

INTRODUCTION: Legislative Recommendations

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

The chart immediately following this Introduction summarizes congressional action on recommendations the National Taxpayer Advocate proposed in her 2001 through 2013 Annual Reports.¹ The National Taxpayer Advocate places a high priority on working with the tax-writing committees and other interested parties to try to resolve problems encountered by taxpayers. In addition to submitting legislative proposals in each Annual Report, the National Taxpayer Advocate meets regularly with members of Congress and their staffs and testifies at hearings on the problems faced by taxpayers to ensure that Congress has an opportunity to receive and consider a taxpayer perspective. The following discussion highlights legislative activity during the 113th Congress relating to the National Taxpayer Advocate's proposals.

During the 113th Congress, the Senate Committee on Finance and the House Committee on Ways and Means both developed session drafts on proposed tax reform legislation that contained proposals similar to ones recommended by the National Taxpayer Advocate in her Annual Reports to Congress.² The proposed legislation included the following:

- Repeal the Alternative Minimum Tax;³
- Require returns of partnerships made on the basis of the calendar year to be filed on or before March 15th following the close of the calendar year, and returns made on the basis of a fiscal year to be filed on or before the 15th day of the third month following the close of the fiscal year;⁴

- 1 An electronic version of the chart is available on the TAS website at www.TaxpayerAdvocate.irs.gov/2014-Annual-Report. The chart describes all the legislative recommendations the National Taxpayer Advocate has made since 2001, and lists each Code section affected by the recommendations.
- 2 H. COMM. ON WAYS AND MEANS, *Tax Reform Act of 2014: Discussion Draft Section-by-Section Summary* (Feb. 26, 2014), available at http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf, and S. COMM. ON FIN., *Proposal to Combat Tax Fraud, Make Filing Safer, Simpler and More Efficient* (Nov. 20, 2013), available at <http://www.finance.senate.gov/imo/media/doc/Chairman%27s%20Staff%20Discussion%20Draft%20of%20Tax%20Administration%20Reform%20Language.pdf>.
- 3 H. COMM. ON WAYS AND MEANS, *Tax Reform Act of 2014: Discussion Draft Section-by-Section Summary*, § 2001 (Feb. 26, 2014), available at http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf. See also National Taxpayer Advocate 2013 Annual Report to Congress 292-301, at 293 (Legislative Recommendation: *Repeal the Alternative Minimum Tax*) (recommending the complete repeal of the Alternative Minimum Tax); National Taxpayer Advocate 2008 Annual Report to Congress 356-62, at 361-62 (Legislative Recommendation: *Repeal the Alternative Minimum Tax for Individuals*) (recommending the repeal of the alternative minimum tax for individuals); National Taxpayer Advocate 2004 Annual Report to Congress 383-85 (Key Legislative Recommendation: *Alternative Minimum Tax*) (recommending the repeal of provisions relating to the Alternative Minimum Tax); National Taxpayer Advocate 2001 Annual Report to Congress 166-77, at 168, 175 (Key Recommendations: *Alternative Minimum Tax for Individuals*) (recommending the repeal of IRC §§ 55, 56, 57, 58, and 59 which pertain to the Alternative Minimum Tax for individuals; or, in the alternative, the individual Alternative Minimum Tax Exemptions should be indexed for inflation).
- 4 H. COMM. ON WAYS AND MEANS, *Tax Reform Act of 2014: Discussion Draft Section-by-Section Summary*, § 6201 (Feb. 26, 2014), available at http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf. See also National Taxpayer Advocate 2003 Annual Report to Congress 302-07, at 303 (Key Legislative Recommendation: *Filing Due Date of Partnership and Certain Trusts*).

- Permit a qualifying, newly incorporated small business to elect to be treated as an S corporation for any taxable year if the business makes such an election on a timely filed Form 1120S, *U.S. Income Tax Return for an S Corporation*;⁵
- Suspend the period to file a petition with the U.S. Tax Court for judicial review of determination of spousal relief while a person is prohibited by a bankruptcy stay from filing such a petition, and for 60 days thereafter;⁶
- Permit organizations that unsuccessfully seek recognition of IRC § 501(c)(4) exempt status to seek declaratory judgments;⁷
- Provide a safe harbor for *de minimis* errors on information returns and payee statements;⁸
- Develop an Internet platform for Form 1099 filings;⁹
- Require that electronically prepared paper returns include scannable codes;¹⁰
- Grant the IRS the authority to regulate federal income tax return preparers;¹¹

5 H. COMM. ON WAYS AND MEANS, *Tax Reform Act of 2014: Discussion Draft Section-by-Section Summary*, § 3606 (Feb. 26, 2014), available at http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf. See also National Taxpayer Advocate 2010 Annual Report to Congress 410-11, at 411 (Legislative Recommendation: *Extend the Due Date for S Corporation Elections to Reduce the High Rate of Untimely Elections*). The National Taxpayer Advocate recommended that Congress amend IRC § 1362(b)(1) to allow a small business corporation to elect to be treated as an S corporation by checking a box on its timely filed (including extensions) Form 1120S, *U.S. Income Tax Return for an S Corporation*.

6 H. COMM. ON WAYS AND MEANS, *Tax Reform Act of 2014: Discussion Draft Section-by-Section Summary*, § 164 (Feb. 26, 2014), available at http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf. See also National Taxpayer Advocate 2006 Annual Report to Congress 429-30 (Additional Legislative Recommendations: *Innocent Spouse Relief Fixes*) (recommending to suspend the period for filing a petition in Tax Court to obtain judicial review of an innocent spouse determination while a bankruptcy stay is in effect and for 60 days thereafter).

7 See National Taxpayer Advocate Special Report to Congress: *Political Activity and the Rights of Applicants for Tax-Exempt Status* 16 (June 2014). In a special report to Congress the National Taxpayer Advocate recommended that Congress consider legislation to provide applicants for exemption under IRC § 501(c)(4) with the ability to seek a declaratory judgment if denied or unanswered after nine months so that more judicial guidance can develop. Also, a declaratory judgment permits an organization to challenge in court a revocation of its exempt status or an IRS determination that it is a private foundation, rather than a public charity, before the assessment of any income taxes that might result from the loss of exempt status or any excise taxes that might result from the reclassification to a private foundation.

8 S. COMM. ON FIN., *Proposal to Combat Tax Fraud, Make Filing Safer, Simpler and More Efficient*, § 2 (Nov. 20, 2013), available at <http://www.finance.senate.gov/imo/media/doc/Chairman%27s%20Staff%20Discussion%20Draft%20of%20Tax%20Administration%20Reform%20Language.pdf>. See also National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 5, at 69, 89, 91, 96 (Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*). However, the proposal is for \$25, rather than \$50 as recommended by the National Taxpayer Advocate.

9 *Id.*

10 *Id.*

11 S. COMM. ON FIN., *Proposal to Combat Tax Fraud, Make Filing Safer, Simpler and More Efficient*, § 19 (Nov. 20, 2013), available at <http://www.finance.senate.gov/imo/media/doc/Chairman%27s%20Staff%20Discussion%20Draft%20of%20Tax%20Administration%20Reform%20Language.pdf>. See also National Taxpayer Advocate 2013 Annual Report to Congress 61-74, at 62, 74 (Most Serious Problem: *REGULATION OF RETURN PREPARERS: Taxpayers and Tax Administration Remain 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; National Taxpayer Advocate 2008 Annual Report to Congress 503-12; National Taxpayer Advocate 2006 Annual Report to Congress 197-221; National Taxpayer Advocate 2005 Annual Report to Congress 223-37; National Taxpayer Advocate 2004 Annual Report to Congress 67-88; National Taxpayer Advocate 2003 Annual Report to Congress 270-301; National Taxpayer Advocate 2002 Annual Report to Congress 216-30; *Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. On Oversight of the H. Comm. on Ways and Means*, 109th Cong. (2005) (statement of Nina E. Olson, National Taxpayer Advocate).

- Assign victims of identity theft a single point of contact;¹² and
- Accelerate the due dates for filing Forms W-2, *Wage and Tax Statement*, W-3, *Transmittal of Wage and Tax Statements*, and 1099 with the IRS and Social Security Administration.¹³

The following sections discuss bills introduced during the 113th Congress that reflect legislative recommendations made by the National Taxpayer Advocate in her Annual Reports to Congress.

Tax Refund Theft Prevention Act of 2014

Senators Hatch and Wyden introduced the Tax Refund Theft Prevention Act of 2014, which would enact a number of the National Taxpayer Advocate's previous recommendations.¹⁴ The legislation would provide taxpayers with access to real-time transcripts of third-party data to aid in return preparation.¹⁵ The legislation would also establish a safe harbor for *de minimis* errors on information returns and payee statements.¹⁶ The legislation contains two proposals regarding electronic filing, including establishing an Internet platform for Form 1099 filings;¹⁷ and requirements that electronically prepared paper returns include scannable code.¹⁸ Finally, the legislation would require the IRS to establish a single point of contact for identity theft victims and to work with the identity theft victim until all related issues are resolved.¹⁹

Real Time Tax System

In our 2012 and 2011 Annual Reports to Congress, the National Taxpayer Advocate recommended that the IRS provide taxpayers with electronic access to third-party data to assist taxpayers in return preparation and that the IRS develop a pre-populated return option for taxpayers.²⁰ On April 15, 2013, Senator Shaheen introduced the Simpler Tax Filing Act of 2013, which would require the Secretary of the Treasury to study the feasibility of providing certain taxpayers with an optional, pre-prepared tax return.²¹

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- 12 S. COMM. ON FIN., *Proposal to Combat Tax Fraud, Make Filing Safer, Simpler and More Efficient*, § 1 (Nov. 20, 2013), available at <http://www.finance.senate.gov/imo/media/doc/Chairman%27s%20Staff%20Discussion%20Draft%20of%20Tax%20Administration%20Reform%20Language.pdf>. See also National Taxpayer Advocate 2013 Annual Report to Congress at 83 (Most Serious Problem: *IDENTITY THEFT: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*).
- 13 S. COMM. ON FIN., *Proposal to Combat Tax Fraud, Make Filing Safer, Simpler and More Efficient*, § 12 (Nov. 20, 2013), available at <http://www.finance.senate.gov/imo/media/doc/Chairman%27s%20Staff%20Discussion%20Draft%20of%20Tax%20Administration%20Reform%20Language.pdf>. See also National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 5, at 86-88 (Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).
- 14 Tax Refund Theft Prevention Act of 2014, S. 2736, 113th Cong. (2014).
- 15 S. 2736, § 12, 113th Cong. (2014). See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 69, 89, 91, 96 (Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).
- 16 *Id.* However, the proposal is for \$25, rather than \$50.
- 17 S. 2736, § 3, 113th Cong. (2014). National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 75-76 (Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).
- 18 Tax Refund Theft Prevention Act of 2014, S. 2736, § 4, 113th Cong. (National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 70, 91, 96 (Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*)).
- 19 S. 2736, § 5, 113th Cong. (2014). National Taxpayer Advocate 2013 Annual Report to Congress at 83 (Most Serious Problem: *IDENTITY THEFT: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*).
- 20 National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical as the IRS Develops a Real-Time Tax System*); National Taxpayer Advocate 2011 Annual Report to Congress 284-95 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*).
- 21 Simpler Tax Filing Act of 2013, S. 722, 113th Cong. (2013).

The bill also would require the Secretary of the Treasury, in consultation with the Taxpayer Advocate Service (TAS), to report to the House Committee on Ways and Means and the Senate Committee on Finance on actions necessary to achieve the goal of offering pre-prepared tax returns by tax year 2018. The report would be required to include analysis of the budgetary, administrative, and legislative barriers to achieving that goal, including the funding that it would require.²²

Taxpayer Receipt Act of 2013

To enhance taxpayer awareness of the connection between taxes paid and benefits received, the National Taxpayer Advocate recommended that Congress direct the IRS to provide all taxpayers with a “taxpayer receipt” showing how their tax dollars are being spent.²³ This “taxpayer receipt” could be a more detailed version of the pie chart currently published by the IRS showing federal income and outlays,²⁴ but would be provided directly to each taxpayer in connection with the filing of a tax return.²⁵ On August 22, 2013, Representative McDermott proposed legislation that would provide individual taxpayers, via U.S. mail, annual receipts for income taxes reported for the preceding taxable year. The receipt would state the amount paid, the taxpayer’s filing status, earned income, and taxable income. Additionally, the receipt would contain tables listing expenditures in various categories of the federal budget, the ten most costly tax expenditures, and related spending information.²⁶

Taxpayer Bill of Rights

Over the last decade, the National Taxpayer Advocate has recommended many legislative changes that would protect taxpayer rights at a time when the IRS budget is shrinking and, at times, resources were being shifted to enforcement. Among our proposals was to enact a comprehensive Taxpayer Bill of Rights (TBOR) that would explicitly detail the rights and responsibilities of taxpayers.²⁷ In June 2014, the IRS adopted a TBOR, which set out ten rights and provided taxpayers with clear explanations of their rights.²⁸ However, to cement these fundamental concepts as a permanent part of our tax system, the National Taxpayer Advocate is once again recommending that Congress codify a TBOR. Additionally, because about 16 years have elapsed since Congress last passed major tax procedure legislation, and some statutory protections are outdated or the passage of time has shown that new protections are needed, the National

22 Simpler Tax Filing Act of 2013, S. 722, 113th Cong. (2013).

23 National Taxpayer Advocate 2012 Annual Report to Congress 8 (Most Serious Problem: *The Complexity of the Tax Code*).

24 IRC § 7523 requires the IRS to include pie-shaped graphs showing the relative sizes of major outlay categories and major income categories in its instructions for Forms 1040, 1040A, and 1040EZ; see, e.g., IRS Form 1040 Instructions (2014), at 100.

25 In April 2011, the White House launched a calculator on its website titled “Your Federal Taxpayer Receipt” that allows taxpayers to enter the actual or estimated amounts of their Social Security, Medicare, and income tax payments and to see a breakdown showing how their payments are being applied to major categories of federal spending, including Social Security, Medicare, national defense, health care, job and family security programs, interest on the national debt, Veterans benefits, and education. See www.whitehouse.gov/files/taxreceipt/. While we view the availability of this calculator as a positive development, most taxpayers will not take the time to visit this website. We therefore believe a taxpayer receipt should be provided in connection with the filing of a return.

26 Taxpayer Receipt Act of 2013, H.R. 3039 113th Cong. (2013).

27 See Legislative Recommendation: *Codify the Taxpayer Bill of Rights, infra*. See also National Taxpayer Advocate 2013 Annual Report to Congress 5 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*); National Taxpayer Advocate’s Report to Acting Commissioner Daniel Werfel, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (Nov. 4, 2013), available at www.TaxpayerAdvocate.irs.gov/2013AnnualReport; National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*); National Taxpayer Advocate 2007 Annual Report to Congress 478-89 (Key Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis “Apology” Payments*).

28 IR-2014-72, IRS Adopts “Taxpayer Bill of Rights;” 10 Provisions to be Highlighted on IRS.gov, in Publication 1 (Jun. 10, 2014).

Taxpayer Advocate encourages Congress to enact the legislative recommendations relating to taxpayer rights detailed in this and previous annual reports. On July 22, 2013, Representative Roskam introduced the Taxpayer Bill of Rights Act of 2013,²⁹ which would amend IRC § 7803 to require the Commissioner of Internal Revenue to ensure that IRS employees are familiar with and act in accordance with taxpayer rights. These rights include the *right to be informed, to be assisted, to be heard, to pay no more than the correct amount of tax, to an appeal, to certainty, to privacy, to confidentiality, to representation, and to a fair and just tax system.*³⁰ These rights are identical to those proposed in our 2011 report. On July 31, 2013, the bill was approved by the House of Representatives, but the Senate did not act on it.

Small Business Taxpayer Bill of Rights Act of 2013

Senator Cornyn and Representative Richmond introduced companion bills that would enact a number of the National Taxpayer Advocate's previous recommendations.³¹ The proposed legislation would prohibit *ex parte* communications (*i.e.*, those that do not include the taxpayer or the taxpayer's representative) between Appeals officers and other IRS employees.³² In addition, the proposed legislation would extend the period in which a third party can bring suit for return of levied funds or proceeds.³³

The legislation also contains two of the National Taxpayer Advocate's recommendations regarding relief from joint and several liability. The bills would:

- Suspend the running of the period for filing a Tax Court petition seeking review of an innocent spouse claim for the period of time the taxpayer is prohibited by reason of the automatic stay imposed under section 362 of the Bankruptcy Code from filing such petition, plus 60 additional days;³⁴ and

29 Taxpayer Bill of Rights Act of 2013, H.R. 2768, 113th Cong. (2013).

30 *Id.*

31 Small Business Taxpayer Bill of Rights Act of 2013, S. 725, 113th Cong. (2013) and H.R. 3479, 113th Cong. (2013). See also National Taxpayer Advocate 2013 Annual Report to Congress 5-19 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*).

32 S. 725, 113th Cong. § 7 (2013) and H.R. 3479, 113th Cong. § 7 (2013). See National Taxpayer Advocate 2009 Annual Report to Congress 346-50 (Legislative Recommendation: *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State*) (noting the IRS Restructuring and Reform Act of 1998 prohibits *ex parte* communication between Appeals employees and other IRS employees, but recent IRS practices allowing Appeals employees to share office space with other IRS employees foster a perception of a lack of independence).

33 Both bills extend the time for third parties to sue from nine months to three years. S. 725, 113th Cong. § 9 (2013); H.R. 3479, 113th Cong. § 9 (2013). See National Taxpayer Advocate 2001 Annual Report to Congress 202-09 (Legislative Recommendation: *Return of Levy or Sale Proceeds*).

34 S. 725, 113th Cong. § 11 (2013); H.R. 3479, 113th Cong. § 11 (2013). See National Taxpayer Advocate 2004 Annual Report to Congress 490-92 (Legislative Recommendation: *Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court*).

- Clarify that the scope and standard of review for taxpayers seeking equitable relief from joint and several liability under IRC § 6015(f) is *de novo*.³⁵

The Small Business Payroll Protection Act of 2013

In recent years, a number of third party payers have gone out of business or embezzled their customers' funds. Because employers remain liable for payroll taxes, self-employed and small business taxpayers who fall victim in these cases can experience significant burden. This burden includes not only being forced to pay the amount twice—once to the third party payer that absconded with or dissipated the funds, and a second time to the IRS—but also being liable for interest and penalties. Some small businesses may not be able to recover from these setbacks and will be forced to cease operations.

This issue suggests the need for better procedures to protect businesses trying to comply with the payroll tax requirements, particularly for small business taxpayers that hire smaller third party payers. For the past decade, the National Taxpayer Advocate has recommended numerous administrative and legislative actions to assist victims of payroll service provider (PSP) failure.³⁶ More specifically, to protect taxpayers from third party misappropriation of payroll taxes, the National Taxpayer Advocate recommended in her 2012 Annual Report that Congress:

- Amend the Code to require any person who enters into an agreement with an employer to collect, report, and pay any employment taxes to furnish a performance bond that specifically guarantees payment of federal payroll taxes collected, deducted, or withheld by such person from an employer and from wages or compensation paid to employees;
- Amend IRC § 3504 to require agents with an approved Form 2678, *Employer/Payer Appointment of Agent*, to allocate reported and paid employment taxes among their clients using a form prescribed by the IRS and impose a penalty for the failure to file absent reasonable cause; and

35 S. 725, 113th Cong. § 14 (2013); H.R. 3479, 113th Cong. § 14 (2013). See National Taxpayer Advocate 2011 Annual Report to Congress 531-36 (Legislative Recommendation: *Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) Is De Novo*). We note that the Court of Appeals for the Ninth Circuit, in *Wilson v. Comm'r*, 705 F.3d 980 (9th Cir. 2013), held that the scope and standard of the Tax Court's review of claims for relief under IRC § 6015(f) is *de novo*. The IRS acquiesced in the *Wilson* decision. *Action on dec.*, 2012-07 (June 17, 2013). However, the National Taxpayer Advocate believes that an amendment to IRC § 6015 (the innocent spouse provision of the Code) is still necessary with respect to another issue, the issue of whether a taxpayer can raise innocent spouse relief as a defense in collection actions, and recommended that Congress address this problem in three Annual Reports to Congress. National Taxpayer Advocate 2010 Annual Report to Congress 377; National Taxpayer Advocate 2009 Annual Report to Congress 378; National Taxpayer Advocate 2007 Annual Report to Congress 549. The problem appears to persist as two district courts issued opinions recently holding that they do not have jurisdiction over IRC § 6015 claims raised as a defense in an action to reduce joint federal tax assessments to judgment or in a lien foreclosure suit. *U.S. v. Popowski*, 110 A.F.T.R.2d (RIA) 6997 (D.S.C. 2012); *U.S. v. Elman*, 110 A.F.T.R.2d (RIA) 6993 (N.D. Ill. 2012). For more detailed information, see National Taxpayer Advocate 2013 Annual Report to Congress 408-19 (Most Litigated Issue: *Relief from Joint and Several Liability Under IRC § 6015*).

36 See National Taxpayer Advocate 2012 Annual Report to Congress 426-44 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*); National Taxpayer Advocate 2012 Annual Report to Congress 553-59 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 337-54 (Most Serious Problem: *Third Party Payers*); National Taxpayer Advocate 2007 Annual Report to Congress 538-44 (Legislative Recommendation: *Taxpayer Protection From Third Party Payer Failures*); National Taxpayer Advocate 2004 Annual Report to Congress 394-99 (Legislative Recommendation: *Protection from Payroll Service Provider Misappropriation*).

- Amend the U.S. Bankruptcy Code to clarify that IRC § 6672 penalties survive bankruptcy in the case of non-individual debtors.³⁷

On May 8, 2013, Senator Mikulski introduced the Small Business Payroll Protection Act of 2013, to amend the Code to require the Secretary to establish a registration system for payroll tax deposit agents (defined as any person that provides payroll processing or tax filing and deposit service to one or more employers). The proposal requires such agents to: (1) submit a bond or to submit to quarterly third-party certifications, (2) make certain disclosures to their clients concerning liability for payment of employment taxes, and (3) pay penalties for failing to collect or pay over employment taxes or for attempting to evade or defeat payment of such taxes.³⁸

Consolidated Appropriations Act, 2014 and Consolidated and Further Continuing Appropriations Act, 2015

Congress recently enacted legislation that incorporates two of the National Taxpayer Advocate's past recommendations.³⁹ Both the Consolidated Appropriations Act, 2014 and the Consolidated and Further Continuing Appropriations Act, 2015 require the IRS to:

1. Issue dual address change notices related to an employer making employment tax payments (with one notice sent to both the employer's former and new address); and
2. Give special consideration to an offer in compromise (OIC) request from a victim of fraud or bankruptcy by a third-party payroll tax preparer.⁴⁰

The National Taxpayer Advocate will monitor the process to ensure the IRS is on track to issue the dual notices by the date promised, and has concerns about how the IRS will implement its recently issued guidance on processing OICs submitted by victims of PSPs.⁴¹

Restrict Access to the Death Master File

As one means to stem the growing number of tax-related identity theft cases, the National Taxpayer Advocate recommended that Congress restrict access to the Social Security Administration's death master

37 See National Taxpayer Advocate 2012 Annual Report to Congress 553-59 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 538-44; National Taxpayer Advocate 2004 Annual Report to Congress 394-99. Third party payer recommendations initially had included a provision to clarify that the Trust Fund Recovery Penalty applies to third party payers, which was not included here because the IRS implemented this administratively. See Interim Guidance Memorandum SBSE-05-0711-044, *Interim Guidance for Conducting Trust Fund Recovery Penalty Investigations in Cases Involving a Third-Party Payer* (July 01, 2011) (also incorporated in IRM 5.1.24.5.8 (Aug. 15, 2012)). See also S. 1321, 109th Cong. (2005) (introduced by Senator Santorum), S. 3583, 109th Cong. (2006) (introduced by Senator Snowe), S. 1773, 110th Cong. (2007) (introduced by Senator Snowe), and S. 900, 113th Cong. (2013) (introduced by Senator Mikulski and discussed in more detail below) included parts of third party payer recommendations made by the National Taxpayer Advocate.

38 S. 900, 113th Cong. (2013).

39 See National Taxpayer Advocate 2012 Annual Report to Congress 426-44 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*).

40 See Consolidated Appropriations Act, 2014, Pub. L. No. 113-76, Division E, Title I, § 106, 128 Stat. 5, 190 (2014) and Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, Division E, Title I, § 106, 128 Stat. 2130, 2338 (2014).

41 For a detailed discussion, see Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply with the Law Regarding Victims of Payroll Service Provider Failure*, *supra*.

file (DMF).⁴² The fiscal year 2014 budget bill, which was signed into law on December 26, 2013, contained a provision that restricts access to the DMF records of individuals who died during the previous three calendar years.⁴³

Consolidate Education Incentives

The National Taxpayer Advocate has suggested consolidating and simplifying various Code provisions to make compliance less difficult.⁴⁴ Senator Schumer and Representative Doggett introduced companion bills that include the National Taxpayer Advocate's recommendation to consolidate the education tax credits known as the Hope Scholarship and the Lifetime Learning Credits.⁴⁵ The proposed legislation would amend the Code to replace the two credits with a new American Opportunity Tax Credit that: (1) allows an income tax credit of up to \$3,000 of the qualified tuition and related expenses of a student who is carrying at least one half of a normal course load; (2) increases the income threshold for reductions in the credit amount based upon modified adjusted gross income; (3) allows a lifetime dollar limitation on such credit of \$15,000 for all taxable years; and (4) makes 40 percent of the credit refundable. Additionally, the bill allows an exclusion from gross income of any amount received as a federal Pell grant.

Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes

In the 2012 Annual Report, the National Taxpayer Advocate recommended that Congress amend IRC § 7871(a) to include the adoption credit (IRC § 23) in the list of Code sections for which a Native American tribal government is treated as a "State."⁴⁶ Because a Native American tribe is not considered a state for purposes of the credit and cannot certify a child's special needs, taxpayers who adopt a Native American special needs child cannot claim the special needs adoption credit. On July 9, 2014, Senator Tim Johnson introduced the Tribal Adoption Parity Act, which would allow tribal governments to make the determination that a child is a child with special needs for purposes of the adoption tax credit.⁴⁷ On the House side, Representative Kilmer introduced the Adoption Tax Credit Parity Act of 2013 on June 12, 2013.⁴⁸

Legislative Recommendations that Have Led to Administrative Changes

Sometimes legislative recommendations made by the National Taxpayer Advocate are accomplished through the issuance of regulations or other administrative guidance. Before proposing a legislative recommendation to Congress, the National Taxpayer Advocate attempts to work with the IRS to address her concerns through the issuance of regulations or other administrative guidance, if possible. When the IRS disagrees with a change that could be accomplished administratively or would not move quickly enough, the National Taxpayer Advocate on occasion recommends that Congress take action. In some cases, the IRS has reconsidered its position and addressed issues raised in the National Taxpayer Advocate legislative recommendations through the issuance of guidance, as described below.

42 See National Taxpayer Advocate 2011 Annual Report to Congress 519-23 (Legislative Recommendation: *Restrict Access to the Death Master File*). The DMF is a database available to the public that includes decedents' full names, Social Security numbers, dates of birth, dates of death, and the county, state, and Zip code of their last addresses.

43 Bipartisan Budget Act of 2013, Pub. L. No. 113-67, § 203, 127 Stat. 1165, 1177-79 (2013).

44 See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress 370-72 (Legislative Recommendation: *Simplify and Streamline Education Tax Incentives*).

45 S. 835, 113th Cong. (2013) and H.R. 1738, 113th Cong. (2013).

46 National Taxpayer Advocate 2012 Annual Report to Congress 521-25 (Legislative Recommendation: *Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes*).

47 Tribal Adoption Parity Act, S. 2570, 113th Cong. (2014).

48 The Adoption Tax Credit Tribal Parity Act of 2013, H.R. 2332, 113th Cong. (2013).

Removal of the 36-Month Non-Payment Testing Period Rule for Cancellation of Debt Reporting

The 36-month “testing period” rule created by regulations issued pursuant to IRC § 6050P creates a presumption that a creditor is required to issue a Form 1099-C, *Cancellation of Debt*, even if the creditor is not actually discharging the debt.⁴⁹ This enables a creditor to continue to try to collect a debt while the IRS proposes additional tax due to the reported cancellation of the same debt.⁵⁰ This rule divorces the creditor’s reporting obligation from the question whether a debt has actually been discharged.⁵¹ Because this requirement was regulatory and not statutorily required, the National Taxpayer Advocate originally sought to have the IRS amend its regulations, but when it appeared the IRS did not intend to act, she recommended that Congress amend IRC § 6050P to effectively overturn the 36-month regulatory “testing period” as a basis on which to issue a Form 1099-C.⁵²

In October 2014, the IRS published a Notice of Proposed Rulemaking regarding the “Removal of the 36-Month Non-Payment Testing Period Rule.”⁵³ The notice said the Department of the Treasury and the IRS believe that information reporting under IRC § 6050P should coincide with the actual discharge of debt rather than non-payment for 36 months, and that removal of this rule will reduce confusion for taxpayers and increase compliance.⁵⁴

49 National Taxpayer Advocate 2010 Annual Report to Congress 383-86 (Legislative Recommendation: *Remove the 36-Month “Testing Period” that May Trigger Cancellation of Debt Reporting*). See IRC §§ 61(a)(12) (providing that a taxpayer’s gross income includes income from the discharge of indebtedness) and 6050P; Treas. Reg. § 1.6050P-1(a) (requiring creditors that discharge an indebtedness of at least \$600 during any calendar year to file a Form 1099-C information return with the IRS).

50 Under the 36-month non-payment testing period rule, a discharge of indebtedness is “deemed” to have occurred if (and only if) an identifiable event has occurred, “whether or not an actual discharge of indebtedness has occurred.” See Treas. Reg. § 1.6050P-1(a) (There is an exception, under Treas. Reg. § 1.6050P-1(b)(3), that a creditor may, at its discretion, report an actual discharge of indebtedness that occurs before an identifiable event occurs. The continued collection activity is relevant only where the creditor wishes to rebut a presumption that a debt has been canceled. The creditor may rebut the presumption if the creditor engaged in a significant bona fide collection activity at any time within the 12-month period ending at the close of the calendar year if the facts and circumstances existing as of January 31 of the calendar year following the expiration of the non-payment testing period indicate that the indebtedness has not yet been discharged).

51 See National Taxpayer Advocate 2010 Annual Report to Congress at 385 (Legislative Recommendation: *Remove the 36-Month “Testing Period” that May Trigger Cancellation of Debt Reporting*).

52 *Id.* at 383.

53 Removal of the 36-Month Non-Payment Testing Period Rule, 79 Fed. Reg. 61791 (Oct. 15, 2014). The comment period is open until January 13, 2015.

