in part, in only 14 out of 102 cases. Taxpayers appeared to have the most difficulty in applying sections of the Internal Revenue Code that exclude items from gross income.

**Trade or Business Expenses:** The deductibility of trade or business expenses is perennially one of the ten most litigated tax issues in the Federal courts. During the review period, 68 cases that included trade or business expense issues were decided. The courts affirmed the IRS position in nearly 75 percent of the cases, while taxpayers prevailed just seven percent of the time; the remaining cases resulted in split decisions. Substantiation of trade or business expenses was the primary sub-issue litigated by taxpayers, who often failed to provide sufficient documentation of expenses they incurred, causing them to lose otherwise permissible deductions. The IRS can assist these taxpayers, and minimize litigation, by continuing to provide clear guidance on the deductibility of trade or business expenses.

**Joint & Several Liability:** If a married couple files a joint tax return, both spouses are held jointly and severally liable for any deficiency or tax due. The IRS can then choose to collect tax shown on the return from either taxpayer. Internal Revenue Code § 6015, which provides relief from joint and several liability in a limited number of circumstances, has been among the most litigated tax issues since its enactment in 1998. During the review period, 62 opinions involving IRC § 6015 were issued in the Federal court system. Unlike many other litigated issues, however, representation by counsel does not seem to have an impact. Of the taxpayers who prevailed in their cases, just over half (seven of 12) did so without representation, while half of the split decisions also came in cases where the taxpayer was unrepresented (*pro se*).



**IRC § 6662, Negligence Penalty:** Fifty-four cases involving the accuracy-related penalty for negligence or disregard of rules or regulations under IRC § 6662(b)(1) were decided during the review period. Lack of substantiation for the reasonable cause explanation given by the taxpayer was the most prevalent reason for upholding the penalty in these cases. At the same time, almost 20 percent of the taxpayers seeking relief from the accuracy-related penalty were successful. This suggests that the IRS should study whether its training and procedures for assessing the penalty need fine-tuning, and whether the penalty truly enhances tax compliance.

**IRC § 6651, Failure-to-File Penalty:** Taxpayers litigated 47 cases involving the failure to file penalty in the Federal courts during the review period, although 45 of these cases contained collateral issues. Taxpayers seek relief from the failure to file penalty by asserting “reasonable cause” for the failure. As the cases reviewed demonstrate, it is sometimes very difficult for taxpayers to meet this standard, yet in some instances a penalty does not seem appropriate to us. For this and other reasons, the National Taxpayer Advocate reiterates her previous recommendation to broaden the scope of the “reasonable cause” justification for the failure to file timely tax returns to include taxpayers with a history of compliance who make one-time inadvertent errors.

**Family Status Issues:** These issues include eligibility for dependency exemptions, head of household status, child and dependent care credits, and child credits. During the review period, 44 cases regarding family status were decided in the Federal courts, but only three litigants were represented by counsel. In almost 50 percent of cases in which the IRS position was sustained, the taxpayer provided little or no evidence or offered evidence that the court found “self-serving.” Simplifying the tax law provisions affecting low and middle income taxpayers may reduce the number of family status cases reaching the courts. The recent enactment of a uniform definition of a child should also help.

**IRC § 6673, Frivolous Litigation:** Thirty-five cases were decided during the review period on the issue of whether a taxpayer conducted litigation against the IRS primarily for delay or advanced frivolous or groundless arguments under Internal Revenue Code § 6673. In these cases, the IRS asked the court to impose monetary sanctions against taxpayers, or the court did so on its own against taxpayers, for advancing frivolous arguments or unduly delaying the litigation proceedings. The courts consistently held that penalties were warranted where taxpayers advanced “boilerplate, tax-protestor arguments” that were frivolous and without merit. The IRS is seeking these penalties in more and more cases, and the courts are imposing the penalties in the vast majority of them.

**Earned Income Tax Credit:** An analysis of litigated cases involving the EITC indicates that many low income taxpayers face difficulties when attempting to comply with the numerous and often confusing EITC requirements. Some taxpayers lack understanding of the eligibility requirements relating to the various credits and deductions available for working families with children. While some EITC cases are litigated due to legitimate interpretive and factual disputes, this analysis makes clear that too many low income taxpayers struggle to determine their EITC eligibility.

**IRC § 6672, Trust Fund Recovery Penalty:** Internal Revenue Code § 6672 imposes the Trust Fund Recovery Penalty against “responsible persons” who fail to withhold and pay over the employee portion of payroll taxes to the IRS. Twenty-six cases involving this penalty were decided during the review period. Taxpayers continue to challenge the IRS’s determinations as to who, by virtue of position or authority, was responsible for ensuring that the trust fund taxes were paid. Further, issues continue to arise as to when taxpayers have willfully failed to pay this money to the government.