54 *Id.*

National Taxpayer Advocate Legislative Recommendations with Congressional Action

Alternative Minimum Tax (AMT)				
Repeal the Individual AMT	Repeal the AMT outright.			
National Taxpayer Advocate 2001 Annual Report to Congress 82–100; National Taxpayer Advocate 2004 Annual Report to Congress 383–385; National Taxpayer Advocate 2008 Annual Report to Congress 356–362.				
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 1616	Lee	10/30/2013	Referred to the Finance Committee
	HR 243	Ross	1/14/2013	Referred to Ways & Means Committee
Legislative Activity 112th Congress	HR 86	Bachmann	1/5/2011	Referred to Ways & Means Committee
	HR 99	Dreler	1/5/2011	Referred to Ways & Means Committee
	HR 547	Garrett	2/8/2011	Referred to Ways & Means Committee
	HR 3400	Garrett	11/10/2011	Referred to Ways & Means Committee
	S 727	Wyden	4/5/2011	Referred to the Finance Committee
	S 820	Shelby	4/14/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	HR 3804	Huelskamp	1/23/2012	Referred to Ways & Means Committee
	S 3018	Wyden	2/23/2010	Referred to the Finance Committee
	HR 240	Garrett	1/7/2009	Referred to the Ways & Means Committee
	HR 782	Paul	1/28/2009	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	S 932	Shelby	4/30/2009	Referred to the Finance Committee
	S 55	Baucus	1/4/2007	Referred to the Finance Committee
	S 14	Kyl	4/17/2007	Referred to the Finance Committee
	S 1040	Shelby	3/29/2007	Referred to the Finance Committee
	HR 1366	English	3/7/2007	Referred to the Ways & Means Committee
	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
	HR 3970	Rangel	10/25/2007	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	S 2293	Lott	11/1/2007	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 464
	HR 1186	English	3/9/2005	Referred to the Ways & Means Committee
	S 1103	Baucus	5/23/2005	Referred to the Finance Committee
	HR 2950	Neal	6/16/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee

Legislative Activity 108th Congress	HR 43	Collins	1/7/2003	Referred to the Ways & Means Committee
	HR 1233	English	3/12/2003	Referred to the Ways & Means Committee
	S 1040	Shelby	5/12/2003	Referred to the Finance Committee
	HR 3060	N. Smith	9/10/2003	Referred to the Ways & Means Committee
	HR 4131	Houghton	4/2/2004	Referred to the Ways & Means Committee
	HR 4164	Shuster	4/2/2004	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 437	English	2/6/2001	Referred to the Ways & Means Committee
	S 616	Hutchison	3/26/2002	Referred to the Finance Committee
	HR 5166	Portman	7/18/2002	Referred to the Ways & Means Committee
Index AMT for Inflation				
National Taxpayer Advocate 2001 Annual Report to Congress 82–100.	If full repeal of the individual AMT is not possible, it should be indexed for inflation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3223	McConnell	9/13/2010	Placed on the Senate Calendar
	HR 5077	Hall	4/20/2010	Referred to the Ways & Means Committee
	HR 719	Lee	1/27/2009	Referred to the Ways & Means Committee
	S 722	Baucus	3/26/2009	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	HR 703	Garrett	2/9/2005	Referred to the Ways & Means Committee
	HR 4096	Reynolds	10/20/2005	12/7/2005–Passed the House; 12/13/2005–Placed on the Senate Legislative Calendar
Legislative Activity 108th Congress	HR 22	Houghton	1/7/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 5505	Houghton	10/1/2002	Referred to the Ways & Means Committee
Eliminate Several Adjustments for Individual AMT				
National Taxpayer Advocate 2001 Annual Report to Congress 82–100.	Eliminate personal exemptions, the standard deduction, deductible state and local taxes, and miscellaneous itemized deductions as adjustment items for individual AMT purposes.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 336	DeMint	2/14/2011	Referred to the Finance Committee
Legislative Activity 110th Congress	S 102	Kerry	1/4/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1861	Harkin	10/7/2005	Referred to the Finance Committee
Legislative Activity 108th Congress	HR 1939	Neal	5/12/2003	Referred to the Ways & Means Committee

Private Debt Collection (PDC)

Repeal PDC Provisions

National Taxpayer Advocate 2006 Annual Report to Congress 458–462.

Repeal IRC § 6306, thereby terminating the PDC initiative.

	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	HR 796	Lewis	2/3/2009	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	S 335	Dorgan	1/18/2007	Referred to the Finance Committee
	HR 695	Van Hollen	1/24/2007	Referred to the Ways & Means Committee
	HR 3056	Rangel	7/17/2007	10/10/2007-Passed the House; 10/15/2007 Referred to the Finance Committee

Tax Preparation and Low Income Taxpayer Clinics (LITC)

Matching Grants for LITC for Return Preparation

National Taxpayer Advocate 2002 Annual Report to Congress vii–viii.

Create a grant program for return preparation similar to the LITC grant program. The program should be designed to avoid competition with VITA and should support the IRS's goal (and need) to have returns electronically filed.

Legislative Activity 111th Congress	Pub. L. No. 111-117, Div. C, Title I, 123 Stat. 3034, 3163 (2009).			
Legislative Activity 110th Congress	Pub. L. No. 110-161, Div. D, Title I, 121 Stat. 1975, 1976 (2007).			
	Bill Number	Sponsor	Date	Status
	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1967	Clinton	8/2/2007	Referred to the Finance Committee
	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
	Legislative Activity 108th Congress	S 476	Grassley	2/27/2003
S 685		Bingaman	3/21/2003	Referred to the Finance Committee
S 882		Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
HR 1661		Rangel	4/8/2003	Referred to the Ways & Means Committee
HR 3983		Becerra	3/17/2004	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
	HR 3991	Houghton	3/19/2001	Referred to the Ways & Means Committee
	HR 7	Baucus	7/16/2002	Reported by Chairman Baucus with an amendment; referred to the Finance Committee

Regulation of Income Tax Return Preparers				
<p>National Taxpayer Advocate 2002 Annual Report to Congress 216–230; National Taxpayer Advocate 2003 Annual Report to Congress 270–301; National Taxpayer Advocate 2007 Annual Report to Congress 83–95 & 140-155; National Taxpayer Advocate 2008 Annual Report to Congress 423–426; National Taxpayer Advocate 2009 Annual Report to Congress 41–69.</p>	<p>Create an effective oversight and penalty regime for return preparers by taking the following steps:</p> <ul style="list-style-type: none"> ◆ Enact a registration, examination, certification, and enforcement program for federal tax return preparers; ◆ Direct the Secretary of the Treasury to establish a joint task force to obtain accurate data about the composition of the return preparer community and make recommendations about the most effective means to ensure accurate and professional return preparation and oversight; ◆ Require the Secretary of the Treasury to study the impact cross-marketing tax preparation services with other consumer products and services has on the accuracy of returns and tax compliance; and ◆ Require the IRS to take steps within its existing administrative authority, including requiring a checkbox on all returns in which preparers would enter their category of return preparer (<i>i.e.</i>, attorney, CPA, enrolled agent, or unenrolled preparer) and developing a simple, easy-to-read pamphlet for taxpayers that explains their protections. 			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Identity Theft				
<p>Single Point of Contact National Taxpayer Advocates 2013 Annual Report</p>	<p>Designate a single point of contact for identity theft victims to work with the identity theft victim until all related issues are resolved.</p>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 2736	Hatch	7/31/2014	Referred to Finance Committee

Referrals to LITCs				
National Taxpayer Advocate 2007 Annual Report to Congress 551–553.	Amend IRC § 7526(c) to add a special rule stating that notwithstanding any other provision of law, IRS employees may refer taxpayers to LITCs receiving funding under this section. This change will allow IRS employees to refer a taxpayer to a specific clinic for assistance.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1573	Durbin	9/15/2011	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 171
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
Public Awareness Campaign on Registration Requirements				
National Taxpayer Advocate 2002 Annual Report to Congress 216–230.	Authorize the IRS to conduct a public information and consumer education campaign, utilizing paid advertising, to inform the public of the requirements that paid preparers must sign the return prepared for a fee and display registration cards.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
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Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee

Increase Preparer Penalties																																																																	
National Taxpayer Advocate 2003 Annual Report to Congress 270–301.	Strengthen oversight of all preparers by enhancing due diligence and signature requirements, increasing the dollar amount of preparer penalties, and assessing and collecting those penalties, as appropriate.																																																																
Legislative Activity 112th Congress	Pub. L. No. 112-41 § 501, 125 Stat. 428, 459 (2011).																																																																
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National Taxpayer Advocate 2008 Report to Congress 427–441.	Direct the Department of the Treasury and the IRS to (1) minimize refund turnaround times; (2) implement a Revenue Protection Indicator; (3) develop a program to enable unbanked taxpayers to receive refunds on stored value cards (SVCs); and (4) conduct a public awareness campaign to disseminate accurate information about refund delivery options.																																																																
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Small Business Issues

Health Insurance Deduction/Self-Employed Individuals

National Taxpayer Advocate 2001 Annual Report to Congress 223;
National Taxpayer Advocate 2008 Annual Report to Congress 388–389.

Allow self-employed taxpayers to deduct the costs of health insurance premiums for purposes of self-employment taxes.

Legislative Activity 111th Congress

Pub. L. No. 111-240, § 2504 STAT 2560 (2010).

Bill Number	Sponsor	Date	Status
S 725	Bingaman	3/26/2009	Referred to the Finance Committee
HR 1470	Kind	3/12/2009	Referred to the Ways & Means Committee

Legislative Activity 110th Congress

S 2239 Bingaman 10/25/2007 Referred to the Finance Committee

Legislative Activity 109th Congress

S 663 Bingaman 3/17/2005 Referred to the Finance Committee

S 3857 Smith 9/16/2006 Referred to the Finance Committee

Legislative Activity 108th Congress

HR 741 Sanchez 2/12/2003 Referred to the Ways & Means Committee

HR 1873 Manzullo Velazquez 4/30/2003 Referred to the Ways & Means Committee

Legislative Activity 107th Congress

S 2130 Bingaman 4/15/2002 Referred to the Finance Committee

Married Couples as Business Co-owners

National Taxpayer Advocate 2002 Annual Report to Congress 172–184.

Amend IRC § 761(a) to allow a married couple operating a business as co-owners to elect out of subchapter K of the IRC and file one Schedule C (or Schedule F in the case of a farming business) and two Schedules SE if certain conditions apply.

Legislative Activity 110th Congress

Pub.L. No. 110-28, Title VIII, § 8215, 121 Stat. 193, 194 (2007).

Bill Number	Sponsor	Date	Status
HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee

Legislative Activity 108th Congress

HR 1528 Portman 6/20/2003 5/19/2004–Passed/agreed to in Senate, with an amendment

S 842 Kerry 4/9/2003 Referred to the Finance Committee

HR 1640 Udall 4/3/2003 Referred to the Ways & Means Committee

HR 1558 Doggett 4/2/2003 Referred to the Ways & Means Committee

Income Averaging for Commercial Fishermen

National Taxpayer Advocate 2001 Annual Report to Congress 226.

Amend IRC § 1301(a) to provide commercial fishermen the benefit of income averaging currently available to farmers.

Legislative Activity 108th Congress

Pub. L. No. 108-357, § 314, 118 Stat. 1468, 1469 (2004).

Election to be Treated as an S Corporation				
National Taxpayer Advocate 2004 Annual Report to Congress 390–393.	Amend IRC § 1362(a) to allow a small business corporation to elect to be treated as an S corporation no later than the date it timely files (including extensions) its first Form 1120S, <i>U.S. Income Tax Return for an S Corporation</i> .			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 2271	Franken	3/29/2012	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
Regulation of Payroll Tax Deposits Agents				
National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	Allow a small business corporation to elect to be treated as an S corporation by checking a box on it's timely filed Form 1120S U.S. Income Tax Return for an S Corporation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 900	Mikulski	05/08/2013	Referred to the Finance Committee
Legislative Activity 110th Congress	S 1773	Snowe	7/12/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 3583	Snowe	6/27/2006	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Issue Dual Address Change Notice				
National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	Issue dual address change notices related to an employer making employment tax payments (with one notice sent to both the employer's former and new address)			
Legislative Activity 113th Congress	Pub. L. No. 113-76, Division E, Title I, § 106, 128 Stat. 5, 190 (2014) and Pub. L. No. 113-235, Division E, Title I, § 106, 128 Stat. 2130, 2338 (2014).			
Special Consideration for offer in compromise				
National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	Give special consideration to an offer in compromise (OIC) request from a victim of fraud or bankruptcy by a third-party payroll tax preparer.			
Legislative Activity 113th Congress	Pub. L. No. 113-76, Division E, Title I, § 106, 128 Stat. 5, 190 (2014) and Pub. L. No. 113-235, Division E, Title I, § 106, 128 Stat. 2130, 2338 (2014).			
Simplification				
Reduce the Number of Tax Preferences				
National Taxpayer Advocate 2010 Annual Report to Congress 365–372.	Simplify the complexity of the tax code generally by reducing the number of tax preferences.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee

<p>Simplify and Streamline Education Tax Incentives</p> <p>National Taxpayer Advocate 2008 Annual Report to Congress 370–372; National Taxpayer Advocate 2004 Annual Report to Congress 403–422.</p>	<p>Enact reforms to simplify and streamline the education tax incentives by consolidating, creating uniformity among, or adding permanency to the various education tax incentives. Specifically, (1) incentives under § 25A should be consolidated with § 222 and possibly § 221, (2) the education provisions should be made more consistent regarding the relationship of the student to the taxpayer, (3) the definitions for “Qualified Higher Education Expenses” and “Eligible Education Institution” should be simplified, (4) the income level and phase-out calculations should be more consistent under the various provisions, (5) all dollar amounts should be indexed for inflation, and (6) after initial use of sunset provisions and simplification amendments, the incentives should be made permanent.</p>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 835	Schumer	4/25/2013	Referred to the Finance Committee
	HR 1738	Doggett	4/25/2013	Referred to the Ways & Means Committee
	HR 3476	Israel	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
	S 3267	Schumer	6/6/2012	Referred to the Finance Committee
	HR 6522	Israel	9/21/2012	Referred to the Ways & Means Committee
<p>Simplify and Streamline Retirement Savings Tax Incentives</p> <p>National Taxpayer Advocate 2008 Annual Report to Congress 373–374; National Taxpayer Advocate 2004 Annual Report to Congress 423–432.</p>	<p>Consolidate existing retirement incentives, particularly where the differences in plan attributes are minor. For instance, Congress should consider establishing one retirement plan for individual taxpayers, one for plans offered by small businesses, and one suitable for large businesses and governmental entities (eliminating plans that are limited to governmental entities). At a minimum, Congress should establish uniform rules regarding hardship withdrawals, plan loans, and portability.</p>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
Tax Gap Provisions				
<p>Corporate Information Reporting</p> <p>National Taxpayer Advocate 2008 Annual Report to Congress 388.</p>	<p>Require businesses that pay \$600 or more during the year to non-corporate and corporate service providers to file an information report with each provider and with the IRS. Information reporting already is required on payments for services to non-corporate providers. This applies to payments made after December 31, 2011.</p>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 1796	Baucus	10/19/2009	10/19/2009 Placed on Senate Legislative Calendar under General Orders. Calendar No. 184

<p>Reporting on Customer's Basis in Security Transaction</p> <p>National Taxpayer Advocate 2005 Annual Report to Congress 433–441.</p>	<p>Require brokers to keep track of an investor's basis, transfer basis information to a successor broker if the investor transfers the stock or mutual fund holding, and report basis information to the taxpayer and the IRS (along with the proceeds generated by a sale) on Form 1099-B.</p>			
<p>Legislative Activity 110th Congress</p>	<p>Pub. L. No. 110-343, § 403, 121 Stat. 3854, 3855 (2008).</p>			
	<p>Bill Number</p>	<p>Sponsor</p>	<p>Date</p>	<p>Status</p>
	<p>HR 878</p>	<p>Emanuel</p>	<p>2/7/2007</p>	<p>Referred to the Ways & Means Committee</p>
	<p>S 601</p>	<p>Bayh</p>	<p>2/14/2007</p>	<p>Referred to the Finance Committee</p>
	<p>S 1111</p>	<p>Wyden</p>	<p>4/16/2007</p>	<p>Referred to the Finance Committee</p>
	<p>HR 2147</p>	<p>Emanuel</p>	<p>5/3/2007</p>	<p>Referred to the Ways & Means Committee</p>
	<p>HR 3996 PCS</p>	<p>Rangel</p>	<p>10/30/2007</p>	<p>11/14/2007–Placed on the Senate Calendar; became Pub. L. No. 110-166 (2007) without this provision</p>
	<p>S 2414</p>	<p>Bayh</p>	<p>3/14/2006</p>	<p>Referred to the Finance Committee</p>
	<p>HR 5176</p>	<p>Emanuel</p>	<p>4/25/2006</p>	<p>Referred to the Ways & Means Committee</p>
	<p>HR 5367</p>	<p>Emanuel</p>	<p>5/11/2006</p>	<p>Referred to the Ways & Means Committee</p>
	<p>Bill Number</p>	<p>Sponsor</p>	<p>Date</p>	<p>Status</p>
<p>Legislative Activity 112th Congress</p>	<p>S 1289</p>	<p>Carper</p>	<p>6/28/2011</p>	<p>Referred to the Finance Committee</p>
	<p>Bill Number</p>	<p>Sponsor</p>	<p>Date</p>	<p>Status</p>
<p>Legislative Activity 109th Congress</p>	<p>S 1321RS</p>	<p>Santorum</p>	<p>6/28/2005</p>	<p>9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336</p>
				<p>9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614</p>

<p>Study of Use of Voluntary Withholding Agreements</p> <p>National Taxpayer Advocate 2004 Annual Report to Congress 478–489; National Taxpayer Advocate 2005 Annual Report to Congress 381-396.</p>	<p>Amend IRC § 3402(p)(3) to specifically authorize voluntary withholdings agreements between independent contractors and service-recipients as defined in IRC § 6041A(a)(1).</p>			
<p>Legislative Activity 109th Congress</p>	<p>S 1321RS</p>	<p>Santorum</p>	<p>6/28/2005</p>	<p>9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336. 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614</p>
<p>Require Form 1099 Reporting for Incorporated Service Providers</p> <p>National Taxpayer Advocate 2007 Annual Report to Congress 494–496.</p>	<p>Require service recipients to issue Forms 1099-MISC to incorporated service providers and increase the penalties for failure to comply with the information reporting requirements.</p>			
<p>Legislative Activity 111th Congress</p>	<p>Pub. L No. 111-148 § 9006 (2010).</p> <p>However, this Act also contains a reporting requirement for goods sold, which the National Taxpayer Advocate opposes because of the enormous burden it places on businesses. See Legislative Recommendation: Repeal the Information Reporting Requirement for Purchases of Goods over \$600, but Require Reporting on Corporate and Certain Other Payments.</p>			
<p>Require Financial Institutions to Report All Accounts to the IRS by Eliminating the \$10 Threshold on Interest Reporting</p> <p>National Taxpayer Advocate 2007 Annual Report to Congress 501–502.</p>	<p>Eliminate the \$10 interest threshold beneath which financial institutions are not required to file Form 1099-INT reports with the IRS.</p>			
	<p>Bill Number</p>	<p>Sponsor</p>	<p>Date</p>	<p>Status</p>
<p>Legislative Activity 112th Congress</p>	<p>S 1289</p>	<p>Carper</p>	<p>6/28/2011</p>	<p>Referred to the Finance Committee</p>
<p>Legislative Activity 111th Congress</p>	<p>S 3795</p>	<p>Carper</p>	<p>9/16/2010</p>	<p>Referred to the Finance Committee</p>
<p>Revise Form 1040, Schedule C to Break Out Gross Receipts Reported on Payee Statements Such as Form 1099</p> <p>National Taxpayer Advocate 2007 Annual Report to Congress 40.</p>	<p>Administrative recommendation that the IRS add a line to Schedule C so that taxpayers would separately report the amount of income reported to them on Forms 1099 and other income not reported on Forms 1099. If enacted by statute, the IRS would be required to implement this recommendation.</p>			
	<p>Bill Number</p>	<p>Sponsor</p>	<p>Date</p>	<p>Status</p>
<p>Legislative Activity 111th Congress</p>	<p>S 3795</p>	<p>Carper</p>	<p>9/16/2010</p>	<p>Referred to the Finance Committee</p>
<p>Include a Checkbox on Business Returns Requiring Taxpayers to Verify that they Filed all Required Forms 1099</p> <p>National Taxpayer Advocate 2007 Annual Report to Congress 40.</p>	<p>Administrative recommendation that the IRS require all businesses to answer two questions on their income tax returns: “Did you make any payments over \$600 in the aggregate during the year to any unincorporated trade or business?” and “If yes, did you file all required Forms 1099?” S 3795 would require the IRS to study whether placing a checkbox or similar indicator on business tax returns would affect voluntary compliance.</p>			
	<p>Bill Number</p>	<p>Sponsor</p>	<p>Date</p>	<p>Status</p>
<p>Legislative Activity 111th Congress</p>	<p>S 3795</p>	<p>Carper</p>	<p>9/16/2010</p>	<p>Referred to the Finance Committee</p>

Authorize Voluntary Withholding Upon Request				
National Taxpayer Advocate 2007 Annual Report to Congress 493–494.	Authorize voluntary withholding agreements between independent contractors and service recipients.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Require Backup Withholding on Certain Payments When TINs Cannot Be Validated				
National Taxpayer Advocate 2005 Annual Report to Congress 238–248.	Administrative recommendation that the IRS require payors to commence backup withholding if they do not receive verification of a payee's TIN. (S. 3795 would require voluntary withholding on certain payments.)			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Worker Classification				
National Taxpayer Advocate 2008 Annual Report to Congress 375–390.	Direct Treasury and the Joint Committee on Taxation to report on the operation of the revised worker classification rules and provide recommendations to increase compliance.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Taxpayer Bill of Rights and <i>De Minimis</i> “Apology” Payments				
Taxpayer Bill of Rights				
National Taxpayer Advocate 2007 Annual Report to Congress 486–489.	Enact a Taxpayer Bill of Rights setting forth the fundamental rights and obligations of U.S. taxpayers.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	HR 2768	Roskam	6/22/2013	Passed the House of Representatives, and was referred to the Senate Finance Committee on 8/31/2013
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Ways & Means Committee
	HR 5047	Becerra	4/15/2010	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
<i>De Minimis</i> “Apology” Payments				
National Taxpayer Advocate 2007 Annual Report to Congress 490.	Grant the National Taxpayer Advocate the discretionary, nondelegable authority to provide <i>de minimis</i> compensation to taxpayers where the action or inaction of the IRS has caused excessive expense or undue burden to the taxpayer and the taxpayer meets the IRC § 7811 definition of significant hardship.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Simplify the Tax Treatment of Cancellation of Debt Income				

Simplify the Tax Treatment of Cancellation of Debt Income				
National Taxpayer Advocate 2008 Annual Report to Congress 391–396.	Enact one of several proposed alternatives to remove taxpayers with modest amounts of debt cancellation from the cancellation of debt income regime.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	HR 4561	Lewis	2/2/2010	Referred to the Ways & Means Committee
Joint and Several Liability				
Tax Court Review of Request for Equitable Innocent Spouse Relief				
National Taxpayer Advocate 2001 Annual Report to Congress 128–165.	Amend IRC § 6015(e) to clarify that taxpayers have the right to petition the Tax Court to challenge determinations in cases seeking relief under IRC § 6015(f) alone.			
Legislative Activity 109th Congress	Pub. L. No. 109-432, § 408, 120 Stat. 3061, 3062 (2006).			
Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court).				
National Taxpayer Advocate 2004 Annual Report to Congress 490–92.	Allow a taxpayer seeking review of an innocent spouse claim or a collection case in U.S. Tax Court a 60-day suspension of the period for filing a petition for review, when the U.S. Bankruptcy Court has issued an automatic stay in a bankruptcy case involving the taxpayer's claim.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 725	Cornyn	4/15/2013	Referred to the Finance Committee
	HR 3479	Thornberry	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Ways & Means Committee
Clarify that the Scope and Standard of Tax Court Determinations Under IRC § 6015(f) Is De Novo.				
National Taxpayer Advocate 2011 Annual Report to Congress 531–536.	Amend IRC § 6015 to specify that the scope and standard of review in tax court determinations under IRC § 6015(f) is <i>de novo</i> .			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 725	Cornyn	4/15/2013	Referred to the Finance Committee
	HR 3479	Thornberry	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 60550	Becerra	6/28/2012	Referred to the Ways & Means Committee

Collection Issues				
Improve Offer In Compromise Program Accessibility				
National Taxpayer Advocate 2006 Annual Report to Congress 507–519.		Repeal the partial payment requirement, or if repeal is not possible, (1) provide taxpayers with the right to appeal to the IRS Appeals function the IRS's decision to return an offer without considering it on the merits; (2) reduce the partial payment to 20 percent of current income and liquid assets that could be disposed of immediately without significant cost; and (3) create an economic hardship exception to the requirement.		
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
	HR 2342	Lewis	5/12/2009	Referred to the Ways & Means Committee
Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens				
2009 National Taxpayer Advocate Report to Congress 357–364.		Provide clear and specific guidance about the factors the IRS must consider when filing a Notice of Federal Tax Lien (NFTL) and amend the Fair Credit Reporting Act to set specific timeframes for reporting derogatory tax lien information on credit reports.		
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
	HR 6439	Hastings	11/18/2010	Referred to the Ways & Means Committee
Permit the IRS to Release Levies on Small Business Taxpayers				
2011 National Taxpayer Advocate Report to Congress 537–543.		Amend IRC § 6343(a)(1)(d) to: permit the IRS, in its discretion, to release a levy against the taxpayer's property or rights to property if the IRS determines that the satisfaction of the levy is creating an economic hardship due to the financial condition of the taxpayer's business.		
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 4368	McDermott	4/17/2012	Referred to the Ways & Means Committee
Return of Levy or Sale Proceeds				
National Taxpayer Advocate 2001 Annual Report to Congress 202–214.		Amend IRC § 6343(b) to extend the period of time within which a third party can request a return of levied funds or the proceeds from the sale of levied property from nine months to two years from the date of levy. This amendment would also extend the period of time available to taxpayers under IRC § 6343(d) within which to request a return of levied funds or sale proceeds.		
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee

Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 1677	Rangel	3/26/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1321 RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in House
	HR 586	Lewis	2/13/2001	4/18/02–Passed the House with an amendment; referred to the Senate
Reinstatement of Retirement Accounts National Taxpayer Advocate 2001 Annual Report to Congress 202–214.				
Amend the following IRC sections to allow contributions to individual retirement accounts and other qualified plans from the funds returned to the taxpayer or to third parties under IRC § 6343: <ul style="list-style-type: none"> ◆ § 401 – Qualified Pension, Profit Sharing, Keogh, and Stock Bonus Plans ◆ § 408 – Individual Retirement Account, and SEP-Individual Retirement Account ◆ § 408A – Roth Individual Retirement Account 				
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 1677	Rangel	3/26/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in H.R. 1528 through an amendment and HR 1528 passed in lieu of S 882
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to Senate
	HR 3991	Houghton	3/19/2002	Defeated in the House
Consolidation of Appeals of Collection Due Process (CDP) Determinations National Taxpayer Advocate 2005 Annual Report to Congress 451–470.				
Consolidate judicial review of CDP hearings in the United States Tax Court, clarify the role and scope of Tax Court oversight of Appeals' continuing jurisdiction over CDP cases, and address the Tax Court's standard of review for the underlying liability in CDP cases.				
Legislative Activity 109th Congress	Pub. L. No. 109-280, § 855, 120 Stat. 1019 (2006).			

<p>Partial Payment Installment Agreements</p> <p>National Taxpayer Advocate 2001 Annual Report to Congress 210–214.</p>	<p>Amend IRC § 6159 to allow the IRS to enter into installment agreements that do not provide for full payment of the tax liability over the statutory limitations period for collection of tax where it appears to be in the best interests of the taxpayer and the IRS.</p>			
<p>Legislative Activity 108th Congress</p>	<p>Pub. L. No. 108-357, § 833, 118 Stat. 1418, 1600 (2004).</p>			
<p>Waiver of Installment Agreement Fees for Low Income Taxpayers</p> <p>National Taxpayer Advocate 2006 Annual Report to Congress 141–56 (Most Serious Problem: Collection Issues of Low Income Taxpayers).</p>	<p>Implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required.</p>			
	<p>Bill Number</p>	<p>Sponsor</p>	<p>Date</p>	<p>Status</p>
<p>Legislative Activity 112th Congress</p>	<p>HR 4375</p>	<p>Johnson</p>	<p>4/17/2012</p>	<p>Referred to the Ways & Means Committee</p>
	<p>S 2291</p>	<p>Cornyn</p>	<p>4/17/2012</p>	<p>Referred to the Finance Committee</p>
<p>Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State</p> <p>National Taxpayer Advocate 2009 Annual Report to Congress 346-350.</p>	<p>Provide that each Appeals office maintains separate office space, separate phone lines, facsimile, and other electronic communications access, and a separate post office address from any IRS office co-located with the Appeals office.</p>			
	<p>Bill Number</p>	<p>Sponsor</p>	<p>Date</p>	<p>Status</p>
<p>Legislative Activity 112th Congress</p>	<p>HR 4375</p>	<p>Johnson</p>	<p>4/17/2012</p>	<p>Referred to the Ways & Means Committee</p>
	<p>S 2291</p>	<p>Cornyn</p>	<p>4/17/2012</p>	<p>Referred to the Finance Committee</p>
<p>Penalties and Interest</p>				
<p>Interest Rate and Failure to Pay Penalty</p> <p>National Taxpayer Advocate 2001 Annual Report to Congress 179–182.</p>	<p>Repeal the failure to pay penalty provisions of IRC § 6651 while revising IRC § 6621 to allow for a higher underpayment interest rate.</p>			
	<p>Bill Number</p>	<p>Sponsor</p>	<p>Date</p>	<p>Status</p>
<p>Legislative Activity 108th Congress</p>	<p>HR 1528</p>	<p>Portman</p>	<p>6/20/2003</p>	<p>5/19/2004–Passed/agreed to in the Senate, with an amendment</p>
	<p>HR 1661</p>	<p>Rangel</p>	<p>4/8/2003</p>	<p>Referred to the Ways & Means Committee</p>
<p>Interest Abatement on Erroneous Refunds</p> <p>National Taxpayer Advocate 2001 Annual Report to Congress 183–187.</p>	<p>Amend IRC § 6404(e)(2) to require the Secretary to abate the assessment of all interest on any erroneous refund under IRC § 6602 until the date the demand for repayment is made, unless the taxpayer (or a related party) has in any way caused such an erroneous refund. Further, the Secretary should have discretion not to abate any or all such interest where the Secretary can establish that the taxpayer had notice of the erroneous refund before the date of demand and the taxpayer did not attempt to resolve the issue with the IRS within 30 days of such notice.</p>			
	<p>Bill Number</p>	<p>Sponsor</p>	<p>Date</p>	<p>Status</p>
<p>Legislative Activity 109th Congress</p>	<p>HR 726</p>	<p>Sanchez</p>	<p>2/9/2005</p>	<p>Referred to the Ways & Means Committee</p>
<p>Legislative Activity 108th Congress</p>	<p>HR 1528</p>	<p>Portman</p>	<p>6/20/2003</p>	<p>5/19/2004–Passed/agreed to in the Senate, with an amendment</p>
	<p>HR 1661</p>	<p>Rangel</p>	<p>4/8/2003</p>	<p>Referred to the Ways & Means Committee</p>

First Time Penalty Waiver				
National Taxpayer Advocate 2001 Annual Report to Congress 188–192.	Authorize the IRS to provide penalty relief for first-time filers and taxpayers with excellent compliance histories who make reasonable attempts to comply with the tax rules.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in the House
Federal Tax Deposit (FTD) Avoidance Penalty				
National Taxpayer Advocate 2001 Annual Report to Congress 222.	Reduce the maximum FTD penalty rate from ten to two percent for taxpayers who make deposits on time but not in the manner prescribed in the IRC.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
	HR 3991	Houghton	3/19/2002	Defeated in the House
Family Issues				
Uniform Definition of a Qualifying Child				
National Taxpayer Advocate 2001 Annual Report to Congress 78–100.	Create a uniform definition of “qualifying child” applicable to tax provisions relating to children and family status.			
Legislative Activity 108th Congress	Pub. L. No. 108-311, § 201, 118 Stat. 1169-1175 (2004).			
Means Tested Public Assistance Benefits				
National Taxpayer Advocate 2001 Annual Report to Congress 76–127.	Amend the IRC §§ 152, 2(b) and 7703(b) to provide that means-tested public benefits are excluded from the computation of support in determining whether a taxpayer is entitled to claim the dependency exemption and from the cost of maintenance test for the purpose of head-of-household filing status or “not married” status.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 22	Houghton	1/3/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 5505	Houghton	10/01/2002	Referred to the Ways & Means Committee

Credits for the Elderly or the Permanently Disabled				
National Taxpayer Advocate 2001 Annual Report to Congress 218–219.	Amend IRC § 22 to adjust the income threshold amount for past inflation and provide for future indexing for inflation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 107th Congress	S 2131	Bingaman	4/15/2002	Referred to the Finance Committee
Electronic Filing Issues				
Scanable Returns				
National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96.	Require electronically prepared paper returns to include scanable 2-D code.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S. 2736	Hatch	7/14/14	Referred to the Finance Committee
Safe harbor for <i>de minimis</i> errors returns and payee statements				
National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96.	Safe harbor for <i>de minimis</i> errors on information			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 2736	Hatch	7/14/14	Referred to the Finance Committee
Direct Filing Portal				
National Taxpayer Advocate 2004 Annual Report to Congress 471–477.	Amend IRC § 6011(f) to require the IRS to post fill-in forms on its website and make electronic filing free to all individual taxpayers.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 110th Congress	S 1074	Akaka	3/29/2007	Referred to the Finance Committee
	HR 5801	Lampson	4/15/2008	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–Referred to the Finance Committee; Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Free Electronic Filing For All Taxpayers				
National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96	Revise IRC § 6011(f) to provide that the Secretary shall make electronic return preparation and electronic filing available without charge to all individual taxpayers.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	S 2736	Hatch	7/14/14	Referred to the Finance Committee

Office of the Taxpayer Advocate

Confidentiality of Taxpayer Communications

National Taxpayer Advocate 2002 Annual Report to Congress 198–215.

Strengthen the independence of the National Taxpayer Advocate and the Office of the Taxpayer Advocate by amending IRC §§ 7803(c)(3) and 7811. Amend IRC § 7803(c)(4)(A)(iv) to clarify that, notwithstanding any other provision of the IRC, Local Taxpayer Advocates have the discretion to withhold from the IRS the fact that a taxpayer contacted the Taxpayer Advocate Service or any information provided by a taxpayer to TAS.

	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee

Access to Independent Legal Counsel

National Taxpayer Advocate 2002 Annual Report to Congress 198–215.

Amend IRC § 7803(c)(3) to provide for the position of Counsel to the National Taxpayer Advocate, who shall advise the National Taxpayer Advocate on matters pertaining to taxpayer rights, tax administration, and the Office of Taxpayer Advocate, including commenting on rules, regulations, and significant procedures, and the preparation of *amicus* briefs.

	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	Referred to the Senate
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee

Taxpayer Advocate Directive

National Taxpayer Advocate 2012 Annual Report to Congress 573–602;
National Taxpayer Advocate 2002 Annual Report to Congress 419–422.

Amended IRC § 7811 to provide the National Taxpayer Advocate with the non-delegable authority to issue a Taxpayer Advocate Directive to the Internal Revenue Service with respect to any program, proposed program, action, or failure to act that may create a significant hardship for a taxpayer segment or taxpayers at large.

	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee

Other Issues

Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact

National Taxpayer Advocate 2008 Annual Report to Congress 419–422.

Modify IRC § 6707A to ameliorate unconscionable impact. Section 6707A of the IRC imposes a penalty of \$100,000 per individual per year and \$200,000 per entity per year for failure to make special disclosures of a “listed transaction.”

Legislative Activity 111th Congress	Pub. L. No. 111-124, § 2041 Stat. 2560 (2010).			
	Bill Number	Sponsor	Date	Status
	S 2771	Baucus	11/16/2009	Referred to the Finance Committee
	HR 4068	Lewis	11/16/2009	Referred to the Ways & Means Committee
	S 2917	Baucus	12/18/2009	Referred to the Finance Committee

Eliminate Tax Strategy Patents				
National Taxpayer Advocate 2007 Annual Report to Congress 512–524.	Bar tax strategy patents, which increase compliance costs and undermine respect for congressionally-created incentives, or require the PTO to send any tax strategy patent applications to the IRS so that abuse can be mitigated.			
Legislative Activity 112th Congress	Pub. L. No. 112-29 § 14(a), 125 Stat. 284, 327 (2011).			
Disclosure Regarding Suicide Threats				
National Taxpayer Advocate 2001 Annual Report to Congress 227.	Amend IRC § 6103(i)(3)(B) to allow the IRS to contact and provide necessary return information to specified local law enforcement agencies and local suicide prevention authorities, in addition to federal and state law enforcement agencies in situations involving danger of death or physical injury.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in HR 1528 through an amendment and HR 1528 passed in lieu of S 882
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
Attorney Fees				
National Taxpayer Advocate 2002 Annual Report to Congress 161–171.	Allow successful plaintiffs in nonphysical personal injury cases who must include legal fees in gross income to deduct the fees “above the line.” Thus, the net tax effect would not vary depending on the state in which a plaintiff resides.			
Legislative Activity 108th Congress	Pub. L. No. 108-357, § 703, 118 Stat. 1418, 1546-48 (2004).			
Attainment of Age Definition				
National Taxpayer Advocate 2003 Annual Report to Congress 308–311.	Amend IRC § 7701 by adding a new subsection as follows: “Attainment of Age. An individual attains the next age on the anniversary of his date of birth.”			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 4841	Burns	7/15/2004	7/21/2004–Passed the House; 7/22/2004–Received in the Senate
Home-Based Service Workers (HBSW)				
National Taxpayer Advocate 2001 Annual Report to Congress 193–201.	Amend IRC § 3121(d) to clarify that HBSWs are employees rather than independent contractors.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
Legislative Activity 107th Congress	S 2129	Bingaman	4/15/2002	Referred to the Finance Committee
Restrict Access to the Death Master File				
National Taxpayer Advocate 2011 Annual Report to Congress 519–523.	Restrict access to certain personally identifiable information in the DMF. The National Taxpayer Advocate is not recommending a specific approach at this time, but outlines below several available options.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	H.J. Res. 59, 113th Cong. § 203 (2013).			
Legislative Activity 112th Congress	S 3432	Nelson	7/25/2012	Referred to the Finance Committee
	HR 6205	Nugent	7/26/2012	Referred to S 835 the Ways & Means Committee

<p>Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes</p> <p>National Taxpayer Advocate 2012 Annual Report to Congress 521.</p>	<p>Amend IRC § 7871(a) to include the adoption credit (IRC § 23) in the list of Code sections for which a Native American tribal government is treated as a “State”.</p>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 835	Johnson	7/09/2014	Referred to the Finance Committee
	HR 1738	Kilmer	6/12/2013	Referred to the Ways and Means Committee

LR
#1**Codify the Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections****PROBLEM**

Taxpayer rights are central to voluntary compliance. If taxpayers believe they are being treated, or can be treated, in an arbitrary and capricious manner, they will mistrust the system and be less likely to comply of their own volition. By contrast, taxpayers will be more likely to comply if they have confidence in the fairness and integrity of the tax system.¹

The Internal Revenue Code (Code or IRC) provides dozens of real and substantive rights that protect taxpayers from unfair and unjust treatment and provide opportunities to challenge arbitrary and capricious government actions. However, taxpayers may not avail themselves of their rights because they are unaware of them. A 2012 survey found less than half of all U.S. taxpayers believe they have rights before the IRS, and only 11 percent said they knew what those rights are.² Taxpayers have no simple way to identify or locate rights in the Code because they are scattered throughout its various sections. It is even more difficult for taxpayers to find “off-code” provisions in different pieces of legislation. Although Congress has passed multiple pieces of legislation with the title of “Taxpayer Bill of Rights,” none of these laws provide a foundational, general description of taxpayer rights.³

In response to these concerns raised by the National Taxpayer Advocate, on June 10, 2014, the IRS formally adopted the Taxpayer Bill of Rights (TBOR).⁴ While this was a significant achievement for increasing taxpayers’ awareness of their rights, and an important first step toward integrating taxpayer rights into all aspects of tax administration, more can be done to cement these fundamental concepts as a permanent part of our tax system.⁵ Specifically, placing a list of the ten core taxpayer rights and five taxpayer responsibilities in the Code would reassure taxpayers that these rights are a fundamental part of our tax system. Furthermore, it would reinforce the unwritten social contract between taxpayers and the IRS by laying out in clear language what is expected of taxpayers and what rights they can expect the IRS to honor.

Although codifying the TBOR would improve awareness of taxpayer rights, the TBOR itself is only as effective as the specific statutory rights that give it effect. When these underlying rights and protections are ignored, weakened, or diluted, the effectiveness of the TBOR is also diminished. There are multiple

- 1 TAS research has shown that trust in government and fairness appear to have significant influence on the compliance behavior of self-employed taxpayers. National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 33-56 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*).
- 2 Forrester Research Inc., *The TAS Omnibus Analysis*, from North American Technographics Omnibus Mail Survey, Q2/Q3 2012 20 (Sept. 2012).
- 3 See Technical and Miscellaneous Revenue Act, Pub. L. No. 100-647, § 6226, 102 Stat. 3342, 3730 (1988) (containing the “Omnibus Taxpayer Bill of Rights,” also known as TBOR 1); Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996) (also known as TBOR 2); Internal Revenue Service Restructuring and Reform Act, Pub. L. No. 105-206, 112 Stat. 685 (1998) (Title III is known as “Taxpayer Bill of Rights III” or TBOR 3). These laws create specific rights in certain instances, but they do not create a thematic, principled-based list of overarching taxpayer rights.
- 4 See *IRS Adopts “Taxpayer Bill of Rights;” 10 Provisions to be Highlighted on IRS.gov*, in *Publication 1*, IR-2014-72, (June 10, 2014). See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights#informed>.
- 5 The National Taxpayer Advocate has recommended that Congress codify the Taxpayer Bill of Rights several times, beginning in her 2007 Annual Report to Congress. See National Taxpayer Advocate 2007 Annual Report to Congress 478-98 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis “Apology” Payment*).

reasons this occurs. Some specific rights contain gaps in coverage and fail to protect taxpayers in all appropriate situations. Rights also become diluted over time when they are not updated to take into account the current environment or fine-tuned to reflect changes in tax administration. Another reason certain rights become ineffective is the lack of an enforceable remedy for a violation of the right. In some cases, specific taxpayer protections are not effective because they are based on administrative practice instead of a statutory direction, and thus are subject to change. Finally, a major reason specific rights are impaired is the IRS fails to properly implement and protect them. This Annual Report to Congress has focused in depth on some of the specific rights provided to taxpayers by the IRS Restructuring and Reform Act of 1998 (RRA 98) and how the IRS is not adequately applying some of the protections that Congress established. For all of the reasons discussed above, the tax system is long overdue for an overhaul to fine-tune existing rights and provide new taxpayer protections.

Since RRA 98 was passed over 16 years ago, there has been no major taxpayer protection legislation passed by both houses of Congress. Although there have been a number of significant taxpayer protection bills introduced,⁶ none of them have received full Congressional approval. The National Taxpayer Advocate believes the time is right for taxpayer rights legislation. The passage of time has shown where new protections and remedies are needed. Without providing these specific taxpayer protections, the TBOR becomes merely a statement of principles, without any teeth to ensure that these fundamental rights are protected on a daily basis, and that taxpayers have remedies and the IRS is held accountable for any violations of these rights.

Beyond codifying the TBOR and providing specific taxpayer protections, there are two essential elements necessary for effective protection of taxpayer rights: funding and oversight. The IRS will be severely hampered in its ability to implement new policies, procedures, and systems for protecting taxpayer rights if it does not receive adequate funding. If there is agreement that taxpayers have certain basic rights, then this places on Congress and the Executive Branch the responsibility to fund the IRS so it can deliver these rights. In addition, this report illustrates what can happen in the years following significant taxpayer protection legislation if there is not regular monitoring—the rights erode over time. RRA 98 required Congress to hold annual joint hearings to review among other things the IRS's progress in meeting its objectives and improving taxpayer service and compliance.⁷ Each hearing was conducted jointly by majority and minority members of the House Committees on Ways and Means, Appropriations, and Government Reform and Oversight and the Senate Committees on Finance, Appropriations, and Governmental Affairs. In order to achieve lasting change, new taxpayer rights legislation should include a similar requirement for periodic hearings without the limitation of five years.

6 Broad taxpayer protection legislation has been introduced in both houses, but has failed to pass either house. See e.g., S. 3355, 112th Cong. (2012) (introduced by Senator Bingaman); H.R. 6050, 112th Cong. (2012) (introduced by Rep. Becerra).

7 Pub. L. No. 105-206, § 4001, 112 Stat. 685, 783 (1998). Note that the statute refers to a “joint review [to] be held at the call of the Chairman of the Joint Committee.” The legislative history, however, makes clear that there was to be “one annual joint hearing” before June 1 of each of the succeeding 5 calendar years. H.R. REP. NO. 105-599, at 328 (1998) (Conf. Rep.).

RECOMMENDATION

To promote taxpayers' awareness of their rights and increase confidence in the fairness of the tax system, the National Taxpayer Advocate recommends that Congress:

- Codify the Taxpayer Bill of Rights that sets forth the fundamental rights and obligations of U.S. taxpayers as detailed below.
- Enact past legislative recommendations as well as those from this year's Annual Report that relate to each of the core taxpayer rights.
- Provide an appropriate level of funding for the IRS so it can properly undertake, implement, and train its employees about the taxpayer right provisions.
- Require annual joint oversight hearings to help identify and address problem areas, with specific focus on how the IRS is meeting the needs of particular taxpayer segments, including individuals, small businesses, and exempt organizations and how it is protecting taxpayer rights.

SPECIFIC LEGISLATIVE RECOMMENDATIONS FOR PROTECTING TAXPAYER RIGHTS

Over the last year, the National Taxpayer Advocate and her staff have developed a “cross-walk” listing of existing statutory taxpayer rights that maps them to the specific rights comprising the Taxpayer Bill of Rights.⁸ As part of this process, we were able to identify gaps in taxpayer protections. While some rights, such as the *right to appeal an IRS decision in an independent forum*, have a significant number of enforceable protections, others, such as the *right to quality service*, have few.

Starting with her first Annual Report to Congress in 2001, the National Taxpayer Advocate has made legislative recommendations to Congress each year that would further the protection of taxpayer rights. Many of these recommendations have been introduced in bills by the House of Representatives or the Senate, with some being signed into law. These recommendations are necessary to strengthen existing rights as well as to create new ones. The new recommendations in this year's report focus specifically on identifying situations where the current statutory rights fall short, and need to be updated or expanded to provide rights and remedies in certain situations. Enactment of these recommendations will provide taxpayers with remedies for violations of their rights, thereby improving voluntary compliance.

Ten Taxpayer Rights⁹

1. The Right to Be Informed

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

- *Amend IRC § 7701 to Provide a Definition of “Last Known Address,” and Require the IRS to Mail Duplicate Notices to Credible Alternative Addresses.*¹⁰ Amend IRC § 7701 to add a definition

⁸ See Taxpayer Advocate Service, *What the Taxpayer Bill of Rights Means for You*, <http://taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights/What-the-Taxpayer-Bill-of-Rights-Means-for-You> (last visited Dec. 22, 2014).

⁹ These rights and their descriptions were negotiated between the National Taxpayer Advocate and other divisions of the IRS and use the official language adopted by the IRS and incorporated into Publication 1, *Your Rights as a Taxpayer* (June 2014). See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

¹⁰ See National Taxpayer Advocate 2012 Annual Report to Congress 525-35. See also National Taxpayer Advocate 2008 Annual Report to Congress 449-51 (Legislative Recommendation: *Mailing Duplicate Notices to Credible Alternate Addresses*).

of “last known address” that incorporates case law, including the Fifth Circuit’s holdings in the *Mulder*¹¹ and *Terrell*¹² cases, and current regulations. Direct the Secretary of Treasury to: (1) develop procedures for checking third-party databases for credible alternate addresses prior to sending notices that establish legal rights and obligations (*i.e.*, Statutory Notices of Deficiency, Collection Due Process notices, notices of federal tax lien, etc.); and (2) when the IRS learns that its records do not contain a taxpayer’s correct address, and the taxpayer has a credible alternate address, require the IRS to mail the notice simultaneously to the last known and credible alternate addresses (as defined by the Secretary).

- *ANNUAL NOTICES: Require the IRS to Provide More Detailed Information on Certain Annual Notices it Sends to Taxpayers.*¹³
 - Amend IRC § 6159 to require the IRS to provide on annual installment agreement statements sent to taxpayers, within one year of the enactment date, a detailed breakdown of information showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalties, and interest.
 - Amend IRC § 7524 to require the IRS to provide on annual reminder notices sent to taxpayers with delinquent accounts, within one year of the enactment date, a detailed breakdown of information showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalty, and interest.
- *IRS CORRESPONDENCE: Codify § 3705(a)(1) of RRA 98, Define “Manually Generated,” and Require Contact Information on Certain Notices in All Cases.*¹⁴
 - Codify RRA 98 § 3705(a)(1).
 - Define the term “manually generated correspondence” as correspondence issued as a result of an IRS employee exercising his or her judgment in working or resolving a specific taxpayer case or correspondence, or where the employee is asking the taxpayer to provide additional case-related information.
 - Require the IRS to provide the name, telephone number, and unique identification number of an IRS manager on notices with legal impact, such as those that start the running of a statute of limitations or trigger appeal rights (such as the Statutory Notice of Deficiency), where such notices have been automatically generated without employee review.

11 *Mulder v. Comm’r*, 855 F.2d 208 (5th Cir. 1988).

12 *Terrell v. Comm’r*, 625 F.3d 254 (5th Cir. 2010).

13 See Legislative Recommendation: *ANNUAL NOTICES: Require the IRS to Provide More Detailed Information on Certain Annual Notices it Sends to Taxpayers*, *infra*. This recommendation also relates to the *right to pay no more than the correct amount of tax*.

14 See Legislative Recommendation: *IRS CORRESPONDENCE: Codify § 3705(a)(1) of RRA 98, Define “Manually Generated,” and Require Contact Information on Certain Notices in All Cases*, *infra*. This recommendation also relates to the *right to quality service and the right to a fair and just tax system*.

- *ACCESS TO THE IRS: Require the IRS to Publish a Public Phone Directory and Report on Implementing an Operator System Similar to “311” Lines.*¹⁵ Require the IRS, within 180 days, to:
 - Publish, on IRS.gov, its current Practitioner Directory or a similar directory that provides the same detailed information regarding the names and contact information for managers of local IRS groups or territories for different functions of the IRS, as well as managers of service and compliance functions located in IRS campuses. Require the IRS to provide an electronic or paper copy of the directory for a particular state or geographic area, if requested by a taxpayer.
 - Develop a report detailing the administrative steps necessary to implement an operator system for its main toll-free phone line, similar to a 311 telephone line. Under such a system, all taxpayers would call a single nationwide toll-free phone number and answer a limited number of questions through an interactive voice response system before being transferred to an operator. If the taxpayer were requesting a specific piece of information such as an account balance or transcript, the operator would provide the information to the taxpayer. For calls regarding other IRS functions and offices, the operator would transfer the taxpayer to the specific office handling the taxpayer’s individual issue or case. Such report should be provided to the Senate Committee on Finance and the House Committee on Ways and Means.

- *Worker Classification.*¹⁶
 - Direct the Department of Treasury and the IRS to publish guidance on classification for both income and employment taxes.
 - Direct the IRS to develop a program similar to the Employment Status Indicator of the United Kingdom.
 - Repeal § 530 of the Revenue Act of 1978¹⁷ and replace it with an IRC provision to eliminate unnecessary confusion and clearly state that it applies to both income taxes and employment taxes. Require the IRS to consult with affected industries. Lift ban on guidance and require the Secretary to issue associated guidance, including guidance with specific industry focus.
 - Amend IRC § 7436 to permit workers to petition the U.S. Tax Court to review the IRS’s classification determinations.
 - Require service recipients engaged in a trade or business to issue Forms 1099-MISC to S corporations (as defined in IRC 1361(a)(1)) and increase the penalties for failure to comply with the information reporting requirements of IRC 6041A.¹⁸

15 See Legislative Recommendation: *ACCESS TO THE IRS: Require the IRS to Publish a Public Phone Directory and Report on Implementing an Operator System Similar to “311” Lines*, *infra*. This recommendation also relates to the *right to quality service*.

16 See National Taxpayer Advocate 2008 Annual Report to Congress 375-90. Two parts of this recommendation, regarding voluntary income tax withholding agreements and backup withholding for noncompliant Schedule C filers are omitted here because similar recommendations are made below. See National Taxpayer Advocate 2005 Annual Report to Congress 381-96 (Legislative Recommendation: *Measures to Reduce Noncompliance in the Cash Economy*). This recommendation also relates to the *right to quality service*. S. 1796, 111th Cong. (2009) (introduced by Senator Baucus) and S. 1289, 112th Cong. (2011) (introduced by Senator Carper) included parts of this recommendation.

17 Pub. L. 95-600, 92 Stat. 2763, 2885-86.

18 The original recommendation, which applied to incorporated service providers, has been amended here to only apply to S corporations.

- Direct Treasury and the Joint Committee on Taxation to report on the operation of the revised worker classification rules and provide recommendations to increase compliance.
- Require the IRS and the Department of Labor to conduct targeted public awareness campaigns to inform workers of the comparative rights afforded to employees and independent contractors, the tax consequences associated with each classification, and the opportunity to enter into voluntary income tax withholding agreements.

2. The Right to Quality Service

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

- *Direct the Treasury Department to Develop a Plan to Reverse the “Pay Refunds First, Verify Eligibly Later” Approach to Tax Return Processing.*¹⁹ Direct the Treasury Department to prepare a report identifying the administrative and legislative steps required to allow the IRS to receive and process information reporting documents before it processes tax returns. The Treasury Department should be given a full year to prepare its report in light of the complexity of the issue and the actions that would be required of the IRS, the Social Security Administration, private employers, and financial institutions. The goal should be to fully implement required changes within five years from the time the report is completed.
- *Tuition Reporting: Allow TIN Matching by Colleges.*²⁰ Allow colleges and universities to verify Taxpayer Identification Numbers with the IRS prior to filing annual information returns on tuition payments.
- *Free Electronic Filing for All Individual Taxpayers.*²¹ Revise IRC § 6011(f) to provide that the Secretary shall make electronic return preparation and electronic filing available without charge to all individual taxpayers. Alternatively, Congress could direct the Secretary to conduct a study, in conjunction with the Office of the Taxpayer Advocate, to evaluate the feasibility of providing taxpayers with both a template for use in preparing their returns and a direct filing portal for use in filing returns. The portal would also enable taxpayers to access a government-controlled database from which taxpayers could import third-party information reports, such as W-2s and 1099s, for use in preparing their returns.²² The study should result in a report describing options considered and conclusions reached, and should be submitted to the House Ways and Means and Senate Finance committees within two years.

19 See National Taxpayer Advocate 2009 Annual Report to Congress 338-45.

20 See National Taxpayer Advocate 2013 Annual Report to Congress 319-23.

21 See National Taxpayer Advocate 2004 Annual Report to Congress 471-77. S. 2861, 110th Cong. (2008) (introduced by Senator Schumer) included parts of this recommendation. There have been numerous bills introduced regarding the recommendation of a direct filing portal, including: S. 1289, 112th Cong. (2011) (introduced by Senator Carper); H.R. 5801, 110th Cong. (2008) (introduced by Rep. Lampson); S. 1074, 110th Cong. (2007) (introduced by Senator Akaka); and S. 1321, 109th Cong. (2005) (introduced by Senator Santorum).

22 See National Taxpayer Advocate 2012 Annual Report to Congress 232-50.

- *Grant Program for Free Tax Preparation for Low Income Taxpayers.*²³ Create an IRS administered grant program for free tax preparation for low income taxpayers. Specifically, grants would be made for demonstration projects as seed money to attract other grants, much like the awards being made under the Violence Against Women Act and welfare to work legislation. The grant would be issued to an organization that is serving as the lead for a coalition of groups, including banks, city or state economic development agencies or health and human services offices, welfare groups, and other social service organizations. The programs would target a significant number of taxpayers (either in a concentrated urban area or more dispersed throughout a larger geographic area).
- *RETURN PREPARATION: Require the IRS to Provide Return Preparation to Taxpayers in Taxpayer Assistance Centers and Via Virtual Service Delivery.*²⁴ Require the IRS to provide return preparation for vulnerable populations (including low income, disabled, and elderly taxpayers) in Taxpayer Assistance Centers (TACs) and via virtual service delivery. Provide sufficient funding for IRS personnel to offer return preparation in TACs.
- *Refund Delivery Options.*²⁵ Require the Department of Treasury and the IRS to:
 1. Evaluate the entire refund process to determine opportunities to shorten the turnaround time;
 2. Develop a pilot program to determine how the inclusion of a Revenue Protection Indicator in the acknowledgement file will impact tax administration. Evaluate the feasibility of including such information in the current “Where’s My Refund” online application;
 3. Evaluate existing stored value card programs to distribute government benefits, with particular emphasis on the experience of the Financial Management Service’s Direct Express Program to distribute Social Security benefits;
 4. Incorporating lessons learned from existing programs, develop a stored value card program to distribute refunds to individual taxpayers before the filing season following the next filing season; and
 5. Conduct an annual public awareness campaign to provide accurate information to taxpayers regarding available refund delivery alternatives, associated turnaround times, and any other pertinent information.
- *VIRTUAL SERVICE DELIVERY (VSD): Establish Targets and Deadlines for the Development and Implementation of VSD in Brick & Mortar Locations, in Mobile Tax Assistance Units, and Over*

23 See National Taxpayer Advocate 2002 Annual Report to Congress vii-viii. This recommendation was made in the introduction of the 2002 report, and was not included in the list of formal legislative recommendations. However, there have been numerous bills introduced in both the House of Representatives and the Senate supporting this recommendation, and two laws have been passed relating to this recommendation. See Consolidated Appropriations Act, 2008, Pub. L. No. 110-161, Div. D, Title 1, 121 Stat. 1844, 1975-76 (2007); Consolidated Appropriations Act, 2010, Pub. L. No. 111-117, Div. C, Title 1, 123 Stat. 3034, 3163 (2009).

24 See Legislative Recommendation: *RETURN PREPARATION: Require the IRS to Provide Return Preparation to Taxpayers in Taxpayer Assistance Centers and Via Virtual Service Delivery*, *infra*.

25 See National Taxpayer Advocate 2008 Annual Report to Congress 427-41. S. 3355, 112th Cong. (2012) (introduced by Senator Bingaman); H.R. 6050, 112th Cong. (2012) (introduced by Rep. Becerra); S. 3215, 111th Cong. (2010) (introduced by Senator Bingaman); H.R. 5047, 111th Cong. (2010) (introduced by Rep. Becerra); H.R. 4994, 111th Cong. (2010) (introduced by Rep. Lewis), included parts of this recommendation.

*the Internet.*²⁶ Establish targets and timelines for development and implementation of VSD in brick and mortar locations, including non-IRS facilities, in mobile tax assistance units, and via taxpayer digital communications over the Internet. Provide funding, or require the IRS to allocate funding, sufficient to enable continued implementation of VSD initiatives in brick and mortar locations, in mobile tax assistance units, and over the Internet.

- *Develop a Form 1023-EZ and Reduce Costs to Taxpayers and the IRS by Implementing “Cyber Assistant.”*²⁷ Require the IRS to develop a Form 1023-EZ;²⁸ and require and provide sufficient funding for the IRS to implement Cyber Assistant for use in preparing applications for recognition of exempt status.
- *Require the IRS to Establish a Voluntary Compliance Program for Exempt Organizations.*²⁹ Require the IRS to create a broad-based, formal, and ongoing voluntary compliance program for exempt organizations similar to those offered in the areas of employee plans, tax-exempt bonds, and Indian tribal governments within 270 days.

3. The Right to Pay No More than the Correct Amount of Tax

Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties, and to have the IRS apply all tax payments properly.

- *Another Marriage Penalty – Taxing the Wrong Spouse.*³⁰
 1. Eliminate joint and several liability for joint filers. Require married taxpayers to file a split-column tax return, which identifies separate items of income, deduction, credit, and payment, similar to the combined return adopted by a number of states.³¹
 2. Repeal the rule of *Poe v. Seaborn*³² that each spouse is taxed on one-half of any community income. Apply the federal rules for allocating a nonresident alien’s community income to all couples, with slight modification.
 3. Require the IRS to exhaust efforts to collect against assets under the liable spouse’s control before collecting against assets under the nonliable spouse’s control, unless such efforts would be futile.

26 See Legislative Recommendation: *VIRTUAL SERVICE DELIVERY (VSD): Establish Targets and Deadlines for the Development and Implementation of VSD in Brick & Mortar Locations, in Mobile Tax Assistance Units, and Over the Internet, infra.*

27 See National Taxpayer Advocate 2011 Annual Report to Congress 562-65. Part of this recommendation, requiring the IRS to allow administrative review of its conclusion that an organization’s exempt status was automatically revoked, is omitted here because it is included in a recommendation below. See Legislative Recommendation: *EO JUDICIAL AND ADMINISTRATIVE REVIEW: Allow IRC § 501(C)(4), (C)(5), or (C)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status, infra.*

28 On July 1, 2014, the IRS released a revised Form 1023-EZ. See IRM 21.3.8.11.8, *Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code* (Nov. 18, 2014). The new form does not require organizations to furnish any documents in support of their claim that they are tax exempt, or to even provide a narrative description of their proposed activities. They merely attest that they meet the requirements for tax exemption. Legislative direction is needed to clarify the nature and amount of information organizations should be required to provide in order for the IRS to make a determination about their tax exempt status.

29 See National Taxpayer Advocate 2007 Annual Report to Congress 537.

30 See National Taxpayer Advocate 2005 Annual Report to Congress 407-32. The National Taxpayer Advocate proposed a different version of this recommendation in 2001. See National Taxpayer Advocate 2001 Annual Report to Congress 129-45 (Legislative Recommendation: *Separate Liability Election*). This recommendation also relates to the *right to a fair and just tax system*.

31 If Congress were to enact this provision, many of the other recommendations regarding relief from joint and several liability would be moot.

32 282 U.S. 101 (1930).

- *Allow Taxpayers to Raise Innocent Spouse Relief as a Defense in Collection Action.*³³ Amend IRC §§ 6015 and 66 to specify that taxpayers may raise innocent spouse relief as a defense in a proceeding brought under any provision of title 26 (including §§ 6213, 6320, 6330, 7402, and 7403) or any case under title 11 of the United States Code.
- *Credits and Refunds.*³⁴ Amend IRC § 6015(g)(3) so that, when relief is granted in full or in part under IRC § 6015(c), payments made after the date of filing an innocent spouse claim can be refunded.
- *Amend IRC § 6511 to Allow Refund Claims Past the Return Statute Expiration Date (RSED) When Excess Collection is Due to IRS Error.*³⁵ Require the IRS to send out annual statements to taxpayers under continuous levy showing payments received, penalties assessed, and interest charged, along with a detailed breakout of the application of such payments to tax, penalties, and interest for all relevant tax years.³⁶ This annual statement is necessary since taxpayers who discover errors have a limited window of time to request refunds of overpayments. Alternatively, the National Taxpayer Advocate recommends that IRC § 6511 be amended to allow taxpayers two years from the date they learn of the excess collection to make refund claims if the excess collection is due to IRS negligence. This legislative recommendation would provide relief to taxpayers where the excess collection is due to IRS negligence.
- *Adjustment of Estimated Tax Penalty in Accordance with Amended Returns.*³⁷ Amend IRC § 6654 to clarify that, for purposes of the estimated tax penalty, the return for the taxable year is the original return or any subsequently filed amended return.

4. The Right to Challenge the IRS's Position and Be Heard

Taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions, to expect that the IRS will consider their timely objections and documentation promptly and fairly, and to receive a response if the IRS does not agree with their position.

- *Mandate that the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights.*³⁸ Require the IRS to develop math error notices that clearly describe what is being changed and why, and tell the taxpayer what

33 See National Taxpayer Advocate 2010 Annual Report to Congress 377-82. This recommendation also relates to the *right to challenge the IRS's position and to be heard* and the *right to appeal*. This recommendation also included a provision to amend §§ 6015 and 66 to specify that taxpayers may request equitable relief at any time before the expiration of the period of limitations on collection. This provision was omitted here because the IRS has adopted this recommendation in Rev. Proc. 2013-34. See also National Taxpayer Advocate 2009 Annual Report to Congress 378-80 (Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6105 and 66 as a Defense in Collection Actions*).

34 See National Taxpayer Advocate 2001 Annual Report to Congress 155-58. This recommendation also included a provision to modify IRC § 6015(g) to provide guidance to the Secretary for developing a broader interpretation of the issuance of refunds under IRC § 6015(f). This provision was omitted here because of changes made by Rev. Proc. 2013-34.

35 See National Taxpayer Advocate 2006 Annual Report to Congress 547-48.

36 See Legislative Recommendation: *ANNUAL NOTICES: Require the IRS to Provide More Detailed Information on Certain Annual Notices it Sends to Taxpayers, infra*.

37 See National Taxpayer Advocate 2001 Annual Report to Congress 220. S. 213, 107th Cong. (2002) (introduced by Senator Shaw) included parts of this recommendation.

38 See National Taxpayer Advocate 2011 Annual Report to Congress 524-30. See also National Taxpayer Advocate 2002 Annual Report to Congress 185-97 (Legislative Recommendation: *Math Error Authority*) (recommending amending IRC § 6213(g)(2) to limit the definition of mathematical and clerical error and repealing IRC § 6213(g)(2)(M), which authorizes the IRS to use math error summary assessment procedures for an entry on the return with respect to a qualifying child for the Earned Income Tax Credit, where the taxpayer has been identified as the non-custodial parent of that child by the Federal Case Registry of Child Support Orders established under § 453(h) of the Social Security Act).

steps he or she should take to contest the change. The National Taxpayer Advocate further recommends that Congress consider the following issues in connection with any future expansions of math error authority under IRC § 6213(g):

1. Confine use of math error authority to instances that are not factually complex, can be verified on accurate, reliable government databases, and do not require the IRS to analyze facts and circumstances or weigh the adequacy of information.
2. Permit the IRS to use math error authority in conjunction with private third-party databases only where the information has been identified as reliable and accurate, and thus, would not subject the IRS to constraints in litigation.
3. Restrict math error authority in situations with a high abatement rate, where the use of math error authority appears to be unduly burdening compliant taxpayers by requiring them to submit additional documentation within a 60-day timeframe compared to a 90-day timeframe when deficiency procedures are used.

To ensure that future grants of math error authority observe these limits, the National Taxpayer Advocate recommends that Congress require the Department of Treasury, in conjunction with the National Taxpayer Advocate, to evaluate and report to Congress on whether any proposed expansions satisfy these criteria. The report should analyze the burdens and benefits of the proposed use of math error authority, considering downstream costs such as those for audit reconsideration and Taxpayer Advocate Service intervention, and rigorously analyze the proposed expansions for accuracy and suitability.

- *Crediting an Overpayment Against an Unassessed, Outstanding Tax Liability.*³⁹ Amend IRC § 6402 to change the term “liability” to “assessed liability,” thereby permitting the IRS to credit any overpayment only against an *assessed* tax liability.

5. The Right to Appeal an IRS Decision in an Independent Forum

Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals’ decision. Taxpayers generally have the right to take their cases to court.

- *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State.*⁴⁰
 1. Require that Appeals have at least one Appeals Officer and Settlement Officer located and regularly available within every state, the District of Columbia, and Puerto Rico, and allow taxpayers access to telephonic, correspondence, or face-to-face hearings with the local office when requested.
 2. Provide that each Appeals office maintain separate office space, separate phone, facsimile, and other electronic communication access, and a separate post office address from any IRS office co-located with the Appeals office.

³⁹ See National Taxpayer Advocate 2008 Annual Report to Congress 442-45.

⁴⁰ See National Taxpayer Advocate 2009 Annual Report to Congress 346-50. This recommendation also relates to the *right to challenge the IRS’s position and be heard* and the *right to a fair and just tax system*. H.R. 4375, 112th Cong. (2012) (introduced by Rep. Johnson) and S. 2291, 112th Cong. (2012) (introduced by Senator Cornyn) included parts of this recommendation. See also Legislative Recommendation: ACCESS TO APPEALS: Require that Appeals Have at Least One Appeals Officer and Settlement Officer Located and Permanently Available Within Every State, the District of Columbia, and Puerto Rico, *infra*.

- *EO JUDICIAL AND ADMINISTRATIVE REVIEW: Amend IRC § 7428 to Allow IRC § 501(c)(4), (c)(5), or (c)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status.*⁴¹ Amend IRC § 7428 to allow taxpayers seeking exempt status as IRC § 501(c)(4), (c)(5), or (c)(6) organizations to seek a declaratory judgment on the same footing as currently allowed for taxpayers seeking exempt status as IRC § 501(c)(3) organizations. Amend IRC § 6033(j) to require the IRS to adopt administrative review procedures for organizations treated as having had their exempt status automatically revoked.
- *Allocate to the IRS the Burden of Proving It Properly Imposed the Two-Year Ban on Claiming the Earned Income Tax Credit.*⁴² Amend IRC § 32(k) to provide that the IRS has the burden of proof as to whether it is appropriate to impose the two-year ban on claiming Earned Income Tax Credit.
- *Final Determination Rights.*⁴³ Amend IRC § 6015 to allow the IRS to rescind a determination letter issued under IRC § 6015 with the agreement of the taxpayer, as permitted under IRC § 6212(d).⁴⁴ Amend IRC § 6015(e)(1)(A) to require the IRS to provide in the notice of final determination the last date to petition the Tax Court. Also, provide for the taxpayer to be able to petition the Tax Court by the later of the date the Secretary specifies in the notice of final determination or 90 days from the date of the notice. Include in IRC § 6015(e)(1)(A)(ii) language that would allow taxpayers outside the United States 150 days to petition the Tax Court, as is currently provided taxpayers who receive a notice of deficiency.
- *Effect of Automatic Stay Imposed in Bankruptcy Cases Upon Innocent Spouse and CDP Positions in Tax Court.*⁴⁵
 1. Amend IRC §§ 6015, 6320, and 6330 to include language similar to that contained in IRC § 6213(f), which provides that in any case under 11 U.C.S. (a bankruptcy case), the running of the time period prescribed by IRC § 6213(a) (90 day or 150 day period) for filing a petition in the Tax Court regarding a deficiency is suspended for the period of time which the debtor-taxpayer is prohibited by reason of the automatic stay from filing such petition, plus 60 days thereafter. In the alternative, Congress should amend each of those sections to include a cross-reference to IRC § 6213, which would provide that rules similar to the rules of IRC § 6213 shall apply for purposes of determining the time for filing a petition.

41 See Legislative Recommendation: *EO JUDICIAL AND ADMINISTRATIVE REVIEW: Amend IRC § 7428 to Allow IRC § 501(c)(4), (c)(5), or (c)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status*, *infra*. This recommendation also relates to the *right to be informed*.

42 See National Taxpayer Advocate 2013 Annual Report to Congress 311-15.

43 See National Taxpayer Advocate 2001 Annual Report to Congress 159-65. This recommendation also relates to the *right to be informed*. This recommendation also included a provision to amend IRC § 6015(e) to allow the taxpayer the right to petition the U.S. Tax Court in determinations made under IRC § 6015(f) (requests for equitable relief from joint and several liability), which was enacted by Pub. L. 109-432 § 408, 120 Stat. 2922, 3061 (2006).

44 IRC § 6015(c) provides for taxpayers who are no longer married or living together to separate their portion of tax liability for any liability which is assessed with respect to the return. IRC § 6015(g)(3) specifically states that no credit or refund shall be allowed as a result of an election under subsection (c).

45 See National Taxpayer Advocate 2004 Annual Report to Congress 490-492. H.R. 3479, 113th Cong. (2013) (introduced by Rep. Thornberry); S. 725, 113th Cong. (2013) (introduced by Senator Cornyn); H.R. 4375, 112th Cong. (2012) (introduced by Rep. Johnson); and S. 2291, 112th Cong. (2012) (introduced by Senator Cornyn) include parts of the recommendation.

2. As yet another option, the National Taxpayer Advocate recommends that Congress add a new provision to the Code to make clear that the time for filing a Tax Court petition will be tolled whenever a taxpayer is prohibited from filing such petition by reason of the automatic stay, regardless of whether a deficiency is at issue.

■ *Collection Due Process Hearing.*⁴⁶

1. Retain the Collection Due Process procedure as a necessary, essential, and statutory taxpayer right.
2. Amend IRC § 6330(c)(2)(B) to provide that, regardless of whether the taxpayer actually received a statutory notice of deficiency, had an opportunity to dispute such liability, or self-assessed the liability on a tax return, the taxpayer may raise issues relating to the existence or amount of any liability that is eligible for an audit reconsideration or a Doubt as to Liability Offer in Compromise. Amend IRC § 6330(c)(3)(C) to provide that the Office of Appeals shall not issue a Notice of Determination in said case until such reconsideration and administrative appeal of the underlying liability has been concluded and the results taken into consideration in making the determination under that paragraph.
3. Amend the flush language of IRC § 6320(a)(2) to provide that the Secretary shall send the notice required under IRC § 6320(a)(1) not more than five business days after the day the notice of lien is mailed or otherwise submitted for filing. Further, amend IRC § 6320(a)(3)(B) to provide that the taxpayer has 30 days from the date the notice is provided under IRC § 6320(a)(2) to request a hearing.

■ *Restructuring and Reform of Collection Due Process Provisions.*⁴⁷

1. Amend IRC §§ 6330(a)(2) and (a)(3)(C) to require the IRS to issue the CDP levy notice at the time it undertakes its first levy action with respect to a tax. Such notice shall describe the specific levy action (levy source, date levy will occur) and provide a name and contact information for the IRS employee whom the taxpayer can contact in order to otherwise resolve the tax debt.
2. Amend IRC § 6330(a)(2)(C) to clarify that when the IRS mails a Notice of Right to a CDP Hearing prior to a proposed levy, it shall send that CDP notice by certified or registered mail but not with “return receipt requested.”
3. Clarify the role and scope of Tax Court oversight of Appeals’ continuing jurisdiction over the taxpayers’ cases under IRC § 6330(d)(2). The scope of continuing judicial oversight should include review of the IRS’s authority to release levies under IRC § 6343(a) and to return levy proceeds under IRC § 6343(d).
4. Codify the IRS Collection Appeals Program (CAP).
5. Codify the IRS Audit Reconsideration process.

⁴⁶ This recommendation also included a list of administrative recommendations to the IRS, which are not included here. See National Taxpayer Advocate 2004 Annual Report to Congress 451-70. Part of this recommendation, to amend IRC § 6330(d) to restrict judicial review to issues other than the underlying liability, is also not included because it was superseded by a later recommendation that would limit, but not remove entirely, the Tax Court’s authority to review the underlying liability. See National Taxpayer Advocate 2005 Annual Report to Congress 447-63 (Legislative Recommendation: *Restructuring and Reform of Collection Due Process Proceedings*).

⁴⁷ See National Taxpayer Advocate 2005 Annual Report to Congress 447-63. This recommendation also included a provision that would consolidate judicial review of Collection Due Process cases in U.S. Tax Court, which was enacted as part of the Pension Protection Act of 2006, Pub. L. No. 109-280, § 854, 120 Stat. 780, 1019 (2006).

6. Amend IRC § 6330(c)(2)(B) to specifically include “audit reconsideration” as an alternative to be considered *within* the CDP hearing process.
 7. Amend IRC § 6330(d)(1) to provide that where a taxpayer is precluded from raising the underlying liability because he has already received a notice of deficiency or he participated meaningfully in a prior hearing or proceeding, the Tax Court’s authority to review the underlying liability shall be limited to a determination of whether the Appeals Officer abused his discretion in failing or refusing to consider the underlying liability in the CDP hearing.
- *Collection Due Process.*⁴⁸ Amend IRC § 6330(a)(2) and subsection (a)(3)(b) as necessary to provide the taxpayer outside the United States an additional 30-day period to request a hearing in response to a Collection Due Process notice. Additionally, amend IRC § 6330(d) to allow an additional 30-day response period to taxpayers appealing a CDP determination from outside the United States.
 - *Collection Due Process and Uneconomical Levies.*⁴⁹ Amend IRC § 6330(c) to clarify that the Appeals hearing officer, prior to making his determination under IRC § 6330(c)(3), must verify that the IRS conducted the required analysis under IRC § 6331(j), and must also consider that analysis in balancing the government’s interest in efficient tax collection with the taxpayer’s legitimate concern about the intrusiveness of the proposed levy action.
 - *Authorize the IRS Office of Appeals to Rescind Notices of Determination Issued in Collection Due Process Cases.*⁵⁰ Amend IRC § 6330 to permit the IRS Office of Appeals, with the consent of the taxpayer, to rescind Collection Due Process Notices of Determination (NODs) in cases where the taxpayer has raised a legitimate concern regarding the NOD within the 30-day period of petitioning the Tax Court, and before the taxpayer has requested Tax Court review.
 - *Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions.*⁵¹ Amend IRC §§ 6320 and 6330 to extend Collection Due Process rights to “affected third parties,” known as nominees, alter egos, and transferees, who hold legal title to property subject to IRS collection actions.
 - *APPELLATE VENUE IN NON-LIABILITY CDP CASES: Amend IRC § 7482 to Provide That The Proper Venue to Seek Review of a Tax Court Decision in All Collection Due Process Cases Lies With the Federal Court of Appeals for the Circuit in Which the Taxpayer Resides.*⁵² Amend IRC § 7482(b)(1)(A) to provide that proper appellate venue for all CDP cases lies with the circuit court of appeals based on the taxpayer’s legal residency.

48 See National Taxpayer Advocate 2002 Annual Report to Congress 244.

49 See National Taxpayer Advocate 2006 Annual Report to Congress 551-52.

50 See National Taxpayer Advocate 2011 Annual Report to Congress 548-51.

51 See National Taxpayer Advocate 2012 Annual Report to Congress 544-52.

52 See Legislative Recommendation: *APPELLATE VENUE IN NON-LIABILITY CDP CASES: Amend IRC § 7482 to Provide That The Proper Venue to Seek Review of a Tax Court Decision in All Collection Due Process Cases Lies With the Federal Court of Appeals for the Circuit in Which the Taxpayer Resides, infra*. This recommendation also relates to the *right to be informed*.

- *STANDARD OF REVIEW: Amend IRC § 6330(d) to Provide for a De Novo Standard of Review of Whether the Collection Statute Expiration Date Is properly Calculated by the IRS.*⁵³ Amend IRC § 6330(d) to provide for a *de novo* standard of review by the Tax Court of whether the Collection Statute Expiration Date is properly calculated by the IRS pursuant to IRC § 6330(c)(1).

6. The Right to Finality

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

- *Elimination of Lengthy Collection Statutes for Limitations Extension.*⁵⁴ Eliminate the IRS's inventory of lengthy Collection Statute Expiration Date (CSED) extensions by enacting legislation that will terminate all CSED extensions on accounts that were in existence before January 1, 2000 and were granted in connection with installment agreements. This provision should be similar to RRA 98 § 3461(c), which eliminated many lengthy CSED extensions as of December 31, 2002 but which did not apply to CSED extensions granted in connection with installment agreements. To ensure that taxpayers who were granted the IRS CSED extensions prior to the effective date of RRA 98 are subject to the same policies and procedures applicable to taxpayers today, a new sunset provision should be enacted to give the IRS two years to take enforcement action if it is appropriate to do so, after which the collection statute will expire.
- *Provide a Fixed Statute of Limitations for U.S. Virgin Islands Taxpayers.*⁵⁵ Provide that the filing of a non-fraudulent return with the U.S. Virgin Islands (USVI) by a person claiming to be a *bona fide* USVI resident is treated as the filing of a return with the IRS so that the filing starts the statute of limitations under IRC § 6501. This change should apply to tax years after 1986. However, it should only be effective with respect to assessments made 90 or more days after it is enacted to allow the IRS time to wrap up any ongoing examinations. As a correlative matter, require the USVI to automatically provide copies of returns filed with its Bureau of Internal Revenue to the IRS within a reasonable period of time.
- *Enact a Statute of Limitations to Limit the Retroactive Effect of Revocation of an Organization's Exempt Status.*⁵⁶ Enact a statute of limitation for revocation of exempt status, generally for three years, that would run from the filing of the return for the year in question. As under current law, in case of substantial omission of items from the return, the statute would run for six years, but in case of fraud, tax evasion, or non-filing of the return, the statute of limitation would not run. The time-bar would apply not only to the effective date of revocation but also to the introduction of past facts from closed years as a reason for revocation. Statutory certainty regarding the period in issue would help to align revocation with assessment.

53 See Legislative Recommendation: *STANDARD OF REVIEW: Amend IRC § 6330(d) to Provide for a De Novo Standard of Review of Whether the Collection Statute Expiration Date Is properly Calculated by the IRS, infra*. This recommendation also relates to 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, and the right to a fair and just tax system.

54 See National Taxpayer Advocate 2006 Annual Report to Congress 520-56.

55 See National Taxpayer Advocate 2009 Annual Report to Congress 391-99.

56 See National Taxpayer Advocate 2010 Annual Report to Congress 391-95.

7. The Right to Privacy

Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary, and will respect all due process rights, including search and seizure protections and will provide, where applicable, a collection due process hearing.

- *Impose Collection Protections on Refund Offsets for EITC Recipients.*⁵⁷ Amend IRC § 6402 by adding language to limit the amount of the tax refund attributable to the Earned Income Tax Credit (EITC) that the Secretary can offset pursuant to IRC §§ 6402(a) through (e). The provision should prohibit the Secretary from offsetting the refund by more than 15 percent of the portion attributable to the EITC.
- *Waiver of Levy Prohibition Under IRC § 6331(k).*⁵⁸ Amend IRC § 6331 to prohibit the IRS from requiring the taxpayer to waive the IRC § 6331(k) prohibition on levies as a condition precedent to the IRS's consideration or acceptance of installment payments or an Offer in Compromise.
- *Apply Uniform Limits and Extensions to Levy Actions on Social Security Benefits.*⁵⁹
 1. Codify IRS administrative policy of exempting all taxpayers with incomes at or below 250 percent of the poverty level from Federal Payment Levy Program (FPLP) levies under IRC § 6331(h);
 2. Modify "specified payments" under IRC § 6331(h) to exclude amounts exempt under IRC § 6334(a)(9) due to a taxpayer's standard deduction and personal exemptions for all levies on Social Security benefits;
 3. Limit both FPLP and paper levies of Social Security benefits to 15 percent of these payments;
 4. Codify existing IRS administrative practice to require the release of FPLP levies upon expiration of the Collection Statute Expiration Date (CSED); and
 5. Prohibit the IRS's post-CSED collection by paper levy upon a taxpayer's fixed and determinable right to future Social Security benefits unless:
 - a. The taxpayer has exhibited flagrant conduct within three months of the CSED as determined by IRS personnel; and
 - b. The levy is limited to the balance due at the CSED.
- *Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences.*⁶⁰ Amend IRC § 7403 to preclude an IRS employee from requesting that the

⁵⁷ See National Taxpayer Advocate 2009 Annual Report to Congress 365-70.

⁵⁸ See National Taxpayer Advocate 2008 Annual Report to Congress 446-48.

⁵⁹ See National Taxpayer Advocate 2009 Annual Report to Congress 371-77. This recommendation also relates to the *right to finality*. See also National Taxpayer Advocate 2006 Annual Report to Congress 527-30 (Legislative Recommendation: *Levy Actions on Fixed and Determinable Rights*); National Taxpayer Advocate 2005 Annual Report to Congress 466-67 (Legislative Recommendation: *Social Security Levies*) (recommending Social Security payments be exempt altogether from levy).

⁶⁰ See National Taxpayer Advocate 2012 Annual Report to Congress 537-43. This recommendation also relates to the *right to a fair and just tax system*. In 2013, the IRS issued interim guidance that adopted this recommendation. See IRS Interim Guidance Memorandum SBSE-05-0414-0032 (Apr. 18, 2014) (reissuing IRS Interim Guidance Memorandum SBSE-05-0413-035 (Apr. 30, 2013) (Principal Residence Suit Foreclosure Recommendations), available at [http://www.irs.gov/pub/foia/ig/spder/SBSE-05-0414-0032\[1\].pdf](http://www.irs.gov/pub/foia/ig/spder/SBSE-05-0414-0032[1].pdf)). The National Taxpayer Advocate believes this recommendation should be made permanent through codification.

attorney general direct the filing of a civil action to foreclose the federal tax lien against a taxpayer's principal residence in U.S. District Court, unless the IRS employee has received executive-level approval after determining that: (1) the taxpayer's other property or rights to property, if sold, are insufficient to pay the amount due, including the expenses of the proceedings; and (2) the foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer.

8. The Right to Confidentiality

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

■ *Confidentiality/Disclosure and Disclosure of Returns and Return Information.*⁶¹

- Disclosure of returns and return information should be limited to those rare instances in which an agency has demonstrated a compelling need for that information which cannot be reasonably obtained from another source. All such disclosures should be subject to the appropriate safeguards and procedures for maintaining the confidentiality of the tax information in the hands of another agency. The Code should specify limits on the amount and use of disclosed information, and make all violations of those limits subject to civil and criminal sanctions.
- Disclosure provisions should be designed so as to minimize access to such information by contractors. Where contractors must be used by an agency, the disclosures should be limited to a “fact of filing” or “match/mismatch” acknowledgement. If such a narrow disclosure provision is unworkable, then the disclosure of tax information should be limited to the number of nontax administration contractors that the IRS can adequately safeguard.
- Prior to any statutory expansion of disclosure exceptions, Treasury and the IRS should conduct a pilot of the proposed program. The pilot should be conducted for a number of years in order to measure the true impact that the proposed disclosure may have on voluntary tax compliance by the participants.
- Any initial statutory authorization should be subject to a five-year sunset provision. Prior to reauthorization, Treasury and the IRS should prepare a report assessing the impact the provision has had on taxpayer privacy and taxpayer voluntary compliance as well as whether advances in public or private sector technology have reduced the need for taxpayer information.
- Finally, every ten years, the Congress should direct the Secretary of the Treasury to review all disclosure exceptions in IRC § 6103, make recommendations about their continued necessity, including suggesting repeal where technological or private sector advances have minimized the need for the disclosure, and report such findings and recommendations to the Joint Committee on Taxation.

⁶¹ See National Taxpayer Advocate 2003 Annual Report to Congress 232-55.

- *Content-Based Disclosures of Tax Return Information Under IRC § 6103(c).*⁶² Amend IRC § 6103(c) to limit the disclosure of tax returns and tax return information requested through taxpayer consent solely to the extent necessary to achieve the purpose for which consent was requested.
 - Additionally, IRC § 6103(p)(3)(C) should be amended to require the Secretary of the Treasury to include in the Treasury's annual disclosure report to the Joint Committee on Taxation detailed information about the number and types of disclosures pursuant to taxpayer consent. Requiring the IRS to track disclosures made through IRC § 6103(c) consent will enable the IRS to monitor how § 6103(c) consents are being used and whether increased taxpayer education or oversight are necessary to protect taxpayer information.
 - To provide a deterrent to misusing taxpayer return information obtained pursuant to a § 6103(c) consent, IRC §§ 7213A and 7431 should be amended to apply criminal and civil sanctions. Implementing criminal and civil sanctions of up to \$1,000 per violation will dissuade lenders from using tax return information for reasons outside the scope of the taxpayer's consent.
 - To ensure that lenders no longer ask individuals to sign blank or incomplete forms, IRC § 7431 should be amended to impose a civil penalty of \$500 for each attempt to obtain a signed blank or incomplete Forms 4506, 4506-T, and 2858, subject to a reasonable cause exception.
- *Filing Issues: Use and Disclosure of Tax Return Information.*⁶³ Congress should amend IRC §§ 7216 and 6713 to:
 1. Prohibit use or disclosure of tax return information for purposes other than tax preparation and filing of returns. The statutes should specifically prohibit the use or disclosure of information for the business solicitation of nontax-related products or services, including but not limited to those related to tax refund delivery and the protection from IRS audit.
 2. Specifically state the exception currently in Treas. Reg. § 301.7216-2(e), which provides that IRC § 7216(a) does not apply to a tax return preparer who is lawfully engaged in the practice of law or accountancy. This exception allows the individual to use or disclose tax return information to another employee or member of the preparer's law or accounting firm for purposes of rendering other legal or accounting services for the taxpayer.
 3. Clarify the reach of IRC § 7216(a) to include preparers of returns other than income tax returns, volunteers, individuals who perform other businesses in addition to return preparation, and contractors performing services in connection with return preparation.
 4. Specifically state that the regulations issued thereunder must require safe harbor language to include in all written consents. The safe harbor language should address the limitations and duration of the consents as well as provide detailed contact information for the taxpayers to report violations or inquire about their rights.

62 See National Taxpayer Advocate 2007 Annual Report to Congress 554-55. This report also makes an administrative recommendation for the IRS to amend Form 4506 and related forms to allow taxpayers to specify the reasons for which they are granting consent. See *id.* at 123.

63 See National Taxpayer Advocate 2006 Annual Report to Congress 496-502.

5. Prohibit the disclosure or use of information to or by any tax return preparer located outside of the United States, unless the taxpayer has provided written consent.

- *Authorize Treasury to Issue Guidance Specific to IRC § 6713 Regarding the Use and Disclosure of Tax Return Information by Preparers.*⁶⁴ Amend IRC § 6713 to authorize the Secretary to prescribe regulations under IRC § 6713. Specifically, Congress should amend IRC § 6713 as follows:
 1. Amend subsection (b) to read: “(b) Exceptions. — Except as otherwise provided in regulations prescribed by the Secretary under subsection (d), the rules of section 7216(b) apply for purposes of this section.”
 2. Create subsection (d) to read: “(b) Regulations. — The Secretary may prescribe such regulations and other guidance as may be necessary or appropriate to carry out this section.”
- *Protect Taxpayer Privacy in Whistleblower Cases.*⁶⁵ Amend IRC § 7623 or other applicable provisions to require redaction of third-party return information in administrative and judicial proceedings relating to a whistleblower claim, with an opportunity for the taxpayer to request further redactions before disclosure. The taxpayer would have a subsequent right of action for civil damages for unauthorized disclosure by the whistleblower.

9. The Right to Retain Representation

Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic (LITC) if they cannot afford representation.

- *Referral to Low Income Taxpayer Clinics.*⁶⁶ Amend IRC § 7526(c) to add a special rule stating that notwithstanding any other provision of law, IRS employees may refer taxpayers to Low Income Taxpayer Clinics receiving funding under this section. This change will allow IRS employees to refer a taxpayer to a specific clinic for assistance. In making such referrals, the IRS should maintain its current disclaimer language to prevent any misconception that taxpayers may be either advantaged or disadvantaged in their cases based on their decision of whether to use a clinic.
- *Designate that Attorneys’ Fees Awarded Pursuant to IRC § 7430 are Ineligible for Offset to Satisfy a Litigant’s Preexisting Government Debts.*⁶⁷ Amend IRC § 7430 to declare that attorneys’ fees are ineligible for offset to satisfy a litigant’s preexisting federal government debt.

10. The Right to a Fair and Just Tax System

Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers have the right to receive assistance from the Taxpayer Advocate Service if they are

64 See National Taxpayer Advocate 2007 Annual Report to Congress 547-48.

65 See National Taxpayer Advocate 2010 Annual Report to Congress 396-99.

66 See National Taxpayer Advocate 2007 Annual Report to Congress 551-53. H.R. 6050, 112th Cong. (2012) (introduced by Rep. Becerra); S. 3355, 112th Cong. (2012) (introduced by Senator Bingaman); S. 1573, 112th Cong. (2011) (introduced by Senator Durbin); H.R. 5047, 111th Cong. (2010) (introduced by Rep. Becerra); S. 3215, 111th Cong. (2010) (introduced by Senator Bingaman); H.R. 4994, 111th Cong. (2010) (introduced by Rep. Lewis) and H.R. 5719, 110th Cong. (2008) (introduced by Rep. Rangel) included this recommendation.

67 See National Taxpayer Advocate 2010 Annual Report to Congress 406-09.

experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.

Recommendations Related to Complexity

- *Enact Tax Reform Now.*⁶⁸ Reform the tax code, based on six core principles, to eliminate tax law complexity as the most serious problem facing taxpayers. The six core principles are: (1) The tax system should not “entrap” taxpayers; (2) The tax laws should be simple enough so that most taxpayers can prepare their own returns without professional help, simple enough so that taxpayers can compute their tax liabilities on a single form, and simple enough so that IRS telephone assistants can fully and accurately answer taxpayers’ questions; (3) The tax laws should anticipate the largest areas of noncompliance and minimize the opportunities for such noncompliance; (4) The tax laws should provide some choices, but not too many; (5) Where the tax laws provide for refundable credits, they should be designed in a way that the IRS can effectively administer; and (6) The tax system should incorporate a periodic review of the tax code—in short, a sanity check. Comprehensive tax reform should eliminate all tax expenditures, unless the benefits of a particular tax incentive outweigh the complexity created by the special rule. The National Taxpayer Advocate also recommends that Congress direct the IRS to provide each taxpayer with a “taxpayer receipt” presenting a general breakdown of how federal dollars are spent.
- *Attainment of Age Definition.*⁶⁹ Amend IRC § 7701 by adding a new subsection as follows: “Attainment of Age. An individual attains the next age on the anniversary of his date of birth.”
- *Amend IRC § 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to be Considered “Not Married.”*⁷⁰ Amend IRC § 7703(b) to remove the cost of maintaining a household test and permit taxpayers living apart on the last day of the tax year who have a legally binding separation agreement to be considered “not married.”
- *FILING STATUS: Clarify the Definition of “Separate Return” in IRC § 6013 and Allow Taxpayers Who Petition the Tax Court to Change Their Filing Status to Married Filing Jointly in Accordance with the Tax Court’s Rules of Practice and Procedure.*⁷¹ Amend IRC § 6013(b)(1) by clarifying the term “separate returns” means any return that is not a joint return. Amend IRC § 6013(b)(2)(B) to allow taxpayers the right to change their filing status to married filing jointly after filing a Tax Court petition in response to a Statutory Notice of Deficiency, in accordance with rules of practice and procedure of the Tax Court or, in the alternative, eliminate IRC § 6013(b)(2)(B).
- *Community Property Laws.*⁷² Amend IRC § 6321 to disregard state community property tax laws in applying IRC § 66.

68 See *id.* at 365-72. See also National Taxpayer Advocate 2005 Annual Report to Congress 375-80 (Legislative Recommendation: *A Taxpayer-Centric Approach to Tax Reform*). S. 727, 112th Cong. (2011) (introduced by Senator Wyden) included parts of the recommendation relating to the reduction of the number of tax preferences.

69 See National Taxpayer Advocate 2003 Annual Report to Congress 308-11.

70 See National Taxpayer Advocate 2012 Annual Report to Congress 513-20.

71 See Legislative Recommendation: *FILING STATUS: Clarify the Definition of “Separate Return” in IRC § 6013 and Allow Taxpayers Who Petition the Tax Court to Change Their Filing Status to Married Filing Jointly in Accordance with the Tax Court’s Rules of Practice and Procedure*, *infra*. This recommendation also relates to the *right to pay no more than the correct amount of tax*.

72 See National Taxpayer Advocate 2001 Annual Report to Congress 221.

- *“Innocent Spouse” Relief Fixes: Provide the Tax Court with Jurisdiction to Review Community Property Relief Determinations Under IRC § 66(c).*⁷³ Provide the Tax Court with jurisdiction to review the IRS’s community property relief determinations under IRC § 66(c).
- *Measures to Reduce Noncompliance in the Cash Economy.*⁷⁴
 1. Amend IRC § 3406 to create a three-pronged reporting and payment system that encourages compliance in certain cash economy transactions by: (1) instituting backup withholding on payments to taxpayers who have demonstrated “Substantial Noncompliance”; (2) releasing backup withholding on payments to Substantially Noncompliant taxpayers who have demonstrated “Substantial Compliance,” and who agree to schedule and make future estimated tax payments through the IRS Electronic Funds Transfer Payment System (EFTPS); and (3) providing that payors will not be required to institute backup withholding on payments to taxpayers (independent contractors) who present payors with a valid IRS “Compliance Certificate.”
 2. Amend IRC § 6302(h) to require the IRS to promote making estimated tax payments through EFTPS.
 3. Amend IRC § 3402(p)(3) to specifically authorize voluntary withholding agreements between independent contractors and service-recipients (as defined in IRC § 6041A(a)(1)), and to specify that independent contractors who enter into voluntary agreements with payor service recipients will be treated as employees only to the extent specified in the agreement, and allow such independent contractors to continue to deduct ordinary and necessary business expenses under IRC § 162(a).
- *SECTION 501(c)(4) POLITICAL CAMPAIGN ACTIVITY: Enact an Optional “Safe Harbor” Election That Would Allow IRC § 501(c)(4) Organizations to Ensure They Do Not Engage in Excessive Political Campaign Activity.*⁷⁵ Enact an optional “safe harbor” election similar to IRC § 501(h) that would allow IRC § 501(c)(4) organizations to elect the use of a numerical test, based solely on their expenditures (*i.e.*, without counting volunteer activities), to determine the amount of political campaign activity they may engage in without jeopardizing their exempt status.

73 See National Taxpayer Advocate 2006 Annual Report to Congress 534-43. Certain parts of this recommendation are omitted here because they repeat earlier recommendations. See National Taxpayer Advocate 2001 Annual Report to Congress 159-65 (Legislative Recommendation: *Final Determination Rights*). Parts of this recommendation, which the IRS has implemented administratively are also omitted, specifically the requirement to establish a reconsideration process for innocent spouse claims (see IRM 25.15.17, Reconsiderations (July 29, 2014)) and the elimination of the two year limitation period for taxpayers seeking equitable relief under IRC § 6015 or IRC § 66 (see Rev. Proc. 2013-34).

74 See National Taxpayer Advocate 2005 Annual Report to Congress 381-96; see also National Taxpayer Advocate 2007 Annual Report to Congress 490-502 (Legislative Recommendation: *Measures to Address Noncompliance in the Cash Economy*). This recommendation also relates to the *right to a fair and just tax system*. Part of this recommendation, to amend IRC § 6041A to require third-party information reporting for applicable payments to corporations is omitted because it is included above. See National Taxpayer Advocate 2008 Annual Report to Congress 375-90 (Legislative Recommendation: *Worker Classification*). S. 1321, 109th Cong. (2005) (introduced by Senator Santorum) would require a study of the use of voluntary withholding agreements and for the IRS to promote estimated tax payments through the EFTPS. S. 3795, 111th Cong. (2010) and S. 1289, 112th Cong. (2011), both introduced by Senator Carper, would require financial institutions to report all accounts to the IRS by eliminating the \$10 threshold on interest reporting. Finally, S. 3795, 111th Cong. (2010) (introduced by Senator Carper) would authorize voluntary withholding upon request.

75 See Legislative Recommendation: *SECTION 501(c)(4) POLITICAL CAMPAIGN ACTIVITY: Enact an Optional “Safe Harbor” Election That Would Allow IRC § 501(c)(4) Organizations to Ensure They Do Not Engage in Excessive Political Campaign Activity*, *infra*. This recommendation also relates to the *right to be informed*.

Recommendations Related to the Office of the Taxpayer Advocate

- *Recommendations related to Revising the Taxpayer Assistance Order (TAO) Authority Under IRC §7811 and Protecting TAS Confidentiality.*⁷⁶
 1. Amend IRC § 7811 to require the Commissioner or the Deputy Commissioner of Internal Revenue to raise his or her objections to a TAO issued by the National Taxpayer Advocate by responding in writing within a reasonable time, as established by the National Taxpayer Advocate in the TAO, and to provide a detailed written explanation of the reasons for the TAO modification or rescission.⁷⁷
 2. If the TAO is modified or rescinded by the Deputy Commissioner, grant the National Taxpayer Advocate authority to elevate the TAO to the Commissioner of Internal Revenue and require the Commissioner to provide a detailed written response with explanation of the reasons for his or her final decision within timeframes established by the National Taxpayer Advocate in the TAO.⁷⁸
 3. Amend IRC § 7811 to include “impairment of taxpayer rights” as a definition of “significant hardship” for purposes of issuing a TAO.⁷⁹
 4. Amend IRC § 7803(c)(4)(A)(iv) to clarify that, notwithstanding any other provision of the Code, Local Taxpayer Advocates have the discretion to withhold from the IRS the fact that a taxpayer contacted the Taxpayer Advocate Service (TAS) or any information provided by a taxpayer to TAS.⁸⁰
 5. Amend IRC § 7803(c)(4)(A) to provide that in litigation before a federal court, Local Taxpayer Advocates shall not through discovery or compulsory process be required to disclose the fact that the taxpayer contacted the Taxpayer Advocate Service or any information provided by the taxpayer to TAS, unless the court determines that such testimony or disclosure is necessary to: (a) prevent a manifest injustice; (b) help establish a violation of law; or (c) prevent harm to the public health or safety, of sufficient magnitude in the particular case to outweigh the integrity of the Taxpayer Advocate Service in general by reducing the confidence of taxpayers in future cases that their communications will remain confidential.⁸¹

76 These recommendations are based on legislative recommendations contained in the National Taxpayer Advocate's 2011 and 2002 Annual Reports. However, some portions were modified to clarify the position of the National Taxpayer Advocate. See National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*); National Taxpayer Advocate 2002 Annual Report to Congress 198-215 (Legislative Recommendation: *The Office of the Taxpayer Advocate*). H.R. 1661, 108th Cong. (2003) (introduced by Rep. Rangel) and H.R. 1528, 108th Cong. (2003) (introduced by Rep. Portman and passed by the House) included the recommendations regarding confidentiality of taxpayer communications and the position of counsel to the National Taxpayer Advocate.

77 National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*) (recommendation is modified).

78 This provision was not included in the recommendations in the National Taxpayer Advocate's 2002 and 2011 Annual Reports to Congress.

79 National Taxpayer Advocate 2002 Annual Report to Congress 198-215 (Legislative Recommendation: *The Office of the Taxpayer Advocate*).

80 *Id.*

81 *Id.*

- *Codify the Authority of the Office of the Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives.*⁸² In addition to the proposals related to the TAO authority discussed immediately above, the National Taxpayer Advocate recommends that Congress:
 1. Authorize the National Taxpayer Advocate to submit *amicus curiae* briefs in federal appellate litigation on matters relating to the protection of taxpayer rights that the National Taxpayer Advocate has identified as concerns in her Annual Reports to Congress.
 2. Require the IRS to submit proposed or temporary regulations pre-publication to the National Taxpayer Advocate for comment within a reasonable time, and address those comments in the preamble to final regulations.
 3. Authorize the National Taxpayer Advocate to appoint an independent counsel who reports directly to the National Taxpayer Advocate, to provide independent legal advice, including submission of *amicus curiae* briefs and comments on proposed or temporary regulations.
 4. Grant to the National Taxpayer Advocate nondelegable authority to issue a Taxpayer Advocate Directive (TAD) with respect to any IRS program, proposed program, action, or failure to act that may create a significant hardship for a segment of the taxpayer population or for taxpayers at large, and require the Commissioner or the Deputy Commissioner of Internal Revenue to raise his or her objections to a TAD issued by the National Taxpayer Advocate by responding in writing within a reasonable time, as established by the National Taxpayer Advocate in the TAD, and to provide a detailed written explanation of the reasons for the TAD modification or rescission.⁸³
 5. If the TAD is modified or rescinded by the Deputy Commissioner, grant the National Taxpayer Advocate authority to elevate the TAD to the Commissioner of Internal Revenue and require the Commissioner to provide a detailed written response with explanation of the reasons for his or her final decision within timeframes established by the National Taxpayer Advocate in the TAD.⁸⁴
 6. Amend IRC § 7811 to include “impairment of taxpayer rights” as a definition of “significant hardship” for purposes of issuing a TAD.⁸⁵
- *Enact a Uniform Federal Agency External Ombudsman Act.*⁸⁶ Enact a Federal Agency External Ombudsmen Act to ensure protections to and create uniformity among all future federal external ombudsmen.

82 See National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*).

83 National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*) (recommendation is modified).

84 This provision was not included in the recommendations in the National Taxpayer Advocate’s 2002 and 2011 Annual Reports to Congress.

85 National Taxpayer Advocate 2002 Annual Report to Congress 198-215 (Legislative Recommendation: *The Office of the Taxpayer Advocate*).

86 See National Taxpayer Advocate 2010 Annual Report to Congress 412-13.

- *CONTACT INFORMATION ON STATUTORY NOTICES OF DEFICIENCY: Revise IRC § 6212 to Require the IRS to Place Taxpayer Advocate Service Contact Information on the Face of the Statutory Notice of Deficiency and Include Low Income Taxpayer Clinic Information with Notices Impacting that Population.*⁸⁷ Revise IRC § 6212 to require the IRS to do the following:
 1. Include language on the face of the Statutory Notice of Deficiency (SNOD) informing the taxpayer of the right to contact a local office of TAS. Such language should also provide the address and phone number of the TAS office aligned with the taxpayer's last known residence.
 2. For SNODs determined by the IRS, in consultation with the National Taxpayer Advocate, to have a significant probability of impacting low income taxpayers, include language on the face of the notice describing Low Income Taxpayer Clinics (LITCs) and provide a website link that lists contact information for all the LITCs.
 3. For SNODs that are certain to impact low income taxpayers (*e.g.*, those proposing to assess the Earned Income Tax Credit), also include in the envelope used to mail the SNOD Publication 4134, *Low Income Taxpayer Clinic List*, which provides information on the services provided by LITCs and contact information for each clinic.
- *Clarify that the Emergency Exception to the Anti-Deficiency Act Includes IRS Activities that Protect Taxpayer Life and Property.*⁸⁸ Clarify that the emergency exception to the Anti-Deficiency Act includes IRS activity involving the safety of human life, including taxpayer life, or the protection of property, including taxpayer property. Alternatively, the National Taxpayer Advocate recommends that Congress clarify that the National Taxpayer Advocate's authority to issue TAOs pursuant to IRC § 7811 continues during a lapse in appropriations and includes the authority to incur obligations in advance of appropriations, and that the IRS can incur obligations in advance of appropriations to comply with any TAO issued under IRC § 7811.
- *De Minimis Apology Statement.*⁸⁹ Amend IRC § 7811 to grant the National Taxpayer Advocate the discretionary, nondelegable authority to compensate taxpayers where the action or inaction of the IRS has caused excessive expense or undue burden to the taxpayer, and the taxpayer meets the IRC § 7811 definition of significant hardship. Discretionary payments should range from a minimum of \$100 up to a maximum of \$1,000, indexed for inflation. The National Taxpayer Advocate also recommends that, unless otherwise provided by specific appropriation, authorize the Secretary of the Treasury to allocate no more than \$1 million per year to "apology" payments. Furthermore, amend IRC § 7803(c)(2)(B)(ii) to require the National Taxpayer Advocate to include in her Annual Report to Congress a section summarizing the awards made under this amendment. Finally, amend the Code to exclude these "apology" payments from gross income.

87 See Legislative Recommendation: *CONTACT INFORMATION ON STATUTORY NOTICES OF DEFICIENCY: Revise IRC § 6212 to Require the IRS to Place Taxpayer Advocate Service Contact Information on the Face of the Statutory Notice of Deficiency and Include Low Income Taxpayer Clinic Information with Notices Impacting that Population, infra*. This recommendation also relates to the *right to retain representation*.

88 See National Taxpayer Advocate 2011 Annual Report to Congress 552-57.

89 See National Taxpayer Advocate 2007 Annual Report to Congress 478-89. S. 1289, 111th Cong. (2011) and S. 3795, 111th Cong. (2010), both introduced by Senator Carper, include parts of this recommendation.

Recommendations Related to Tax Return Preparers and Payroll Service Providers

■ *Federal Tax Preparers Oversight and Compliance*⁹⁰

1. Increase the preparer penalties under IRC §§ 6695(a) through (e) with respect to certain requirements for preparation of income tax returns for other persons, from \$50 per occurrence to \$100 per occurrence.
2. Increase the preparer penalty under IRC § 6695(f) for negotiation of a refund check from \$500 per check to \$1,000 per check.
3. Amend IRC § 6695(g) to impose a tiered penalty structure for violation of the EITC due diligence requirements: for the first year in which a penalty is imposed, the penalty would be \$100 per occurrence; for the second year, \$500 per occurrence; and for the third year, \$1,000 per occurrence. Provide for waiver, or abatement of penalties, in whole or in part, where the preparer enrolls in EITC education courses and demonstrates an ability to comply with due diligence requirements.⁹¹
4. Amend IRC § 6695(g) to require the EITC due diligence certification to be signed, under penalties of perjury, by the return preparer and attached to the taxpayer's income tax return; that it include a description of how and when the preparer obtained the information upon which he based the EITC eligibility determination (for example, from original documents, the taxpayer's statements, or from prior year's records); and that the preparer be required to certify that he or she has a system of recordkeeping for the information outlined in the regulations and a record retention policy of three years.
5. Amend IRC § 6695 to authorize the Secretary to impose a civil penalty against a tax return preparer who, by reason of intentional misstatement, misrepresentation, fraud, or deceit or any unlawful act causes a taxpayer a tax liability attributable to the Earned Income Tax Credit (EITC), in an amount equal to the tax attributable to the disallowed EITC.
6. Amend IRC § 6695 to impose a penalty of \$100 per occurrence on persons who fail to sign or include certain information on specified IRS forms prepared by them for a fee, including applications for offers in compromise, financial information statements of individuals and businesses, and similar forms.
7. Amend the Internal Revenue Code to authorize the Secretary to impose a \$1,000 penalty, in addition to other available sanctions, on Electronic Return Originators (ERO) who repeatedly fail to comply with ERO Program requirements. Where preparers, including EROs, commit violations by charging a fee for services that is a percentage of the taxpayer's refund or is based on a return item, or failing to advise the taxpayer of the fact that a Refund Anticipation Loan product is a loan and the terms of that loan, the penalty shall be the greater of \$100 per occurrence or 50 percent of the fee for such service.

90 See National Taxpayer Advocate 2003 Annual Report to Congress 270-301. This recommendation also included a provision to increase the IRC § 6694(a) preparer penalty for understatements due to unrealistic positions from \$250 to \$1,000, and the IRC § 6694(b) penalty for intentional disregard of the rules and regulations from \$1,000 to \$5,000, which were enacted by Pub. L. 110-28, § 8246(b), 121 Stat. 112, 203 (2007). Numerous bills have been introduced that would increase return preparer penalties. See, e.g., H.R. 5047, 111th Cong. (2010) (introduced by Rep. Becerra); S. 1219, 110th (2007) (introduced by Senator Bingaman); S. 1321, 109th Cong. (2005) (introduced by Senator Santorum); S. 882, 108th Cong. (2003) (introduced by Senator Baucus).

91 Pub. L. No. 112-41, § 501, 125 Stat. 428, 459 (2011) increased the penalty under IRC § 6695(g) from \$100 to \$500.

8. Amend the Internal Revenue Code to authorize the Secretary to impose a \$1,000 penalty per occurrence against any person who willfully and intentionally misrepresents his or her professional status on a Power of Attorney authorizing him or her to represent a taxpayer before the Internal Revenue Service, or who willfully and intentionally practices before the IRS without proper authorization, under rules prescribed by the Secretary.
 9. Increase the preparer penalty under IRC § 6713 for unauthorized disclosure or use of information by preparers from \$250 to \$500 per disclosure or use, and increase the aggregate amount of penalties imposed on a preparer during any calendar year from \$10,000 to \$25,000.
 10. Require the Secretary, in consultation with the National Taxpayer Advocate, to study the impact that cross-marketing tax preparation services with other consumer products and services has on the accuracy of returns and tax compliance, and report the results of that study to the House Committee on Ways and Means and the Senate Committee on Finance within one year of its establishment.
 11. Require the Commissioner of Internal Revenue to appoint two consumer protection advocates to the Electronic Tax Administration Advisory Committee.
- *The Time Has Come to Regulate Federal Return Preparers.*⁹² Enact a registration, examination, certification, and enforcement program for unenrolled tax return preparers. This program should consist of the following components:
1. Any tax return preparer as defined in IRC § 7701(a)(36) other than an attorney, certified public accountant, or enrolled agent must register with the IRS, and Congress should authorize the IRS to impose a per-return penalty for failure to register, absent reasonable cause.
 2. All registered preparers must pass an initial examination designed by the Secretary to test the technical knowledge and competency of unenrolled return preparers to prepare federal tax returns. The exam can be administered in two separate parts. The first part would address the technical knowledge required to prepare relatively less complex Form 1040-series returns. The second part would test the technical knowledge required to prepare business returns, including complex sole proprietorship schedules.
 3. All registered preparers must complete CPE requirements as specified by the Secretary. The Secretary should have the authority to permit preparers to satisfy such requirements by instead passing a specified examination.

⁹² See National Taxpayer Advocate 2008 Annual Report to Congress 423-26; see also National Taxpayer Advocate 2002 Annual Report to Congress 216-30 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*) and National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*). This recommendation also relates to the *right to be informed* and the *right to pay no more than the correct amount of tax*. The IRS implemented many of the procedures recommended. However, some of the procedures, including the requirements that paid tax-return preparers pass an initial certification exam and complete at least 15 hours of continuing education courses each year, were found invalid under *Loving v. Commissioner*, 917 F. Supp. 2d 67 (D.D.C. 2013), *aff'd* 742 F.3d 1013 (D.C. Cir., Feb. 11, 2014). *Loving* held that the IRS did not have the authority to regulate tax-return preparers under 31 U.S.C.S. § 330. Since January 1, 2011, all paid tax-return preparers and enrolled agents are required to have a Preparer Tax Identification Number (“PTIN”) and the *Loving* decision did not invalidate this requirement. See IRC §6109. The National Taxpayer Advocate recommends that Congress codify all of these recommendations. There have been numerous bills introduced in both the House of Representatives and the Senate incorporating aspects of this recommendation, see, e.g., S. 3355, 112th Cong. (2012) (introduced by Rep. Bingaman); H.R. 6050, 112th Cong. (2012) (introduced by Rep. Becerra).

4. All registered preparers must renew their registration every year,⁹³ at which point they must show evidence of completion of CPE requirements.
 5. The Secretary should be authorized and directed to conduct a public awareness campaign to inform the public about the registration requirements and offer guidelines about what taxpayers should look for in choosing a qualified tax return preparer.
- *Assessment of Civil Penalties Against Preparers of Fraudulent Returns.*⁹⁴ Amend the IRC to provide that when the issuance of an erroneous refund to a return preparer is due to fraud, the IRS may impose a penalty, in addition to other penalties provided by law, equal to 100 percent of that erroneous refund.
 - *Taxpayer Protection from Third-Party Payer Failures.*⁹⁵
 1. Amend the Code to define “third-party payer” as any person who provides services of filing, reporting, withholding, and payment of employment taxes on behalf of client taxpayers if such person has the authority, control, receipt, custody, or disposal of client taxpayers’ funds intended by the taxpayers to be used for the purpose of making federal payroll tax deposits;
 2. Amend the Code to make a third-party payer jointly and severally liable for the amount of tax collected from client employers, but not paid over to the Treasury, plus applicable interest and penalties;
 3. Amend the Code to authorize the Secretary of the Treasury to require third-party payers that have the authority, control, receipt, custody or disposal of client funds intended for the purpose of making federal payroll tax deposits to: (1) register with the IRS; (2) be sufficiently bonded; and (3) provide mandatory disclosure on the form prescribed by the IRS to client taxpayers that the employer may be potentially responsible for unpaid payroll taxes and that the employer can and should periodically verify, through IRS, that their employment tax liability is satisfied in full;
 4. Amend the U.S. Bankruptcy Code to clarify that IRC § 6672 penalties survive bankruptcy, even when the debtor is not an individual.
 - *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes.*⁹⁶
 1. Amend the IRC to require any person who enters into an agreement with an employer to collect, report, and pay any employment taxes to furnish a performance bond that

93 The original recommendation required renewal every three years. Currently, the IRS requires preparers to renew Preparer Tax Identification Numbers every year. See IRM 1.32.19.21.7, *Obtaining and Renewing a Preparer Tax Identification Number (PTIN)* (Nov. 8, 2012).

94 See National Taxpayer Advocate 2011 Annual Report to Congress 558-61.

95 See National Taxpayer Advocate 2007 Annual Report to Congress 538-44. This recommendation also included a provision to clarify that the Trust Fund Recovery Penalty applies to third party payers, which was not included here because the IRS implemented this administratively. See Interim Guidance Memorandum, SBSE-05-0711-044, *Interim Guidance for Conducting Trust Fund Recovery Penalty Investigations in Cases Involving a Third-Party Payer* (July 1, 2011) (also incorporated in IRM 5.1.24.5.8, *Trust Fund Recovery Penalty (TFRP) Investigations* (Aug. 15, 2012)). See also National Taxpayer Advocate 2004 Annual Report to Congress 394-99 (Legislative Recommendation: *Protection from Payroll Service Provider Misappropriation*). S. 900, 113th Cong. (2013) (introduced by Senator Mikulski); S. 1773, 110th Cong. (2007) (introduced by Senator Snowe); S. 3583, 109th Cong. (2006) (introduced by Senator Snowe); S. 1321, 109th Cong. (2005) (introduced by Senator Santorum) included parts of this recommendation.

96 See National Taxpayer Advocate 2012 Annual Report to Congress 553-59. Part of the recommendation regarding IRC § 6672 penalties surviving bankruptcy has been omitted here because it was included above. See National Taxpayer Advocate 2007 Annual Report to Congress 538-44 (Legislative Recommendation: *Taxpayer Protection from Third-Party Payer Failures*).

specifically guarantees payment of federal payroll taxes collected, deducted, or withheld by such person from an employer and from wages or compensation paid to employees.

2. Amend IRC § 3504 to require agents with an approved Form 2678, *Employer/Payer Appointment of Agent*, to allocate reported and paid employment taxes among their clients using a form prescribed by the IRS and impose a penalty for the failure to file absent reasonable cause.

- *OFFERS IN COMPROMISE: Authorize the National Taxpayer Advocate to Determine Whether an Offer in Compromise Submitted by a Victim of Payroll Service Provider Fraud Is “Fair and Equitable.”*⁹⁷ To address the inherent conflict with the IRS determining whether acceptance of an offer in compromise by a victim who was defrauded by a payroll service provider is fair and equitable, Congress should specify that such determination be made by National Taxpayer Advocate.

Recommendations Related to Penalties

- *Reforming the Penalty Regime.*⁹⁸ Congress should have the IRS (1) collect and analyze more detailed penalty data on a regular basis, and (2) conduct an empirical study to quantify the effect of each penalty on voluntary compliance. This quantitative research should also identify changes to penalty laws and penalty administration that would improve voluntary compliance. Congress should appropriate additional funds for this research, as necessary. Without such research, any penalty analysis will be somewhat subjective and superficial. Nonetheless, the limited data and analysis that are available suggest the following changes to the major penalty provisions would promote voluntary compliance based on the principles described above:
 1. Prevent IRS systems from automatically assessing accuracy-related penalties without considering all of the facts and circumstances;
 2. Consider the feasibility of clarifying the definition of a “tax shelter” for purposes of the substantial understatement penalty;
 3. Restructure the penalty for failure to file a “reportable transaction” information disclosure;⁹⁹
 4. Improve the proportionality and effectiveness of the failure to file penalty for those who are more than six months late;
 5. Reduce the penalty for late filers who timely pay within a period of extension;

97 See Legislative Recommendation: *OFFERS IN COMPROMISE: Authorize the National Taxpayer Advocate to Determine Whether an Offer in Compromise Submitted by a Victim of Payroll Service Provider Fraud Is “Fair and Equitable,”* *infra*.

98 See National Taxpayer Advocate 2008 Annual Report to Congress 414-18. For a more detailed discussion of this topic and each of the recommendations, see National Taxpayer Advocate 2008 Annual Report to Congress, vol. 2 2-45 (Research Study: *A Framework for Reforming the Penalty Regime*). This recommendation also included a provision to clarify that the Trust Fund Recovery Penalty applies to third party payers, which was not included here because the IRS implemented this administratively. See Interim Guidance Memorandum, SBSE-05-0711-044, *Interim Guidance for Conducting Trust Fund Recovery Penalty Investigations in Cases Involving a Third-Party Payer* (July 01, 2011) (also incorporated in IRM 5.1.24.5.8, Trust Fund Recovery Penalty (TFRP) Investigations (Aug. 15, 2012)).

99 The Small Business Jobs Act of 2010 enacted a similar recommendation to modify the penalty for failure to include reportable transaction information with a return so that it bears a proportional relationship to the amount of any tax savings realized. Pub. L. No. 111-240, 124 Stat. 2504, 2560 (2010). See National Taxpayer Advocate 2008 Annual Report to Congress 419-22 (Legislative Recommendation: *Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact*) (also expressing concern about the lack of a “reasonable cause” exception, the “stacking” of multiple § 6707A penalties, and the potential imposition of the § 6707A penalty on taxpayers who derived no tax benefit whatsoever).

6. Reduce the number of failure to pay penalty rates and eliminate interaction with the failure to file penalty;¹⁰⁰
 7. Simplify the prior year estimated tax payment safe harbor and encourage taxpayers to use it;
 8. Simplify the estimated tax penalty computation and provide an automatic waiver of *de minimis* estimated tax penalties;
 9. Allow the IRS to abate estimated tax penalties for first-time estimated taxpayers who have reasonable cause; and
 10. Reduce the penalty for failure to make tax deposits in the prescribed manner.
- *Revise the Willfulness Component of the Trust Fund Recovery Penalty Statute to Encourage Business Owners to Continue Operation of Financially Struggling Businesses When the Tax Liability Accrues Due to an Intervening Bad Act.*¹⁰¹ Amend IRC § 6672 to provide that the conduct of a responsible person who obtains knowledge of trust fund taxes not being timely paid because of an intervening bad act shall not be deemed willful if the delinquent business: (1) promptly makes payment arrangements to satisfy the liability based upon the IRS's determination of the minimal working capital needs of the business, and (2) remains current with payment and filing obligations.
 - *Legislative Recommendations to Reduce the Burden of Filing a Report of Foreign Bank and Financial Accounts (FBAR) and Improve the Civil Penalty Structure.*¹⁰²
 1. Cap the civil FBAR penalty at the lesser of (a) ten percent of the unreported account balance or five percent for non-willful violations (similar to the IRS's mitigation guidelines), and (b) forty percent of the portion of any underpayment attributable to the improperly undisclosed accounts (similar to the penalty for undisclosed foreign financial assets (*e.g.*, assets not reported on Form 8938) under IRC § 6662(j)).¹⁰³
 2. Eliminate or waive the civil penalty for failure to report an account on an FBAR if there is no evidence the account was used in connection with a crime and:¹⁰⁴
 - a. The account information was already provided to the IRS, for example, on a Form 8938, *Statement of Specified Foreign Financial Assets*, or by a third party (*e.g.*, a financial institution or government);¹⁰⁵

100 H.R. 1661, 108th Cong. (2003) (introduced by Rep. Rangel) and H.R. 1528, 108th Cong. (2003) (introduced by Rep. Portman and passed/agreed to in Senate with amendment) included parts of this recommendation.

101 See National Taxpayer Advocate 2010 Annual Report to Congress 400-05.

102 See Legislative Recommendation: *FOREIGN ACCOUNT REPORTING: Legislative Recommendations to Reduce the Burden of Filing a Report of Foreign Bank and Financial Accounts (FBAR) and Improve the Civil Penalty Structure*, *infra*. This recommendation also relates to the *right to be informed*, 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*, and the *right to confidentiality*.

103 To avoid stacking, only one penalty should apply to understatements of income from foreign financial assets not disclosed on either a Form 8938 or an FBAR.

104 Under this recommendation, the civil FBAR penalty could still be waived on the basis of reasonable cause as is the case under current law.

105 Because the Financial Crimes Enforcement Network (FinCEN) may not be authorized to receive all of the account information provided to the IRS by third parties, it may be advisable for legislation to distinguish between information available to the IRS and information available to FinCEN. An alternative would be to have the disclosure of account information to the IRS by third parties create a presumption that, in the absence of evidence to the contrary, a taxpayer's failure to provide the same information was due to reasonable cause and was not willful.

- b. The amount of unreported income from the account does not create a substantial understatement under IRC § 6662(d);¹⁰⁶ or
 - c. The taxpayer resides in the same jurisdiction as the account.
 - 3. Clarify that the government has the burden to establish actual willfulness (*i.e.*, specific intent to violate a known legal duty, rather than mere negligence or recklessness) before asserting a willful FBAR penalty, and cannot meet this burden by relying solely on circumstantial evidence.¹⁰⁷
 - 4. Authorize the IRS to modify closing agreements with the taxpayer's consent, particularly when necessary to promote equity or public policy (including consistency). The National Taxpayer Advocate also recommends directing the IRS to use this authority to amend offshore voluntary disclosure closing agreements to make them consistent with the terms of agreements publicly offered to similarly-situated taxpayers in subsequent IRS programs.
 - 5. Align the FBAR filing deadline and threshold(s) with the Form 8938 filing deadline and threshold(s). Specifically, increase the \$10,000 FBAR filing threshold to match the threshold applicable to Form 8938 (*i.e.*, at least \$50,000), adjust it for inflation, and change the FBAR filing due date to coincide with the due date applicable to a taxpayer's federal income tax return and Form 8938 (including extensions). If Congress aligns these due dates and thresholds, it should also consider requiring the Treasury Department to consolidate the reporting of foreign accounts (*i.e.*, the FBAR and Form 8938) so that taxpayers only have to report them on one form. To facilitate this change, legislation should clarify that the IRS may disclose certain account information to FinCEN without violating IRC § 6103. The legislation should require the IRS to highlight (on the new form) any information not subject to the normal confidentiality rules (*e.g.*, because it is not part of the tax return).¹⁰⁸
- **MANAGERIAL APPROVAL: Amend IRC § 6751(b) to Require IRS Employees to Seek Managerial Approval Before Assessing the Accuracy-Related Penalty Attributable to Negligence under IRC § 6662(b)(1).**¹⁰⁹ Amend IRC § 6751(b)(2)(B) to require written managerial approval prior to assessment of the accuracy-related penalty imposed on the portion of underpayment attributable to negligence or disregard of rules or regulations under IRC § 6662(b)(1), and specify which penalties and facts or circumstances result in penalties “automatically calculated through electronic means.”

106 Even if the understatement is substantial, legislation could require the government to consider whether it was reasonable for the taxpayer to believe that any unreported income would be offset by foreign tax credits in connection with its reasonable cause determination.

107 Under current law, the government is only required to establish willfulness by a preponderance of the evidence. See, *e.g.*, *United States v. McBride*, 908 F. Supp. 2d 1186 (D. Utah 2012) (applying the “preponderance” standard, rather than “clear and convincing,” or “beyond a reasonable doubt”).

108 Congress might also clarify that taxpayers not otherwise required to file a tax return could, nonetheless, use the same form to satisfy their reporting obligations under the Bank Secrecy Act.

109 See Legislative Recommendation: **MANAGERIAL APPROVAL: Amend IRC § 6751(b) to Require IRS Employees to Seek Managerial Approval Before Assessing the Accuracy-Related Penalty Attributable to Negligence under IRC § 6662(b)(1)**, *infra*. This recommendation also relates to the *right to quality service* and the *right to pay no more than the correct amount of tax*.

- *ERRONEOUS REFUND PENALTY: Amend Section 6676 to Permit “Reasonable Cause” Relief.*¹¹⁰ To allow for consideration of taxpayers’ facts and circumstances before imposing a penalty for erroneously claiming a credit or refund, the National Taxpayer Advocate recommends that Congress amend IRC § 6676 to permit relief from the penalty for individual taxpayers who acted with reasonable cause and in good faith.
- *Small Business Burdens – Payroll Deposit Tax Penalties.*¹¹¹ Amend IRC § 6656 to clarify that: (1) the reasonable cause exception to the Federal Tax Deposit (FTD) penalty shall specifically apply to instances where a taxpayer has made a timely deposit, but failed to make the deposit in the prescribed manner and such failure was not due to willful neglect; and (2) in no circumstance shall the FTD penalty exceed two percent of the underpayment amount when a taxpayer has made a timely deposit, but failed only to make the deposit in the prescribed manner.

Recommendations Related to Collection

- *Offers in Compromise: Effective Tax Administration.*¹¹²
 1. *Equitable Considerations:* The National Taxpayer Advocate recommends that the IRS be given more specific direction to compromise tax liabilities in cases where it is inequitable to collect them, notwithstanding the fact that such amounts are legally due pursuant to a technical application of the Code and not subject to abatement under other rules. Equitable consideration offers (ECOs) would replace equity/policy Effective Tax Administration offers as a basis for compromise.¹¹³
 2. *Hardship Considerations:* Add new paragraph 7122(c)(5) of the Code to read as follows: “RULES RELATING TO OFFERS BASED UPON HARDSHIP. — Notwithstanding any other provision of this title, unless the taxpayer has a recent unexplained history of noncompliance with tax filing or payment obligations, the Secretary may compromise

110 See Legislative Recommendation: *ERRONEOUS REFUND PENALTY: Amend Section 6676 to Permit “Reasonable Cause” Relief, infra*. See also National Taxpayer Advocate 2011 Annual Report to Congress 544-47 (Legislative Recommendation: *Amend the Erroneous Refund Penalty to Permit Relief in Case of Reasonable Cause for Claim to Refundable Credits*). This recommendation also relates to the *right to challenge the IRS’s position and be heard*.

111 See National Taxpayer Advocate 2004 Annual Report to Congress 400. See also National Taxpayer Advocate 2001 Annual Report to Congress 222 (Legislative Recommendation: *Federal Tax Deposit (FTD) Avoidance Penalty*). Numerous bills included part of this recommendation. See, e.g., S. 1321, 109th Cong. (2005) (introduced by Senator Santorum); H.R. 1661, 108th Cong. (2003) (introduced by Rep. Rangel); H.R. 1528, 108th Cong. (2003) (introduced by Rep. Portman and passed/agreed to in Senate with amendment).

112 See National Taxpayer Advocate 2004 Annual Report to Congress 433-50.

113 The National Taxpayer Advocate recommended specific language as follows: Add new paragraph 7122(c)(4) of the Code to read as follows: “SPECIAL RULES RELATING TO OFFERS BASED UPON EQUITABLE CONSIDERATIONS. — Notwithstanding any other provision of this title, the Secretary shall compromise a liability when it is inequitable to collect any unpaid tax (or any portion thereof, including penalties and interest). (A) It shall be deemed inequitable to collect an income tax liability in excess of the economic benefit received from the transaction to which the liability relates. For purposes of this section, a transaction shall include all related transactions. (B) In other cases, the Secretary shall consider all of the facts and circumstances, including: i. whether the taxpayer acted reasonably and in good faith under the circumstances, such as, by taking reasonable actions to avoid or mitigate the situation; ii. whether an income tax liability is disproportionate to (even if not in excess of) the economic benefit received from the transaction to which the liability relates; iii. whether the taxpayer is a victim of a third-party bad act or other unexpected event; iv. whether the taxpayer has a recent history of compliance with tax filing and payment obligations or a reasonable explanation for noncompliance; v. whether any IRS employee has not followed standard procedures in connection with the case, including applicable published administrative guidance (such as the Internal Revenue Manual); vi. whether IRS action or inaction has unreasonably delayed resolution of the taxpayer’s case; and vii. any other relevant fact or circumstance indicating that justice, equity, or public policy justifies the compromise. No single fact or circumstance described in clause (i)-(vii), above, shall be determinative of whether to compromise a liability under subparagraph (B). This determination shall be made without regard to the taxpayer’s ability to fully pay the liability. Compromises under this paragraph 7122(c)(4) may require appropriate adjustments to basis, carryovers, or other tax attributes.

a liability if collection of unpaid tax (or any portion thereof, including penalties and interest) would cause a hardship for the taxpayer or for a third party, without regard to whether the taxpayer is a person or an entity. This determination shall be made without regard to the taxpayer's ability to fully pay the liability.”

3. *Offer Processing Order*: Add new sub-paragraph 7122(c)(3)(C) of the Code to read as follows: “in the case of an offer in compromise submitted on more than one basis, the Secretary shall evaluate the taxpayer's bases for compromise in the order indicated by the taxpayer, and the Secretary's decision to compromise on one basis shall not depend on whether the Secretary would be willing to compromise on another basis; and”.
- *Improve Offer in Compromise Program Accessibility*.¹¹⁴ Modify IRC § 7122(c) so that taxpayers are not required to include a partial payment with “lump-sum” offer applications. Alternatively, modify the offer in compromise (OIC) rules as follows:
 1. Provide taxpayers with the right to appeal to the IRS Appeals function the IRS's decision to return an OIC before or after accepting it for processing. The IRS could use the existing Collection Appeals Process, which allows it to review appeals in just five days.
 2. Provide an exception to the partial payment requirement for taxpayers who do not have immediate access to current income and liquid assets that could be used to fund an offer without incurring significant costs (e.g., taxable income or penalties resulting from the withdrawal of assets from a qualified retirement plan). For those taxpayers who have immediate access to such funds, the partial payment requirement should be 20 percent (for lump-sum offers) of any current income and liquid assets that could be disposed of immediately without significant cost.
 3. Apply the low income exception in cases where payment of the combined OIC user fee and partial payment (or borrowing for such payments) would cause an economic hardship.
 - *Waiver of Installment Agreement Fees for Low Income Taxpayers*.¹¹⁵ Implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required.
 - *Return of Levy or Sale Proceeds*.¹¹⁶
 1. Amend IRC § 6343(b) to extend the period of time within which a third party can request a return of levied funds or the proceeds from the sale of levied property from nine months to two years from the date of levy. This amendment will also extend the period of time available to taxpayers under IRC § 6343(d) within which to request a return of levied funds or sale proceeds.

114 See National Taxpayer Advocate 2006 Annual Report to Congress 507-19. H.R. 6050, 112th Cong. (2012) (introduced by Rep. Becerra); S. 3355, 112th Cong. (2012) (introduced by Senator Bingaman); S. 1289, 112th Cong. (2011) (introduced by Senator Carper); H.R. 4994, 111th Cong. (2010) (introduced by Rep. Lewis); H.R. 2342, 111th Cong. (2009) (introduced by Rep. Lewis), included parts of this recommendation.

115 See National Taxpayer Advocate 2006 Annual Report to Congress 141-56 (Most Serious Problems). H.R. 4375, 112th Cong. (2012) (introduced by Rep. Johnson); S. 2291, 112th Cong. (2012) (introduced by Senator Cornyn) included parts of the recommendation.

116 See National Taxpayer Advocate 2001 Annual Report to Congress 202-09. There have been numerous bills introduced in the House of Representatives and Senate that include parts of this recommendation. See, e.g., H.R. 5719, 110th Cong. (2008) (introduced by Rep. Rangel), and S. 882, 108th Cong. (2003) (introduced by Senator Baucus and incorporated in H.R. 1528 through an amendment, which passed in lieu of S. 882) (including the requirement to reinstate retirement accounts).

2. Amend IRC §§ 6532(c)(1) and (2) to extend the period of time within which a suit or proceeding under IRC § 7426 shall begin from nine months to two years from the date of levy or agreement giving rise to such action.¹¹⁷
3. Amend IRC § 6343(d) to extend the period of time within which a taxpayer shall request a return of levied funds or the proceeds from the sale of levied property to a period of four years from the date of levy or sale of the levied property where the IRS's action with regard to that levy was in reckless or flagrant disregard of established IRS rules, procedures, or regulations and the taxpayer incurred significant harm as a result of that action. Interest shall be allowed and paid with respect to such levies as permitted under IRC § 6343(c).
4. Amend the following code sections to authorize reinstatement of funds to retirement accounts and other pension plans where the IRS levied upon the plans in error or in flagrant disregard of established IRS rules, procedures, or regulations and the funds were returned under IRC § 6343(d): (1) § 401 Qualified Pension, Profit Sharing, Keogh and Stock Bonus Plans; (2) § 408 Individual Retirement Account, SEP-Individual Retirement Account; and (3) § 408A Roth Individual Retirement Account. Further, amend these code sections to provide that the IRS shall abate all tax and interest assessed as a result of the levy.

- *Amend IRC § 6343(a) to Permit the IRS to Release Levies that Impose Economic Hardship on Business Taxpayers.*¹¹⁸ Amend IRC § 6343(a)(1)(d) to: (1) permit the IRS, in its discretion, to release a levy against the taxpayer's property or rights to property if the IRS determines that the satisfaction of the levy is creating an economic hardship due to the financial condition of the taxpayer's business; and (2) require the IRS, in making the determination to release a levy against a business on economic hardship grounds, to consider the economic viability of the business, the nature and extent of the hardship (including whether the taxpayer exercised ordinary business care and prudence), and the potential harm to individuals if the business is liquidated, as well as whether the taxes could be collected from a responsible person under an IRC § 6672 Trust Fund Recovery Penalty (TFRP) assessment.
- *Levy on Mutual Funds, including Money Market Funds.*¹¹⁹ Amend IRC § 6332 to include a new paragraph (d) to read: "Special Rule for agent of mutual funds, including money market funds. Any agent for a mutual fund including money market funds shall dispose of sufficient shares at market value to satisfy the amount due on such levy up to the market value of share owned by the person against whom the tax is assessed."

117 Under IRC § 7426, any person (other than the taxpayer) who claims the IRS wrongfully levied upon property he or she has an interest in or lien on, to satisfy the tax liability of another, may file a wrongful levy suit against the United States in federal district court.

118 See National Taxpayer Advocate 2011 Annual Report to Congress 537-43. This recommendation also relates to the *right to privacy*. H.R. 4368, 112th Cong. (2012) (introduced by Rep. McDermott) included part of this recommendation.

119 See National Taxpayer Advocate 2002 Annual Report to Congress 247.

- *Strengthening Taxpayer Protections in the Filing and Reporting of Federal Tax Liens.*¹²⁰ Amend the Code to:
 1. Require that prior to filing a Notice of Federal Tax Lien (NFTL), the IRS must review the taxpayer's information (including IRS and available third party information) concerning the taxpayer's assets, income, and the value of the equity in the assets; and make a determination, weighing all facts and circumstances, that (1) the NFTL will attach to property, and (2) that the benefit to the government of the NFTL filing outweighs the harm to the taxpayer and that the NFTL filing will not jeopardize the taxpayer's ability to comply with the tax laws in the future.
 2. Allow a taxpayer to appeal any lien filing determination to the IRS Office of Appeals before the NFTL is filed. The IRS must notify taxpayers of their right to have an appeals officer review an NFTL determination.
 3. Explicitly provide under IRC § 7432 for civil damages for improper NFTL filing or failure to make the required NFTL determination described above.
 4. Clarify that under IRC § 7433, a taxpayer may bring an action for improper lien filing or failure to make the required lien determination described above.
 5. Amend § 605(a)(3) of the Fair Credit Reporting Act to:
 - a. Require removal of derogatory lien filing information from credit reports six years from the "refile by" date on the lien unless the lien is refiled.
 - b. Require immediate removal of derogatory lien filing information from credit reports if the lien is released within two years from the date of filing.
 - c. Require removal of derogatory lien filing information from credit reports within two years from the date of release if released more than two years from the date of the NFTL filing.
 - d. Require immediate removal of all information about the NFTL filing if the IRS withdraws such a notice under IRC § 6323(j).
- *MANAGERIAL APPROVAL FOR LIENS: Require Managerial Approval Prior to Filing a Notice of Federal Tax Lien in Certain Situations.*¹²¹
 1. Codify § 3421 of RRA 98 to require IRS employees to obtain managerial approval prior to filing an NFTL where it is likely that the NFTL will cause a hardship, will do little to protect the government's interest in the taxpayer's property or rights to property, or will impair the taxpayer's ability to pay the tax, including the following three categories: (1) the taxpayer's income falls below 250 percent of the federal poverty level; (2) the taxpayer's account has been placed in currently not collectible status due to economic hardship; or (3) the taxpayer has entered into an installment agreement (IA) with the IRS.

¹²⁰ See National Taxpayer Advocate 2009 Annual Report to Congress 357-64. H.R. 6050, 112th Cong. (2012) (introduced by Rep. Becerra); S. 3355, 112th Cong. (2012) (introduced by Senator Bingaman); H.R. 6439, 111th Cong. (2010) (introduced by Rep. Hastings); H.R. 5047, 111th Cong. (2010) (introduced by Rep. Becerra); and S. 3215, 111th Cong. (2010) (introduced by Senator Bingaman) included parts of this recommendation.

¹²¹ See Legislative Recommendation: *MANAGERIAL APPROVAL FOR LIENS: Require Managerial Approval Prior to Filing a Notice of Federal Tax Lien in Certain Situations*, *infra*. This recommendation also relates to the *right to privacy*.

2. Require the IRS supervisor, as part of the managerial approval process, to consider the following: (1) whether the NFTL would attach to property; (2) whether the benefit of filing an NFTL for the government would outweigh the harm to the taxpayer; and (3) whether the NFTL filing will jeopardize the taxpayer's ability to comply with the tax laws in the future.
3. Require the IRS to take disciplinary action against employees who fail to secure managerial approval prior to filing an NFTL in the situations required by law.

- *Repeal Private Debt Collection (PDC) Practices.*¹²² Repeal IRC § 6306, thereby terminating the PDC initiative.
- *Eliminate the Suspension of the Collection Statute During Qualified Hospitalization Resulting from Service in a Combat Zone.*¹²³ Amend IRC § 7508(a) to eliminate the suspension of the collection statute during any period of qualified hospitalization after service in a combat zone or performance of combatant activities in a contingency operation.

Additional Recommendations

- *Direct Deposit of Income Tax Refunds.*¹²⁴ Amend the Code to create a process through which the IRS and financial institutions work together to identify the incorrect recipient of a direct deposit refund and request the return of the improperly deposited funds. The Right to Financial Privacy Act, 12 U.S.C. § 3401 *et seq.*, prohibits financial institutions from releasing financial records except under limited circumstances. 12 U.S.C. § 3413(c) provides an exception to the financial disclosure rules, allowing for the sharing of financial records in accordance with procedures in the Code. The Code should be amended to establish a formal procedure through which the IRS can receive limited information about an account holder who receives a misdirected direct deposit refund. The information provided to the IRS would be limited to the account holder's name, Social Security number, and necessary contact information to allow the IRS to contact the account holder and attempt to recover the misdirected funds. The National Taxpayer Advocate further recommends that Congress amend Title 31, Money and Finance, of the current U.S. Code to treat misdirected direct deposit refunds in the same manner as checks. 31 U.S.C. § 3343 provides a fund for the replacement of checks that are lost, stolen, destroyed, or defaced. There is currently no similar provision available providing a fund for the replacement of direct deposit refunds misdirected as a result of fraud.
- *Expand Definition of Taxpayer Identification Number (TIN) to Include Internal Revenue Service Number (IRSN).*¹²⁵ Amend IRC §§ 151(e), 32(c)(1)(F), and 32(c)(3)(D) to require a taxpayer to provide a valid TIN or IRSN in order to claim an exemption and the Earned Income Tax Credit (EITC). This recommendation would enable an identity theft victim who files a tax return using an IRSN or similar replacement number to claim an exemption or the EITC.

122 See National Taxpayer Advocate 2006 Annual Report to Congress 458-62. H.R. 5719, 111th Cong. (2009) (introduced by Rep. Lewis); H.R. 5719, 110th Cong. (2008) (introduced by Rep. Rangel); H.R. 695, 110th Cong. (2007) (introduced by Rep. Van Hollen); S. 335, 110th Cong. (2007) (introduced by Senator Dorgan); and H.R. 3056, 110th Cong. (2007) (introduced by Rep. Rangel and passed by the House) included this recommendation.

123 See National Taxpayer Advocate 2009 Annual Report to Congress 381-83.

124 See National Taxpayer Advocate 2005 Annual Report to Congress 464-65.

125 See National Taxpayer Advocate 2007 Annual Report to Congress 545-46.

- *Broaden Relief from Timeframes for Filing a Claim for Refund for Taxpayers with Physical or Mental Impairments.*¹²⁶ Amend IRC § 6511(h)(2) to define a financially disabled individual as follows:
 1. First, replace the existing requirement that the individual impairment be medically determinable with a provision that it be determined by a qualified medical or mental health professional. For this purpose, Congress should specify that a qualified medical or mental health professional is an individual who is licensed by the state in which he or she practices to provide direct medical or mental health treatment to another individual.
 2. Second, replace the existing requirement that the impairment leaves the individual unable to manage his financial affairs with the requirement that the impairment materially limits the management of those affairs.
- *Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income.*¹²⁷ Amend IRC §104(a)(2) to exclude from gross income payments received as settlement for mental anguish, emotional distress, and pain and suffering.
- *Provide a Uniform Definition of a Hardship Withdrawal from Qualified Retirement Plans.*¹²⁸ Establish uniform rules regarding the availability and tax consequences of hardship withdrawals from tax-advantaged retirement plans and arrangements.
 1. Hardship withdrawals should be permitted when a participant is faced with an “unforeseeable emergency.” Examples of an unforeseeable emergency may include: (1) expenses for medical care incurred by the employee, the employee’s spouse or dependents; (2) payments necessary to prevent the eviction of the employee from his or her principal residence or foreclosure on the mortgage on that residence; (3) loss of property due to casualty; or (4) severe financial hardship resulting from an extended period of unemployment.
 2. Such hardship distributions be made exempt from the ten percent additional tax imposed by IRC § 72(t).
- *IRS Authority to Issue Refunds and Credits After Entry of Small Case Tax Court Decision.*¹²⁹ Amend IRC § 6512 to permit the IRS to issue refunds and credits after entry of a Tax Court decision and before it becomes final. This authority should be permissive rather than mandatory so that the IRS is not required to issue the refund or credit if it expects the decision to be vacated before it becomes final.
- *Allow Individual U.S. Taxpayers Residing Abroad the Option to Choose the Currency of Their Country of Residence as Their Functional Currency.*¹³⁰ Amend IRC § 985 to allow individual U.S. taxpayers residing abroad: (1) to adopt the local currency as their functional currency with respect to certain activities associated with their residence in a foreign country (e.g., activities of a qualified residence unit or QRU), giving individuals the flexibility currently extended to business taxpayers; and (2) to use an average exchange rate or other reasonable method of accounting to convert foreign currency into U.S. dollars in order to determine the individual’s

126 See National Taxpayer Advocate 2013 Annual Report to Congress 302-10.

127 See National Taxpayer Advocate 2009 Annual Report to Congress 351-56.

128 See *id.* at 384-90.

129 See National Taxpayer Advocate 2004 Annual Report to Congress 493.

130 See National Taxpayer Advocate 2011 Annual Report to Congress 566-72.

taxable income and gain for taxpayers who do not adopt the QRU and have the U.S. dollar as their functional currency for the taxable year.

- *Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes.*¹³¹ Amend IRC § 7871(a) to include IRC § 23 in the list of Code sections for which a Native American tribal government is treated as a “State.” If a Native American tribal government is treated as a State for purposes of IRC § 23, its determination that a child has special needs would enable adoptive parents to claim the special needs adoption credit, provided that the other requirements of the Internal Revenue Code are met.
- *LATE-FILED RETURNS: Clarify § 523(a) of the Bankruptcy Code to Provide that a Late-Filed Tax Return May Be Considered a Return for Purposes of Obtaining a Bankruptcy Discharge.*¹³² To address conflicting judicial interpretations as to whether the “applicable filing requirements” language in § 523(a) of the Bankruptcy Code imposes a timely filing requirement, the National Taxpayer Advocate recommends that Congress clarify this language to provide that a late-filed tax return may be considered a return for purposes of obtaining a bankruptcy discharge.

Five Taxpayer Responsibilities¹³³

1. The Responsibility to Be Honest

Taxpayers have the responsibility to be truthful in preparing their tax returns and in all other dealings with the IRS.

2. The Responsibility to Provide Accurate Information

Taxpayers have the responsibility to answer all relevant questions completely and honestly, to provide all required information on a timely basis, and to explain all relevant facts and circumstances when seeking guidance from the IRS.

3. The Responsibility to Keep Records

Taxpayers have the responsibility to maintain adequate books and records to fulfill their tax obligations, preserve them during the time they may be subject to IRS inspection, and provide the IRS with access to those books and records when asked so the IRS can examine their tax liabilities to the extent required by law.

4. The Responsibility to Pay Taxes on Time

Taxpayers have the responsibility to pay the full amount of taxes they owe by the due date and to pay any legally correct additional assessments in full. If they cannot pay in full, they have the responsibility to comply with all terms of any full or partial payment plans the IRS agrees to accept.

5. The Responsibility to Be Courteous

Taxpayers have the responsibility to treat IRS personnel politely and with respect.

131 See National Taxpayer Advocate 2012 Annual Report to Congress 521-25.

132 See Legislative Recommendation: *LATE-FILED RETURNS: Clarify the Bankruptcy Law Relating to Obtaining a Discharge*, *infra*. This recommendation also relates to the *right to finality*.

133 The IRS did not include a list of responsibilities when it adopted the Taxpayer Bill of Rights on June 10, 2014. See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

LR
#2

ACCESS TO APPEALS: Require that Appeals Have At Least One Appeals Officer and Settlement Officer Located and Permanently Available within Every State, the District of Columbia, and Puerto Rico

PROBLEM

Committed to the principle that “all taxpayers should enjoy convenient access to Appeals, regardless of their locality,” Congress, as part of RRA 98, required the IRS to “ensure that an appeals officer is regularly available within each State.”¹ The IRS maintains that this mandate is met by Appeals Officers “riding circuit” (*i.e.*, traveling into the jurisdiction to meet with taxpayers in person) at least quarterly in states lacking a permanent Appeals presence.² However, circuit riding Appeals cases often take an additional six months or more to resolve and have significantly lower levels of agreement than face-to-face Appeals cases conducted in field offices.³

The number of states without a permanent Appeals office has risen by 33 percent, from nine to 12, since 2011.⁴ Today, approximately a quarter of the states have no permanent Appeals presence. Taxpayers in those states may be forced to travel long distances, incur additional expenses, or face delays in obtaining an in-person hearing.⁵ Even if they persevere and obtain a face-to-face hearing, their cases may be handled by an Appeals Officer or a Settlement Officer unfamiliar with the local economy or other relevant community issues.⁶ Further, curtailed face-to-face conferences can make it more difficult for Appeals Officers to resolve cases and can cause taxpayers to question the independence and impartiality of Appeals.

Recently, in adopting the Taxpayer Bill of Rights (TBOR), the IRS reaffirmed its commitment to a number of related principles including *the right to appeal an IRS decision in an independent forum, the right to quality service, the right to challenge the IRS’s position and be heard, and the right to a fair and just tax system.*⁷ All of these fundamental rights, which also gave rise to RRA 98, are adversely affected when a face-to-face Appeals conference is not readily and conveniently available.

1 S. Rep. No. 105-174, at 92 (1998); The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, Title III, Subtitle E, § 3465(b), (1998).

2 *The U.S. – China Economic Relationship: A New Approach For a New China, Hearing Before the S. Comm. on Finance, 111th Cong.*, 69-70 (2010) (testimony of Timothy F. Geithner, Sec. of Treasury). See also National Taxpayer Advocate 2009 Annual Report to Congress 81.

3 Appeals response to TAS information request (Aug. 5, 2014); supplemented by fiscal year (FY) 2014 data provided by Appeals on November 6, 2014. For a more in-depth discussion of the Appeals presence issue, see Most Serious Problem: *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State, supra.*

4 IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited June 27, 2014). The territory of Puerto Rico has also lacked a permanent Appeals office during this time.

5 See National Taxpayer Advocate 2009 Annual Report to Congress 346-350. See also *Hearing on Filing Season 2012, Hearing Before the S. Comm. on Finance, 112th Cong.* 3-12 (2012)(testimony of Teresa Thompson, Local Taxpayer Advocate, MT).

6 National Taxpayer Advocate 2009 Annual Report to Congress 76.

7 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

EXAMPLE

A taxpayer lives in rural Montana and operates a small livestock ranch. The IRS audits the taxpayer and proposes an adjustment with which he disagrees. The taxpayer files a protest with the IRS Office of Appeals and requests an in-person conference, believing this direct contact to be essential, as the issue in controversy is factually difficult and legally complex.

Appeals does not maintain a field office in Montana. As a result, the taxpayer's request for a face-to-face conference goes to an Appeals Officer in Washington State. This assignment of the case worries the taxpayer who doubts that the Appeals Officer based in Washington will have adequate knowledge of market forces, weather conditions, and other ranching issues that are central to the tax dispute.

In addition to this concern, the taxpayer cannot afford transportation to Washington State. As a result, his remaining options are to wait for an Appeals Officer to ride circuit, which can substantially extend the length of the Appeals process, or to forgo a face-to-face conference. Wishing for a timely resolution of the tax controversy, the taxpayer reluctantly decides to proceed with the appeal, communicating with the Appeals Officer by telephone and correspondence.

Ultimately, the taxpayer and the Appeals Officer cannot reach an agreement. The taxpayer believes the presentation of his case has been prejudiced by the lack of a readily available Appeals Officer who understands ranching issues, and feels he has been denied access to justice. The taxpayer, therefore, seeks judicial review as a means of resolving the tax controversy that, in his view, could have been properly addressed through a face-to-face meeting with a well-informed Appeals Officer possessing local background.

RECOMMENDATION

To address the lack of convenient access to Appeals, the National Taxpayer Advocate recommends that Congress pass legislation to expressly require that Appeals have at least one Appeals Officer and Settlement Officer located and permanently available within every state, the District of Columbia, and Puerto Rico.

PRESENT LAW

Section 3465(b) of RRA 98 provides “The Commissioner of Internal Revenue shall ensure that an appeals officer is regularly available within each State.”⁸ As expressed by Senator Roth at the time RRA 98 was enacted:

With this legislation, we require the agency to establish an independent Office of Appeals—one that may not be influenced by tax collection employees or auditors. Appeals officers will be made available in every state, and they will be better able to work with taxpayers who proceed through the appeals process.⁹

⁸ RRA 98, Pub. L. No. 105-206, § 3465(b), 112 Stat. 685 (1998).

⁹ 144 CONG. REC. S7622 (1998) (Statement of Sen. Roth).

REASONS FOR CHANGE

The IRS does not dispute that it is subject to § 3465(b) of RRA 98. Instead, the IRS argues that it meets its obligations by allowing for “circuit riding” on at least a quarterly basis to states lacking a permanent Appeals field office.¹⁰

Circuit riding, however, existed prior to the passage of RRA 98.¹¹ Nevertheless, Congress felt compelled to require that Appeals Officers be made regularly available in *all* states. Unlike some other aspects of RRA § 3465, which the legislative history explained as a codification of existing IRS procedures, the “regularly available within each State” mandate was presented as a new requirement.¹² Despite this legislative indication that Congress desired more convenient access and local presence than was being supplied by circuit riding, the IRS has expanded the number of states without an Appeals Officer or Settlement Officer, and has continued to maintain that circuit riding alone fulfills its post-RRA 98 obligations.

In practice, however, many taxpayers are experiencing limitations on their ability to have an in-person Appeals conference. The number of states and territories in which Appeals lacks both an Appeals Officer and a Settlement Officer has grown by 33 percent since 2011. Twelve states and Puerto Rico have no Appeals or Settlement Officers with a post of duty within their borders.¹³ Further, the overall number of Appeals conferences held via circuit riding has progressively fallen over each of the last four years.¹⁴

The National Taxpayer Advocate is concerned that this decreasing trend in the number of circuit riding cases, and the isolation it portends for states without an Appeals presence, is not the result of taxpayer choice. Rather, it is effectively imposed on taxpayers by the expansion of states without a permanent Appeals office and by the diminishing availability of Appeals personnel who can ride circuit.

Available evidence indicates that the lack of face-to-face access to Appeals in all states is harmful to impacted taxpayers. The ability, or lack thereof, to interact on a face-to-face basis with the IRS has a significant effect on taxpayer perceptions and satisfaction. For example, an IRS survey has indicated that overall satisfaction with face-to-face examinations is much higher (71 percent) than for correspondence examinations (43 percent).¹⁵ Similarly, overall dissatisfaction is more than twice as great for correspondence examinations (41 percent) than for face-to-face examinations (18 percent).¹⁶

Further, taxpayers forced to rely on circuit riding in order to obtain a face-to-face Appeals conference often must wait an additional 6 months or more to resolve their Appeals case as compared with taxpayers fortunate enough to live near an Appeals office.¹⁷ Moreover, circuit riding Appeals conferences have

10 National Taxpayer Advocate 2009 Annual Report to Congress 81; IRM 8.6.1.4.1.1 (June 8, 2010).

11 IRM 8622 (Apr. 20, 1990).

12 S. REP. No. 105-174, at 88 (1998).

13 IRS, Human Resources Reporting Center, *available at* <https://persinfo.web.irs.gov/> (last visited June 27, 2014).

14 Appeals does not report circuit riding data on a state-by-state basis. Appeals response to TAS information request (Aug. 5, 2014). Note that circuit riding can occur in rural areas of states that have permanent Appeals offices. Moreover, taxpayers in some states lacking a permanent Appeals presence occasionally have convenient access to a field office in a nearby state. Additionally, circuit riding can occur for reasons unrelated to geography, such as substantial books and records, high inventories, or lack of technical expertise. See IRM 8.6.1.4.1.1 (June 8, 2010). Nevertheless, in the absence of more targeted data from the IRS, analysis of circuit riding data provides the clearest insight into the status of taxpayers residing in states without a regular Appeals presence.

15 IRS, National Research Program 2011 Customer Satisfaction Survey (Feb. 9, 2012).

16 *Id.*

17 Appeals response to TAS information request (Aug. 5, 2014); supplemented by FY 2014 data provided by Appeals on November 6, 2014.

significantly higher levels of disagreement between taxpayers and the IRS, and generate substantially lower levels of agreement than face-to-face Appeals conferences conducted in field offices.¹⁸

This evidence indicates that taxpayers located in states without a permanent Appeals presence are being inadequately served and may lack access to justice. Further, it casts doubt on the effectiveness and equity of circuit riding even when employed by the IRS in states possessing permanent Appeals field offices. Circuit riding Appeals Officers and Settlement Officers do not have the familiarity with the economic, market, geographic, and other state and local conditions necessary to adequately assess the import of facts and circumstances and the credibility of witnesses as a means of fairly and efficiently resolving cases.

EXPLANATION OF RECOMMENDATION

As part of the fiscal year 2011 Senate Budget Resolution, Senator Enzi introduced legislation requiring redeployment of existing IRS resources “to provide at least one full-time Internal Revenue Service appeals officer and one full-time settlement agent in every State.”¹⁹ Ultimately, the Budget Resolution that included Senator Enzi’s amendment was never acted upon by Congress. Nevertheless, the taxpayer service concerns giving rise to this legislation, and § 3465(b) of RRA 98, have not been remedied by the IRS.

Congress should address the lack of taxpayer access to Appeals in those jurisdictions without an Appeals field office by enacting legislation that expressly requires that at least one Appeals Officer and Settlement Officer be located and permanently available within every state, the District of Columbia, and Puerto Rico.²⁰ The IRS can achieve this expanded presence over time through attrition, rather than backfilling, of Appeals personnel currently located in IRS campus (centralized) Appeals offices.

18 Appeals response to TAS information request (Aug. 5, 2014); supplemented by FY 2014 data provided by Appeals on November 6, 2014. See also Most Serious Problem: *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State*, *supra*.

19 See 156 CONG. REC. S2654 (2010) (statement of Sen. Enzi).

20 Although not a panacea, videoconferencing and other means of virtual service delivery represent a promising vehicle for the provision of virtual face-to-face access if properly developed, implemented, and deployed. For further discussion of this topic see 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*, *supra*.

LR
#3

RETURN PREPARATION: Require the IRS to Provide Return Preparation to Taxpayers in Taxpayer Assistance Centers and Via Virtual Service Delivery

PROBLEM

Beginning in the 2014 filing season, the IRS eliminated tax return preparation services by IRS employees.¹ Low income, disabled, and elderly taxpayers were directed to use Free File or Volunteer Income Tax Assistance and Tax Counseling for the Elderly (VITA/TCE) sites.² Taxpayers can no longer have a tax return prepared by an IRS employee, regardless of their income level or situation. The IRS's decision to cease free tax return preparation at Taxpayer Assistance Centers (TACs) raises the following concerns:

- Returns prepared by IRS employees were more accurate than other sources;³
- Other avenues for free return preparation, such as VITA/TCE sites, are limited with regard to the types and the scope of returns these sites can prepare compared to return preparation services previously offered at TACs;⁴ and
- The IRS awarded seven fewer grants to VITA sites from FY 2013 to FY 2014 while the number remained the same for the TCE sites for the same period.⁵

Failing to provide return preparation by IRS employees undermines *the right to quality service* articulated in the recently adopted Taxpayer Bill of Rights.⁶ Under *the right to quality service*, taxpayers are entitled to professional assistance from the IRS and to receive clear and easily understandable communications. By abandoning return preparation, the IRS has left vulnerable taxpayers to turn either to volunteer sites, who may not prepare the type of returns the taxpayers need, or to paid tax return preparers to prepare and

- 1 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), available at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.
- 2 VITA/TCE sites provide free tax return preparation services for qualified individuals in conjunction with IRS assistance and direction. See IRS, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources*, available at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources> (last visited Oct. 17, 2014); IRS, *Free File: Do Your Federal Taxes for Free*, available at <http://www.irs.gov/uac/Free-File-Do-Your-Federal-Taxes-for-Free> (last visited Oct. 27, 2014). The income limitation on eligibility to use Free File changes each taxable year.
- 3 Generally, returns prepared by TACs, where the taxpayers have a household income of less than \$50,000 and do not use schedules E (*Supplemental Income and Loss*), or F (*Profit or Loss From Farming*), or Form 2106 (*Employee Business Expenses*), had lower Discriminant Function (DIF) scores than returns prepared by other preparers or by taxpayers, suggesting that TAC-prepared returns are less likely to understate the tax owed and are thus more accurate. Compliance Data Warehouse, *Individual Returns Transaction File: Tax Year 2010*. TAC criteria for return preparation include returns with income not in excess of \$50,000, and no schedules E, F, or Forms 2106, in addition to other requirements. The DIF score is an IRS calculated estimate of the likelihood that a tax return has understated the amount of tax owed, based on the type of return filed. The only returns that have lower DIF scores than TAC-prepared returns with the caveats listed above are those in Activity Code 272, which are returns with no Schedules C (*Profit or Loss from Business (Sole Proprietorship)*), E, F, or Form 2106 and no claiming of the Earned Income Tax Credit.
- 4 IRS, Publication 4012, *VITA/TCE Volunteer Resource Guide, Scope of Service 8-10* (Oct. 2014). VITAs and TCEs generally cannot prepare IRS Form 1040 Schedule C, *Profit or Loss From Business (Sole Proprietorship)*, complicated and advanced forms such as Schedule D, Capital Gains and Losses, and Schedule F, *Profit or Loss From Farming*, Form 3903, *Moving Expenses*, and others. Internal Revenue Manual (IRM) 22.30.1.3.10.2, after the IRM number then *Prior Year Return Preparation* (Oct. 1, 2014). Only experienced volunteer sites with the necessary software and reference materials may prepare prior year returns.
- 5 IRS response to TAS information request (Aug.15, 2014 and Nov. 19, 2014).
- 6 The IRS adopted the Taxpayer Bill of Rights on June 10, 2014. See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. See also IRS, Publication 1, *Your Rights as a Taxpayer* (2014).

file their returns, resulting in the taxpayer paying for an essential service that the government previously provided for free.

EXAMPLE

A low income taxpayer resides in a rural area of a state. It is a one-hour drive to the closest TAC, where he has had his tax return prepared for years. The state does not have much coverage from the VITA program and the taxpayer does not qualify for TCE services. The closest VITA site to his home is hosted by a library three hours away. Since the TACs stopped preparing returns, the taxpayer stopped filing his returns. This year he decides to make the long trip to the VITA site. However, once he arrives, he finds out that VITA has no one volunteering that day who can prepare his past returns, and cannot help him with a cancellation of debt income issue. The taxpayer returns home and, because he does not feel competent to prepare his own return, seeks out a local preparer who charges a fee for return preparation that the taxpayer, in prior years, obtained for free.

RECOMMENDATION

To provide taxpayers with access to IRS return preparation, the National Taxpayer Advocate recommends that Congress:

- Require the IRS to provide return preparation for vulnerable populations (including low income, disabled, and elderly taxpayers) in TACs and via virtual service delivery.
- Provide sufficient funding for IRS personnel to offer return preparation in TACs.

PRESENT LAW

The IRS is not currently required to provide return preparation services in TACs or via virtual service delivery.

REASONS FOR CHANGE

VITA and TCE sites provide a valuable service to vulnerable taxpayer populations, including low income, disabled, and the elderly; however, they are not a substitute for IRS return preparation services. Return preparation services offered by the IRS were more comprehensive than those currently available at VITA and TCE sites.⁷ VITA and TCE sites are limited by the IRS guidelines for the types of returns they can prepare.⁸ Generally, VITA and TCE sites cannot prepare an IRS Form 1040 with a Schedule C, *Profit or Loss From Business (Sole Proprietorship)*, complicated and advanced forms such as Schedule D, *Capital Gains and Losses*, Schedule F, *Profit or Loss From Farming*, Form 3903, *Moving Expenses*, and certain Form 1099-C, *Cancellation of Debt* issues.⁹

⁷ For a complete discussion of the National Taxpayer Advocate's concerns about VITA and TCE programs, see Most Serious Problem: *VITA/TCE FUNDING: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations*, *supra*.

⁸ IRS, Publication 4012, *VITA/TCE Volunteer Resource Guide, Scope of Service*, 8-10 (Oct. 2014).

⁹ *Id.*

In addition to return preparation services being limited in scope by IRS guidelines, services are limited by the certifications of the volunteers at the VITA/TCE sites, which can fluctuate.¹⁰ The IRS offers both basic and advanced certifications to volunteers which determine what types of returns they can prepare.¹¹ The IRS also offers six specialty certifications, three of which can only be achieved by volunteers if they have first passed advanced certification.¹² If a taxpayer arrives at a VITA or TCE site and requires the preparation of a return that needs advanced certification or a specialty certification and no volunteers with that certification are available that day the taxpayer will be turned away. TACs could prepare a broader scope of forms and returns overall, and in earlier years allowed taxpayers to schedule appointments.

TACs could prepare current and prior year returns, as well as amended returns, until filing season 2013, when the IRS terminated the preparation of previous year returns and amended returns.¹³ VITA and TCE sites can only prepare prior year returns at “experienced” sites if they have the necessary software and reference materials.¹⁴ Leading up to the complete termination of return preparation services at TACs, the IRS made several changes to TAC return preparation, including eliminating appointments, reducing the number of days return preparation was available, and narrowing the scope of returns prepared. These service reductions led to a decrease in return preparation in TACs and have since been used to justify the discontinuance of the service entirely.¹⁵

In addition to the termination of return preparation at about 400 TACs, the number of VITA and TCE sites has decreased since the IRS ceased to offer this service, leaving nine percent fewer sites where taxpayers can seek free return preparation.¹⁶ Overall, the number of returns prepared by the two programs increased by almost 12 percent between FY 2013 and FY 2014.¹⁷ The IRS increased funding for the TCE sites while the number of returns prepared by these sites decreased for the first time since the program was created.¹⁸ The shift of funding from VITA to TCE also decreased the dollar amount of matching funds dedicated to volunteer tax preparation by \$100,000 dollars, since TCE programs are not required to provide matching funds in return for their grants.¹⁹ Moreover, since VITA programs actually increased the number of returns prepared in FY 2014 despite funding cuts, the IRS could have served more taxpayers by funding VITA programs at the FY 2013 level.²⁰ It is unclear to the National Taxpayer Advocate why the IRS chose to reduce resources available to VITA grantees and their beneficiaries, the taxpayer.

10 Volunteers are only protected from liability by the Volunteer Protection Act of 1997, Pub. L. No. 105-19, 100 Stat. 218 (1997), if they follow all guidelines and limitations of the program as defined by the IRS. IRS, Publication 4012, *VITA/TCE Volunteer Resource Guide, Scope of Service*, 8 (Oct. 2014). If volunteers prepare returns or forms they are not certified to prepare, they are not protected from liability.

11 IRM 22.30.1.3.7.1, *Types of VITA and TCE Courses (Volunteers)* (Oct. 1, 2014).

12 *Id.*

13 IRS, Field Assistance, *FY 2013 Return Preparation in Taxpayer Assistance Centers*, Slide 5 (Jan. 17, 2013).

14 IRM 22.30.1.3.10.2, *Prior Year Return Preparation* (Oct. 1, 2014).

15 SERP Alert 12A0095 (Jan. 27, 2012).

16 IRS response to TAS research request (Aug. 15, 2014). In fiscal year (FY) 2013, the IRS had 398 TACs where taxpayers could potentially seek free return preparation if the sites were offering return preparation services in that FY. IRS response to TAS research request (Aug. 15, 2014). In FY 2013, 13,081 VITA and TCE sites offered free return preparation. Combined between TACs and VITA/TCE sites, potentially 13,479 sites offered free return preparation in 2013. IRS response to TAS research request (Nov. 26, 2014). Through June 29, 2014, free return preparation was offered at 12,319 VITA and TCE sites.

17 IRS response to TAS information request (Aug. 15, 2014). Supplemented by IRS response to TAS research request (Dec. 12, 2014).

18 IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014).

19 IRS response to TAS information request (Nov. 19, 2014) and IRS response to fact check (Dec. 27, 2014).

20 IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014). VITA grantees prepared 66,182 more returns in FY 2014 than in FY 2013 (1,419,615 vs. 1,353,433), while TCE grantees prepared 251,929 fewer returns over the same period (1,343,931 vs. 1,595,860).

Historically, returns prepared by TACs, where the taxpayers have a household income of less than \$50,000 and do not use schedules E or F or Form 2106, have lower Discriminant Function (DIF) scores than returns prepared by other preparers or self-prepared by taxpayers, suggesting that TAC-prepared returns are less likely to understate the tax owed and are thus more accurate.²¹ Thus, TACs provided a wider scope of services than VITA and TCE sites and the returns prepared at TACs were more accurate.

By ceasing return preparation at the TACs, the IRS has made it more difficult for taxpayers to seek free return preparation and may cause taxpayers to not file returns or to seek assistance from paid preparers, decreasing filing compliance and imposing burden, including transportation costs and the costs of return preparation on predominantly low income, elderly, and disabled taxpayers, previously served by TACs. The IRS may leave these taxpayers with a choice of paying for a previously free service (if their returns are not covered within the scope of the services provided at the local VITA and TCE sites) or of simply ceasing to file returns. Some low income taxpayers who won't be able to prepare and file their returns will bypass credits and deductions they would be otherwise eligible for, such as the Earned Income Tax Credit (EITC)²² and Child Tax Credit (CTC).²³

In summary, failing to provide return preparation in TACs erodes several taxpayer rights, including *the right to be informed, the right to quality service, and the right to pay no more than the correct amount of tax.*

EXPLANATION OF RECOMMENDATION

The IRS currently maintains 382 TACs, down from 401 in 2011 when it began making adjustments to return preparation services offered by TACs.²⁴ Since the IRS continues to close TACs or effectively close them by reducing staff to one or zero employees, requiring the IRS to provide return preparation in just TAC locations will not restore taxpayer access to return preparation. However, the IRS has been piloting the use of virtual service delivery and has established 49 virtual service sites across the country.²⁵ Return preparation offered through both virtual service sites and the remaining TAC locations would improve service to taxpayers and reduce taxpayer burden. While the IRS must continue to improve the technology available for virtual services and to develop a strategic plan to bring additional virtual service sites on line, using existing sites to provide return preparation, in concert with the TACs, will allow the IRS to reach additional taxpayers.²⁶

21 Compliance Data Warehouse, *Individual Returns Transaction File: Tax Year 2010*. TAC criteria for return preparation include returns with income not in excess of \$50,000, and no schedules E, F, or Forms 2106, in addition to other requirements. The DIF score is an IRS calculated estimate of the likelihood that a tax return has understated the amount of tax owed, based on the type of return filed. The only returns that have lower DIF scores than TAC-prepared returns with the caveats listed above are those in Activity Code 272, which are returns with no Schedules C, E, F, or Form 2106 and no claiming of the Earned Income Tax Credit.

22 IRC § 32.

23 IRC § 24.

24 IRS response to TAS research request (Dec. 23, 2014). At the end of FY 2014, there were 382 open TACs.

25 Network Services response to TAS research request (Aug. 6, 2014). See, e.g., FL-2012-06, *Tax Help for Tampa Area Taxpayers* (May 10, 2012) (Virtual Service Delivery for taxpayers to interact with TAS); Interim Guidance Memorandum AP-08-0714-0007, *Implementation of Virtual Service Delivery (VSD)* (July 24, 2014) (Virtual Service Delivery teleconferencing in Campus Appeals).

26 For a complete discussion of the National Taxpayer Advocate's concerns regarding the IRS's implementation of virtual service delivery, see 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*, *supra*.

Since 2011, the IRS chipped away at the return preparation services provided in the TACs; however, it has not remedied this through other service avenues such as VITAs and TCEs which cannot currently provide the same level or type of service to taxpayers. The National Taxpayer Advocate recommends that Congress remedy this situation by requiring the IRS to provide return preparation in TACs and via virtual service delivery and by providing the funding to allow the IRS to fulfill this mandate.

LR
#4

VIRTUAL SERVICE DELIVERY (VSD): Establish Targets and Deadlines for the Development and Implementation of VSD in Brick & Mortar Locations, in Mobile Tax Assistance Units, and Over the Internet

PROBLEM

In the deliberations leading to passage of the IRS Restructuring and Reform Act of 1998 (RRA 98), both the National Commission on Restructuring the IRS (Restructuring Commission) and Congress articulated a vision of the IRS operating as a business that used cutting-edge computer technology to increase accountability and improve taxpayer service.¹ Taxpayers are ready to embrace this technology.² The Social Security Administration (SSA) and the Department of Veterans Affairs (VA) have made extensive use of VSD to increase the accessibility and availability of their services.³ Nevertheless, despite the vision of the Restructuring Commission and Congress, the openness of taxpayers to embrace computer technology, and the successes of other agencies, the IRS is still operating as a 20th century business, primarily relying on postal correspondence, telephone conversations, and taxpayer visits to brick and mortar locations.⁴

VSD in brick and mortar locations, such as Taxpayer Assistance Centers (TACs), allows taxpayers virtual face-to-face (VFTF) access to the IRS, and is particularly important for taxpayers who live in rural areas or who lack their own computer technology or proficiency in its use.⁵ However, only 49 facilities currently provide VSD and the IRS has allocated no additional funding to expand this capacity.⁶ Mobile tax assistance units, none of which are currently employed by the IRS, could also be equipped with VSD technology to bring VSD to strategic locations and needy populations.

Further, the provision of VSD over the Internet using taxpayer digital communications (TDC), which has the potential to revolutionize tax administration, is still in its conceptual stages.⁷ This halting development of VSD in its various manifestations often has the effect of preventing taxpayers from face-to-face interactions with the IRS, which inhibits crucial communication and thereby infringes on *the right to quality service*, one of the core elements of the Taxpayer Bill of Rights (TBOR), recently adopted by the IRS.⁸

- 1 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 6-8 (June 25, 1997); 144 Cong. Rec. S4182.
- 2 IRS Oversight Board, 2013 Taxpayer Attitude Survey, (conducted August 2013), available at http://www.treasury.gov/IRSOB/reports/Documents/IRSOB_TAS%202013.pdf (last visited Aug. 25, 2014).
- 3 For a more in-depth discussion of this topic and for expanded analysis of the problem addressed by this legislative recommendation, see 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*, *supra*.
- 4 The exception to this circumstance is electronic filing of tax returns, the prevalence of which can be directly traced to the congressional mandate established in RRA 98. See Pub. L. No. 105-206, § 2001, 112 Stat. 685, 723 (1998).
- 5 See 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*, *supra*.
- 6 User & Network Services (Network Services) response to TAS research request (Aug. 6, 2014).
- 7 IRS Online Services (OLS) response to TAS research request (Aug. 18, 2014).
- 8 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

EXAMPLE⁹

A taxpayer who lives in a rural area is the subject of a correspondence audit that raises substantiation questions and legal issues.¹⁰ The taxpayer wishes to have a face-to-face meeting with the IRS agent to properly present his factual information and best explain his overall tax position. The taxpayer has a good deal of documentation, and is willing to obtain more, but is unsure what the IRS requires or would accept as substantiation for his claim.

The IRS does not maintain an office in the taxpayer's vicinity. Moreover, although the taxpayer's local community has a TAC and other public buildings such as a post office and a library, none of these sites are outfitted with videoconferencing equipment.

Because no VSD technology is available to offer a VFTF conference, the taxpayer must either travel to meet with the IRS agent, which the taxpayer cannot afford, or allow the audit to move forward without the desired face-to-face contact. Seeing no alternative, the taxpayer proceeds with the audit, communicating with the IRS solely by mail and telephone, and speaking with numerous employees.

At the conclusion of the audit, the IRS proposes a substantial income adjustment resulting in tax deficiencies and accompanying penalties. The taxpayer, frustrated and disappointed with the process as well as the outcome, walks away from the experience feeling as though he was never able to adequately convey the nuances of his facts and tax position without the ability to interact with a single IRS agent face-to-face.

RECOMMENDATION

To address the need for enhanced and expanded virtual service delivery, the National Taxpayer Advocate recommends that Congress pass legislation to:

1. Establish targets and timelines for development and implementation of VSD in brick and mortar locations, including non-IRS facilities, in mobile tax assistance units, and via TDC over the Internet.
2. Provide funding, or require the IRS to allocate funding, sufficient to enable continued implementation of VSD initiatives in brick and mortar locations, in mobile tax assistance units, and over the Internet.

⁹ For a similar example relating to the lack of access to a face-to-face Appeals conference, see Legislative Recommendation: *ACCESS TO APPEALS: Require that Appeals Have at Least One Appeals Officer and Settlement Officer Located and Permanently Available Within Every State, the District of Columbia, and Puerto Rico, infra/supra*. See also Most Serious Problem: *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State, supra*.

¹⁰ Correspondence examinations are centralized and automated in large IRS campuses. These examinations use batch processing, which automates the initiation, processing, and closing of correspondence examination cases. See NTA Blog: *Are IRS Correspondence Audits Really Less Burdensome for Taxpayers?* (Mar. 13, 2012), available at <http://www.taxpayeradvocate.irs.gov/Blog/are-irs-correspondence-audits-really-less-burdensome-for-taxpayers>.

PRESENT LAW

Section 3465(b) of RRA 98 provides “The Commissioner of Internal Revenue shall ensure that an appeals officer is regularly available within each State.”¹¹ Congress, however, recognizing that this physical presence alone may not be sufficient to meet taxpayer demand and wishing more generally to help the IRS develop the tools to function as a 21st century business, also passed § 3465(c). That section directs the IRS to “consider the use of the videoconferencing of appeals conferences between appeals officers and taxpayers seeking appeals in rural or remote areas.”¹²

In passing RRA 98, Congress urged the IRS to adopt a course of action that likely would have generated substantial progress in the use of VSD to improve customer service. Although Congress called for the IRS to explore VSD in the context of Appeals, technological innovation on that front presumably would have migrated to other IRS divisions. More than 15 years after the enactment of RRA 98, however, the desire reflected in and the opportunity presented by Congress’ videoconferencing directive have yet to be achieved.

REASONS FOR CHANGE

The IRS has ample evidence to indicate that taxpayers generally favor the use of VSD. In a limited pilot conducted by the Wage & Investment (W&I) division of the IRS between October 2011 and June 2012, 87 percent of taxpayers reported they were satisfied with the services provided, and 91 percent would use VSD again.¹³ Similarly, 83 percent of taxpayers responding to a study conducted by the IRS Oversight Board indicated they were likely to use the IRS website, while 72 percent said they were likely to use email to send questions to the IRS.¹⁴

As models for the successful implementation of VSD, the IRS can look to the SSA, which in 2012 held over 25 percent of its hearings by video, and the VA, which operates over 700 sites with videoconferencing capacity for veterans who lack easy access to VA hospitals.¹⁵ Effective use of such technology would allow the IRS to deliver services outside of IRS facilities, enhance utilization of IRS resources, optimize staffing, balance workload, and increase taxpayer access to face-to-face services.¹⁶

Despite the acknowledged benefits of VSD, however, and the express urging of Congress over 15 years ago, the IRS has made only limited progress toward developing and implementing such technology. The IRS appears to have no current intention of expanding VSD in brick and mortar locations.¹⁷ This decision would fall disproportionately hard on low income and elderly taxpayers, who are the most likely

11 Pub. L. No. 105-206, § 3465(b), 112 Stat. 685, 768 (1998). For a discussion of RRA § 3465(b), see Most Serious Problem: *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State, infra/supra*; Legislative Recommendation: *ACCESS TO APPEALS: Require that Appeals Have at Least One Appeals Officer and Settlement Officer Located and Permanently Available Within Every State, the District of Columbia, and Puerto Rico, infra/supra*.

12 Pub. L. No. 105-206, § 3465(c), 112 Stat. 685, 768 (1998). See also 144 Cong. Rec. S4182.

13 E.g., in a limited pilot conducted by W&I between October 2011 and June 2012, 87 percent of taxpayers reported they were satisfied, to very satisfied, with this service, and 91 percent would use it again. W&I response to TAS fact check request (Nov. 4, 2014).

14 IRS Oversight Board, 2013 Taxpayer Attitude Study, available at http://www.treasury.gov/IRSOB/reports/Documents/IRSOB_TAS%202013.pdf (last visited Aug. 25, 2014).

15 See 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, supra*.

16 Virtual Service Delivery: *Delivering Taxpayer Services Using Video Communications Technology* (Jan. 9, 2014). Provided as part of the Network Services response to TAS research request (Aug. 6, 2014).

17 Network Services supplemental response to TAS research request (Aug. 25, 2014).

to lack home computer technology or the proficiency required to use it when interacting with the IRS.¹⁸ The IRS also has no plans to migrate delivery of face-to-face services to more flexible mobile tax assistance units, by which taxpayers could access VSD technology. These mobile units would enable the IRS to respond more nimbly to population shifts and natural disasters, and could be used to benefit underserved communities allowing for both pre-scheduled and walk-in visits.¹⁹ Moreover, none of the projected functionalities of TDC, which will be delivered over the Internet, is in development, and most do not have projected availability dates.²⁰

One of the fundamental rights within TBOR is *the right to quality service* which involves the right of taxpayers to receive prompt, courteous, and professional assistance in their dealings with the IRS, to be spoken to in a way they can easily understand, and to receive clear and easily understandable communications from the IRS. The ability to have face-to-face interactions with the IRS is an indispensable element of this right, and is greatly constrained by the lack of VSD options currently available to taxpayers.

The following table illustrates the funding allocated by the IRS to the development of VSD:

FIGURE 2.4.1, IRS expenditures on VSD in fiscal years 2012–2014²¹

	FY 2012	FY 2013	FY 2014
VSD in brick & mortar locations	\$1,531,000	\$1,736,000	\$0
VSD in mobile tax assistance units	\$0	\$0	\$0
VSD over the Internet (TDC)	\$0	\$375,000	\$1,700,000

Since the passage of RRA 98, the IRS has devoted insufficient resources and funding to the development of VSD. As a result, the IRS suffers from a VSD gap when compared with the technological advances made by some other agencies and private businesses.

By contrast, RRA 98 also established the specific goal that, by 2007, 80 percent of tax and information returns would be electronically filed.²² As part of this legislation, Congress required the IRS Oversight Board, as well as the Electronic Tax Administration Advisory Committee, to report to Congress annually on the progress toward the goal.²³ The IRS did not meet the target in 2007, but the 80 percent electronic filing goal was extended to 2012, at which point it was reached.²⁴

As analyzed by the IRS Oversight Board, “Looking back over the 15 years since the passage of RRA 98, the focus created by that goal [the 10-year, 80 percent electronic filing requirement] has proven to be an

18 See 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*, *supra*. See also Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2014-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established* (June 27, 2014).

19 For a more in-depth discussion of this topic, see Most Serious Problem: *IRS LOCAL PRESENCE: The Lack of a Cross-Functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*, *supra*. See also National Taxpayer Advocate 2008 Annual Report to Congress 95.

20 OLS response to TAS research request (Aug. 18, 2014).

21 Network Services response to TAS research request (Aug. 6, 2014); OLS response to TAS research request (Aug. 18, 2014).

22 Pub. L. No. 105-206, § 2001(a)(2), 112 Stat. 685, 723 (1998).

23 *Id.* at § 2001(d), 112 Stat. 685, 723 (1998).

24 IRS Oversight Board Electronic Filing 2012 Annual Report to Congress, 5 (Dec. 2012).

effective catalyst for coordinated efforts by the IRS, the tax professional community, and Congress. This has led to tremendous progress in electronic filing.”²⁵

EXPLANATION OF RECOMMENDATION

The IRS would benefit from the similar catalyst of congressionally mandated goals for development and implementation of VSD in brick and mortar locations, including non-IRS facilities, in mobile tax assistance units, and via TDC over the Internet. These parameters should include targets for the expanded availability of VSD in brick and mortar locations, emphasizing the use of partner locations to reach taxpayers who most need access to and help with such equipment. In particular, Congress should consider requiring the IRS to explore partnerships with the U.S. Postal Service, which could build VSD-equipped rooms available to a number of agencies including the IRS, the SSA, and the VA. Congress should also establish timetables and reporting obligations for continued expansion of VSD in brick and mortar locations and mobile tax assistance units, and the ongoing development and implementation of TDC over the Internet.

Congressional intervention and oversight would enhance and accelerate the IRS’s VSD initiatives. As with the 80 percent electronic filing goal, Congress should consider requiring the IRS Oversight Board, the Electronic Tax Administration Advisory Committee, or other appropriate entities to report annually on the progress being made toward the applicable targets and deadlines. Funding to facilitate this essential progress, however, will need to be provided by Congress or separately allocated by the IRS pursuant to congressional directive.²⁶

25 IRS Oversight Board Electronic Filing 2013 Annual Report to Congress, 5 (Feb. 2014).

26 The income effect of these VSD efforts cannot be adequately estimated, as the IRS does not appear to have undertaken a comprehensive cost-benefit study relating to VSD. TIGTA has recommended that the cost savings and benefits related to VSD be quantified by the IRS and reported as part of the budget request process. TIGTA, Ref. No. 2014-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established* (June 27, 2014).

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SECTION 501(c)4) POLITICAL CAMPAIGN ACTIVITY: Enact an Optional “Safe Harbor” Election That Would Allow IRC § 501(c)4) Organizations to Ensure They Do Not Engage in Excessive Political Campaign Activity

PROBLEM

Organizations exempt from tax as Internal Revenue Code (IRC) § 501(c)(3) organizations, contributions to which may be tax deductible, are prohibited from *any* participation or intervention in political campaigns on behalf of (or in opposition to) candidates for public office.¹ However, these organizations are permitted to engage in lobbying activity, so long as the activity is “insubstantial.”² Subsection (h) of IRC § 501, added by Congress in 1976, is an elective “safe harbor” that allows for a determination, based solely on the electing IRC § 501(c)(3) organization’s expenditures, of whether its lobbying activities are within permissible limits.³ An IRC § 501(c)(3) organization that does not make an election under IRC § 501(h) is subject to a “facts and circumstances” test to determine whether it has engaged in excessive lobbying activity.⁴

Unlike IRC § 501(c)(3) organizations, IRC § 501(c)(4) organizations, contributions to which are generally not deductible, may engage in substantial lobbying.⁵ IRC § 501(c)(4) organizations may also engage in political campaign activity, but only if they are “*primarily* engaged in promoting in some way the common good and general welfare of the people of the community.”⁶ There is no statutory or regulatory quantification of the term “primarily” for this purpose, nor is there a statutory or regulatory “safe harbor” for determining whether an IRC § 501(c)(4) organization’s political campaign activities are within permissible limits. Section 501(c)(4) organizations engaging in political campaign activity are subject to a “facts and circumstances” test to determine whether they have engaged in impermissible political activity.

According to the Taxpayer Bill of Rights the IRS adopted on June 10, 2014, taxpayers have the *right to be informed*, *i.e.*, “the right to know what they need to do to comply with the tax laws.”⁷ An elective safe harbor for IRC § 501(c)(4) organizations, by establishing acceptable limits of political campaign activity and providing a method for measuring those activities, would support this right.

EXAMPLE

XYZ, Inc., which engages in political campaign activity through its volunteers, applies to the IRS for recognition of its exempt status under IRC § 501(c)(4) as a social welfare organization. Neither XYZ nor the IRS can determine from statutory, regulatory, or judicial authorities:

- How to measure XYZ’s social welfare activity;

1 IRC §§ 170(c) and 501(c)(3).

2 IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(3)(i).

3 Tax Reform Act of 1976, Pub. L. No. 94-455, § 1307, 90 Stat. 1520, 1720 (1976).

4 Treas. Reg. § 1.501(h)-1(a)(4).

5 See, e.g., Treas. Reg. § 1.504(c)(4)-1(a)(2)(ii), referencing “action” organizations.

6 IRC § 501(c)(4)(A); Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (emphasis added). Treas. Reg. § 501(c)(4)-1(a)(2)(ii) provides that promoting social welfare does not include participation or intervention in political campaigns.

7 Taxpayer Bill of Rights, available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>.

- Whether there is a required minimum percentage of such activity, or whether multiple factors should be considered; and if so;
- The weight to be given to these factors.⁸

The IRS's "expedited" procedures would allow it to approve XYZ's application based on XYZ's attestations about how it allocates its time and resources. However, XYZ does not meet the requirements for "expedited" approval because it relies on volunteers whose time is "counted" in determining the portion of its resources allocated to political campaign activity. Confronted with this uncertainty, XYZ may decide to simply refrain from *any* political campaign activity, even though some level of such activity would be permissible. Alternatively, XYZ may gauge for itself the level of permissible political campaign activity and take the risk that the IRS will agree, based on all the facts and circumstances, that it guessed correctly.

RECOMMENDATION

To provide greater certainty to IRC § 501(c)(4) organizations, the National Taxpayer Advocate recommends that Congress enact an optional safe harbor election similar to IRC § 501(h) that would allow IRC § 501(c)(4) organizations to elect the use of a numerical test, based solely on their expenditures (*i.e.*, without counting volunteer activities), to determine the amount of political campaign activity they may engage in without jeopardizing their exempt status.

PRESENT LAW

Congress Provided a Safe Harbor for IRC § 501(c)(3) Organizations with Respect to Their Lobbying Activities.

Organizations exempt under IRC § 501(c)(3) are prohibited from *any* participation or intervention in political campaigns on behalf of (or in opposition to) candidates for public office.⁹ However, they may engage in lobbying activities (*i.e.*, activities to influence legislation) as long as those activities are "insubstantial."¹⁰ One practitioner described this statutory framework (as it existed prior to enactment of IRC § 501(h)) as follows:

Probably the major objection to present law is related to its uncertainty. Although the present law has been in effect for approximately 40 years, neither the courts nor the Internal Revenue Service has been able to derive a universally acceptable definition of "substantial." The Service has refused to take a position on the meaning of substantial in quantitative terms, such as what percentage of expenditures or time devoted to lobbying activities would be deemed insubstantial. Moreover, the Service has at times attempted to view the term "substantial," not only in undefined quantitative terms, but in undefined qualitative terms as well. A "facts and circumstances" test, apparently called for by the Regulations, takes the bewildered charities

8 Moreover, if the IRS denies XYZ's application, or approves the application but later revokes XYZ's exempt status due to excessive political activity, XYZ may not seek a declaratory judgment IRC § 7428. See Legislative Recommendation: *Amend IRC § 7428 to Allow IRC § 501(c)(4), (c)(5), or (c)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status, infra.*

9 IRC § 501(c)(3) provides that a charity may "not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."

10 IRC § 501(c)(3) recognizes exempt status for an organization "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes" only if "[n]o substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation." Treas. Reg. § 1.501(c)(3)-1(b)(3) provides that an organization "is not organized exclusively for one or more exempt purposes if its articles expressly empower it: (i) To devote more than an insubstantial part of its activities to attempting to influence legislation by propaganda or otherwise."

out of definable areas, such as specific financial expenditures and allocations of staff time, and into completely uncharted areas, including not only time of volunteers, but importance of the effort, and very possibly other factors. This appeared to be the case in the Service's attempt to revoke the section 501(c)(3) status of the Maryland Association for Mental Health, Inc., largely on the grounds that the association had engaged in substantial lobbying activity through the use of unpaid volunteers. While such uncertainty gives the Service flexibility, this is exactly what is objectionable to the charities. As Mortimer Caplin pointed out in his testimony before the House Committee on Ways and Means, revenue agents are normally accounting majors, not philosophy majors, and it is almost impossible to tell what one of them would decide on a given set of facts. Inconsistent enforcement of the law by the Internal Revenue Service would naturally follow.¹¹

In 1976, “to set relatively specific expenditure limits to replace the uncertain standards of present law” Congress enacted IRC § 501(h).¹² The provision allows eligible organizations to elect the use of a numerical test based solely on their expenditures to determine whether they have engaged in excessive lobbying activities, thereby causing them to be subject to an excise tax or to lose tax-exempt status under IRC § 501(c)(3). This numerical test is purely elective and thus operates as a “safe harbor.” Eligible organizations that do not elect the expenditure test remain subject to the “insubstantial” test, a facts and circumstances inquiry.¹³

Under the election, the amount of time an organization spends on an activity is not relevant except to the extent an expenditure (*e.g.*, compensation) thereby arises. Volunteer activity is relevant to the determination only to the extent it triggers an expenditure. Section 501(h) limits are determined by reference to IRC § 4911, which imposes an excise tax on “excess lobbying expenditures.”¹⁴ If the § 501(c)(3) organization's lobbying expenditures do not exceed the IRC § 4911(c) limits, the organization will not be taxed under § 4911 or lose its § 501(c) exemption.¹⁵

For electing organizations, permissible lobbying expenditures are calculated on a sliding scale that is a function of the organization's “exempt purpose expenditures.”¹⁶ For example, under IRC § 4911, an organization with exempt purpose expenditures of \$500,000 or less could spend 20 percent of its exempt

11 John B. Hufaker, Esq., Pepper, Hamilton & Sheetz (Philadelphia), *Legislative Activities of Charitable Organizations Other Than Private Foundations, with Addendum on Legislative Activities of Private Foundations*, Research Papers sponsored by the Commission on Private Philanthropy and Public Needs (also known as the Filer Commission) 2917, 2920 (1977) (fn. refs. omitted).

12 H.R. REP. No. 94-1210, pt. 1, at 8 (1976) and S. REP. No. 94-938, pt. 2, at 80 (1976), noting the provision “is designed to set relatively specific expenditure limits to replace the uncertain standards of present law, to provide a more rational relationship between the sanctions and the violations of standards, and to make it more practical to properly enforce the law. However, these new rules replace present law only as to charitable organizations which elect to come under the standards of the bill;” Tax Reform Act of 1976, Pub. L. No. 94-455, § 1307, 90 Stat. 1520, 1720 (1976). For a discussion of the lengthy legislative history of the provision, described as representing “a compromise on a compromise on a compromise on a compromise” see Jill S. Manny, *Nonprofit Legislative Speech: Aligning Policy, Law, and Reality*, 62 CASE W. RES. L. REV. 757 (2012).

13 Treas. Reg. § 1.501(h)-1(a)(4). When final regulations under § 501(h) were issued in 1990, former IRS Commissioner Mortimer Caplin took the opportunity to advise tax practitioners: “[u]nderstanding that the decision whether to elect [the section 501(h) safe harbor] should only be made after a careful review of its implications, we are convinced that making the election will serve the interest of the great majority of eligible 501(c)(3) organizations that engage even remotely in efforts to influence legislation or public opinion or in other activities touching on public policy.” ABA Sec. on Tax'n, *Open Letter*, 10 SEC. TAX'N NEWSL. 73 (1990-91).

14 IRC § 501(h)(2).

15 Treas. Reg. § 1.501(h)-1(a)(3).

16 IRC § 4911(c)(2). IRC § 4911(e)(1)(A) provides that “the term ‘exempt purpose expenditures’ means, with respect to any organization for any taxable year, the total of the amounts paid or incurred by such organization to accomplish purposes described in section 170(c)(2)(B) (relating to religious, charitable, educational, etc., purposes).”

purpose expenditures on lobbying activities. An organization with exempt purpose expenditures of more than \$500,000 but not over \$1 million could spend \$100,000 plus 15 percent of its exempt purpose expenditures over \$500,000 on lobbying activities.¹⁷ An organization with exempt purpose expenditures of more than \$1 million but not over \$1.5 million could spend \$175,000 plus ten percent of its exempt purpose expenditures over \$1 million on lobbying activities.¹⁸ An organization with exempt purpose expenditures of more than \$1.5 million could spend \$225,000 plus five percent of the excess of the exempt purpose expenditures over \$1.5 million.¹⁹ The lobbying expenditures cannot exceed \$1 million for any organization (a limit that is reached when exempt purpose expenditures equal \$17 million), and “grass roots” expenditures must always be less than or equal to 25 percent of the permissible lobbying expenditure as calculated with the sliding scale.²⁰

Congress Has Not Provided a Safe Harbor for IRC § 501(c)(4) Organizations with Respect to Political Campaign Activities.

As discussed above, organizations exempt under IRC § 501(c)(4) are not subject to the same restrictions on their lobbying activities as IRC § 501(c)(3) organizations.²¹ The statutory prohibition on *any* participation or intervention in political campaigns on behalf of candidates for public office, applicable to IRC § 501(c)(3) organizations, also does not apply to organizations exempt under IRC § 501(c)(4). Thus, IRC § 501(c)(4) organizations can engage in some amount of political campaign activity, so long as they are “*primarily* engaged in promoting in some way the common good and general welfare of the people of the community.”²²

“Primarily,” like “insubstantial” (in the context of evaluating lobbying activities of IRC § 501(c)(3) organizations), is undefined in the statute and regulations.²³ The IRS uses a facts-and-circumstances test to determine if an organization has engaged in impermissible political campaign activity.²⁴ Unlike IRC § 501(c)(3) organizations, which can make a IRC § 501(h) safe harbor expenditure election with respect to their lobbying activities, IRC § 501(c)(4) organizations do not have the benefit of an elective statutory “safe harbor.”

17 IRC § 4911(c)(2).

18 *Id.*

19 *Id.*

20 *Id.* Under IRC § 4911(c) and (d) “grass root expenditure” means expenditures for the purpose of influencing legislation “through an attempt to affect the opinions of the general public or any segment thereof” (as opposed to “communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation”).

21 A section 501(c)(4) organization may qualify for exemption even if, because of its lobbying activities, it is an “action” organization (e.g., its main objective can only be attained by legislation and its main activity is advocating for that legislation). See Treas. Reg. § 1.504(c)(4)-1(a)(2)(ii), citing the action organization regulations of Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii) and (iv).

22 IRC § 501(c)(4)(A) exempts organizations operated “exclusively” for the promotion of social welfare, but Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) allows exempt status to organizations “*primarily* engaged in promoting in some way the common good and general welfare of the people of the community” (emphasis added). In any event, Treas. Reg. § 501(c)(4)-1(a)(2)(ii) provides that promoting social welfare does *not* include participation or intervention in political campaigns.

23 On Nov. 29, 2013, the Treasury Department and the IRS requested public comment on a proposed regulation that would provide guidance to tax-exempt social welfare organizations on political activities related to candidates that will not be considered to promote social welfare. Prop. Treas. Reg. § 1.501(c)(4)-1, 78 Fed. Reg. 71535 (Nov. 29, 2013), available at <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-0001>. However, on May 22, 2014, the IRS announced that “[g]iven the diversity of views expressed and the volume of substantive input,” it would revise the proposed regulation before proceeding with a public hearing. Revised proposed regulations have not been published to date.

24 Rev. Rul. 2007-41, 2007-25 I.R.B. 1421; IRS Publication 4221-NC, *Compliance Guide for Tax-Exempt Organizations (Other than 501(c)(3) Public Charities and Private Foundations)*, 5-6 (Sept. 2014), available at <http://core.publish.no.irs.gov/pubs/pdf/p4221-nc-2014-09-00.pdf>. The IRS may in some cases rely instead on an applicant’s attestations pursuant to procedures adopted in 2013, discussed below.

At the administrative level, in 2013, after the Treasury Inspector General for Tax Administration (TIGTA) reported the IRS had adopted inappropriate procedures for evaluating IRC § 501(c)(4) applications, the IRS began issuing Letter 5228, *Application Notification of Expedited 501(c)(4) Option*, to certain organizations whose applications for exempt status under IRC § 501(c)(4) indicated the organizations could potentially be engaged in political campaign intervention or be providing private benefit to a political party.²⁵ The letter offers a “safe harbor” to these organizations if they can certify, among other things, that:

- They devote 60 percent or more of both their spending and time (including volunteer time) to activities that promote social welfare as defined by section 501(c)(4); and
- Campaign intervention amounts to less than 40 percent of both their spending and time (including volunteer time).²⁶

According to the IRS’s interim guidance to employees, organizations providing the required attestations within 45 days of the date of the letter will receive recognition of exempt status within one month.²⁷ There is no explanation in the letter to taxpayers, in the interim guidance to employees, or elsewhere, of why the IRS decided upon the 60/40 ratio or why volunteer time is considered relevant. The procedures have not been incorporated in the Internal Revenue Manual (IRM), but even if they were, the IRS could change or remove them at any time.²⁸ The IRS has not issued any guidance such as a revenue procedure that would require it to continue to follow these procedures.

The IRS reviews the applications of organizations that are not eligible to receive Letter 5228, or that do not respond with the required attestations within 45 days, using “regular” procedures, *i.e.*, “review[ing] the facts and circumstances in the pending application and any other materials to determine if the organization is operated primary for social welfare purposes, including by evaluating the possible political issues.”²⁹

REASONS FOR CHANGE

The extent to which an IRC § 501(c)(4) organization may engage in political campaign activity generally requires an evaluation of the relevant facts and circumstances, yet there is little statutory, regulatory, or judicial guidance as to what facts and circumstances are relevant and how they should be evaluated in relation to each other. This creates uncertainty for taxpayers, in the same way that “inconsistent enforcement of the law by the Internal Revenue Service would naturally follow” from the absence of a safe harbor for evaluating IRC § 501(c)(3) organizations’ lobbying activities, which was the case prior to the 1976 enactment of IRC § 501(h).

25 Tax Analyst, *IRS Provides Instructions for Optional Expedited Process for Some Tax-Exempt Applications*, 2013 TNT 129-15 (July 5, 2013); Interim Guidance, *TEGE-07-1213-24, Request for EO Technical Assistance* (Dec. 23, 2013) available at <http://www.irs.gov/pub/foia/ig/spder/TEGE-07-1213-24%5b1%5d.pdf> (removing the requirement that the application have been outstanding for a specified number of days); Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013) available at <http://www.treasury.gov/tigta/auditreports/2013reports/201310053fr.pdf>.

26 IRS Letter 5228, *Application Notification of Expedited 501(c)(4) Option* (Sept. 2013), available at <http://www.irs.gov/pub/irs-tege/letter5228.pdf>. The letter contains specific instructions explaining what types of expenditures do not promote social welfare (e.g., “direct or indirect participation or intervention in any political campaign on behalf of (or in opposition to) any candidate for public office”).

27 Interim Guidance, *TEGE-07-1213-24, Request for EO Technical Assistance* (Dec. 23, 2013) available at <http://www.irs.gov/pub/foia/ig/spder/TEGE-07-1213-24%5b1%5d.pdf>.

28 See *Barnes v. Comm’r*, 130 T.C. 248, 255 (2008) and cases cited therein (stating that the IRM “does not have the force of law, is not binding on the Commissioner, and does not confer any rights on the taxpayer.”).

29 Interim Guidance, *TEGE-07-1213-24, Request for EO Technical Assistance* (Dec. 23, 2013) available at <http://www.irs.gov/pub/foia/ig/spder/TEGE-07-1213-24%5b1%5d.pdf>.

Moreover, even if the IRS can decide, in an objective and consistent manner, whether organizations have engaged in too much political campaign activity to be exempt under IRC § 501(c)(4), it may not be *perceived* as doing so. Its failure to provide any rationale for establishing the 60/40 allocation in the context of its Letter 5228 procedures exacerbates the perception of arbitrariness. Further, these attestation procedures the IRS has adopted for some IRC § 501(c)(4) applicants include volunteer time in the calculus of permissible levels of political campaign activity. This disproportionately excludes organizations from exempt status when they actually spend a *smaller* portion of their expenditures on political campaign activity. Enacting an elective safe harbor for IRC § 501(c)(4) organizations would support taxpayers' *right to be informed* by setting out parameters they can reference and rely on in determining what they must do to comply with the law. By excluding volunteer time from the equation, the safe harbor provision would allow for a determination of whether amounts that were not subject to tax when contributed to an organization were *expended* in a manner consistent with exempt status under IRC § 501(c)(4).

EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate recommends that Congress enact a provision analogous to the current elective safe harbor under IRC § 501(h), which is available to IRC § 501(c)(3) organizations. This new safe harbor would be available to IRC § 501(c)(4) organizations that engage in political campaign activity.

The provision would not only establish an acceptable level of political campaign activity that does not promote social welfare and do so with reference to an organization's exempt social welfare activity, but would also take into account the size and budget of the organization. Such a provision would quantify the amount of permissible political campaign activity by relating it to the organization's expenditures in furtherance of its exempt (social welfare) purpose. Thus, organizations holding themselves out as meeting the requirements for receiving contributions that are exempt from tax under IRC § 501(c)(4) could be evaluated on how they actually expend those contributions.

Under this analysis, as with the IRC § 501(h) election, volunteer time and activity, which do not generate taxable income for which tax exemption would be available in the first instance, would be irrelevant (except to the extent an expenditure arises as a consequence of volunteer activity, *e.g.*, amounts spent to solicit and train volunteers or transport them to rallies or shopping malls where they campaign).

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#6**FOREIGN ACCOUNT REPORTING: Legislative Recommendations to Reduce the Burden of Filing a Report of Foreign Bank and Financial Accounts (FBAR) and Improve the Civil Penalty Structure****OVERVIEW**

A U.S. citizen or resident with foreign accounts exceeding \$10,000 can be subject to disproportionate civil penalties for failure to report the accounts on a *Report of Foreign Bank and Financial Accounts* (or FBAR) by June 30 of the following year.¹ Another penalty may apply if the accounts exceed \$50,000 and the person does not report them on Form 8938, *Statement of Specified Foreign Financial Assets*, which is part of the tax return.²

Even those who inadvertently failed to file an FBAR (*i.e.*, “benign actors”) are afraid they could be hit with the elevated penalties applicable to *willful* violations because the government may rely on circumstantial evidence of willfulness or willful blindness.³ Such fears have prompted some to enter the IRS’s offshore voluntary disclosure (OVD) programs and agree to pay penalties of such severity that they appear to have been designed for bad actors.⁴ The median penalty applied to taxpayers with the smallest accounts (*i.e.*, those in the 10th percentile with accounts of \$17,368 or less) under the 2011 OVD program, is more than eight times the unreported tax—over ten times the 75 percent penalty for civil tax fraud.⁵

In June 2014, the IRS reduced the amount it requires certain benign actors to pay under its settlement programs.⁶ However, it did not allow those who have already signed closing agreements to receive the same, more reasonable program terms, in effect punishing them for addressing the problem quickly.

Unexpected and disproportionate FBAR penalties may violate a taxpayer’s *rights to be informed and to a fair and just tax system*.⁷ Because they cause some people to agree to excessive OVD settlements, they may also erode the rights to *pay no more than the correct amount of tax, challenge the IRS’s position and be heard, and appeal an IRS decision in an independent forum*, as discussed in prior reports.⁸ These results

- 1 See, e.g., 31 U.S.C. §§ 5314, 5321; 31 C.F.R. §§ 1010.350, 1010.306(c); FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR), http://www.fincen.gov/forms/bsa_forms/.
- 2 The Foreign Account Tax Compliance Act (FATCA), enacted in 2010, created new IRC § 6038D and requires individuals to file Form 8938 with their income tax returns for tax years starting after March 18, 2010, which for most people is their 2011 tax returns filed during the 2012 filing season. See T.D. 9567, 76 Fed. Reg. 78,553, 2012-8 I.R.B. 395 (Dec. 19, 2011). U.S. residents who are single or married filing separately apply the \$50,000 threshold to the value of “specified foreign financial assets” at the end of the year. See, e.g., IRS, *Instructions to Form 8938* (2013). Higher thresholds generally apply in various other situations. *Id.*
- 3 See, e.g., *Williams v. Comm’r*, 489 Fed. App’x. 655, 659 (4th Cir. 2012).
- 4 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress, *supra* (Most Serious Problem: *The OVD Programs Initially Undermined the Law and Still Violate Taxpayer Rights*); National Taxpayer Advocate 2013 Annual Report to Congress 228-237; National Taxpayer Advocate 2012 Annual Report to Congress 134-153; National Taxpayer Advocate 2011 Annual Report to Congress 191-205; *Id.* at 206-72; National Taxpayer Advocate 2013 Objectives Report to Congress 7-8; *Id.* at 21-29; Taxpayer Advocate Directive 2011-1 (Aug. 16, 2011) [collectively, OVD Reports].
- 5 National Taxpayer Advocate 2014 Annual Report to Congress, *supra* (Most Serious Problem: *The OVD Programs Initially Undermined the Law and Still Violate Taxpayer Rights*); Internal Revenue Code (IRC) § 6663 (civil fraud penalty).
- 6 IRS, *Streamlined Filing Compliance Procedures* (June 18, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures> [hereinafter 2014 streamlined program].
- 7 See IRS Pub. 1, *Your Rights as a Taxpayer* (2014).
- 8 See *id.*; OVD Reports.

seem to be an unintended consequence of the civil FBAR penalty regime, which is designed to address criminal conduct.

Background

The penalty for willful failure to file an FBAR was aimed at criminals.

Congress enacted the FBAR filing requirement in 1970 after hearing testimony that criminals were using secret foreign bank accounts for illegal purposes (*e.g.*, tax evasion, securities manipulation, insider trading, evasion of Federal Reserve margin limitations, storing and laundering funds from illegal activities, and acquiring control of U.S. industries without detection by the Securities and Exchange Commission), and that U.S. law enforcement agencies had difficulty obtaining account information from foreign authorities.⁹ Although a criminal penalty already applied to those who willfully failed to report the existence of a foreign account on a tax return, Treasury Department officials testified that a less-severe civil penalty would be easier to assert and less likely to violate the U.S. Constitution.¹⁰ Thus, overlapping civil and criminal FBAR and tax penalties may apply to the willful failure to report a foreign account and any income it generated.¹¹

FBAR reporting compliance was low, but the government imposed few FBAR penalties.

In 2002, the IRS reported to Congress that the FBAR compliance rate was less than 20 percent because it had received fewer than 200,000 FBARs when one million taxpayers may have been required to file.¹² In the face of substantial noncompliance, the IRS cited the difficulty of proving willfulness as a reason for why the government had assessed only two civil FBAR penalties between 1993 and 2002.¹³

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- 9 See, *e.g.*, Pub. L. No. 91-507, § 241, 242 (1970); S. REP. No. 91-1139, at 2-4, 8-9 (1970); H. REP. No. 91-975, at 12 (1970). Accord H.R. REP. No. 241-3, at 27, 50 (1970) (statement of Robert M. Morgenthau, U.S. Att’y, S.D.N.Y.) (“in addition to the usual difficulties attending to the detection of criminal conduct in financial transactions, we have here the added obstacle of the use of secret foreign accounts to avoid discovery... where criminals have made such extraordinary efforts to cover their tracks, we must respond with equal vigor to uncover them.”); *Foreign Bank Secrecy: Hearings on S. 3678 and H.R. 15073 Before the S. Subcomm. on Financial Institutions, Comm. on Banking and Currency, 91st Cong. 2nd Sess. at 170 (1970)* (statement of Eugene T. Rossides, Assistant Secretary of the Treas. for Enforcement and Operations) (“Our overall aim is to build a system to combat organized crime and white collar crime and to deter and prevent the use of secret foreign bank accounts for tax fraud and their use to screen from view a wide variety of criminally related financial activities, and to conceal and cleanse criminal wealth.”).
- 10 See, *e.g.*, *Foreign Bank Secrecy: Hearings on S. 3678 and H.R. 15073 Before the S. Subcomm. on Financial Institutions, Comm. on Banking and Currency, 91st Cong. 2nd Sess. at 152 (1970)* (statement of Robert Cole, Special Assistant for Int’l Affairs, Treas. Dept.) (“Civil penalties can be imposed administratively and there are cases where it might be appropriate to impose a civil penalty where imposition of a criminal penalty [under IRC § 7203 or IRC § 7206(1)] would seem unduly harsh or could raise evidentiary or constitutional problems.”).
- 11 See 31 U.S.C. § 5321 (civil FBAR); 31 U.S.C. § 5322 (criminal FBAR); IRC § 6662 (civil tax); IRC § 7201 (criminal tax); IRC § 7203 (criminal tax); IRC § 7206 (criminal tax). See also IRC § 6038D (a relatively-new civil tax penalty, discussed below).
- 12 Department of the Treasury, *A Report to Congress in Accordance with § 361(B) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001* 6 (Apr. 26, 2002) [*hereinafter* 2002 FBAR Report]; IRS Sets New Audit Priorities, FS-2002-12 (Sept. 2002).
- 13 2002 FBAR Report at 10 (“taxpayers generally assert to the IRS that they were not aware that they were required to file an FBAR. Often, the administrative record lacks evidence to the contrary, such as an advice letter from an accountant or financial planner or any witness to testify that the taxpayer knew of the filing requirement. In such cases, the litigation risk in assessing a penalty is substantial, particularly where, after notice from the IRS or FinCEN, the person has voluntarily backfiled the missing forms. Rather than go forward with penalty assessments based on a less than substantial record, FinCEN’s limited resources have been allocated to other compliance and enforcement efforts...”).

Following reports of people intentionally “attempting to conceal income from the IRS,” Congress enacted a non-willful FBAR penalty.

In 2004, Congress significantly increased the maximum penalty for willful violations and imposed—for the first time—a penalty for non-willful violations.¹⁴ Legislative history suggests a reason for this change was the IRS’s estimate that hundreds of thousands of taxpayers were “attempting to conceal income from the IRS.”¹⁵ It did not reference a concern about taxpayers inadvertently failing to file the form. Thus, even the non-willful FBAR penalty appears to have been aimed at willful violations.

Mindful that the civil FBAR penalty appears to be aimed primarily at those engaged in criminal activity, the National Taxpayer Advocate offers legislative recommendations to reduce its burden for other taxpayers, including benign actors. Specifically, these proposals would:

- Improve the proportionality of the civil FBAR penalty;
- Require the government to prove actual willfulness before imposing the penalty for willful violations;
- Treat taxpayers who correct violations early the same as (or better than) those who correct them later; and
- Reduce the burden of foreign account reporting.

These proposals should help address concerns about the existing offshore penalty programs, and also establish principles of procedural fairness that could help the government design future penalty initiatives.

14 The American Jobs Creation Act of 2004, Pub. L. No. 108-357, Title VIII, § 821(a), 118 Stat. 1586 (2004) (amending 31 U.S.C. § 5321(a)(5)).

15 Joint Committee on Taxation (JCT), *General Explanation of Tax Legislation Enacted in the 108th Cong.*, JCS-5-05, 377-378 (2005) (“For one scheme alone, the IRS estimates that there may be hundreds of thousands of taxpayers with offshore bank accounts attempting to conceal income from the IRS.”). See also S. REP. No. 108-11, at 101 (2003) (“attempting to conceal”); S. REP. No. 108-257, at 32 (2003) (same). Another purpose of the FBAR penalty may have been to detect criminal or terrorist financing activity. See, e.g., JCT, *General Explanation of Tax Legislation Enacted in the 108th Cong.*, JCS-5-05, 377-378 (May 2005).

PENALTIES: Improve the Proportionality of the Civil FBAR Penalty

PROBLEM

Civil penalties for failure to report foreign accounts on an FBAR can be disproportionate in comparison to the value of the unreported account and the amount of associated unreported income. The penalties may be severe because they are aimed at bad actors.¹⁶ However, the IRS is authorized to apply them even if the taxpayer has no (or a *de minimis*) underpayment and the accounts were not used for criminal activity.¹⁷ A single failure to learn about the FBAR reporting requirements can trigger multiple penalties for those who have multiple accounts or repeat the same mistake over a multi-year period.¹⁸ FBAR penalties can also overlap with penalties for failure to report the same account on Form 8938, *Statement of Specified Foreign Financial Assets*, and the penalty for understatements attributable to undisclosed foreign financial assets.¹⁹

The Bank Secrecy Act (BSA) authorizes a maximum civil penalty of up to 50 percent of the maximum balance in each overseas account for each year of willful non-reporting (or, if greater, \$100,000 per violation), in addition to criminal penalties.²⁰ Even the Internal Revenue Manual (IRM) acknowledges that the maximum statutory penalty for “willful” failures to file an FBAR may “greatly exceed an amount that would be appropriate in view of the violation.”²¹ The maximum penalty for a non-willful violation is \$10,000.²² While this may seem reasonable by comparison, a taxpayer who failed to file a single FBAR form may have multiple violations each year—one for each unreported account.²³

Because the statute of limitations is six years, the maximum civil FBAR penalty for large accounts is generally about three times the maximum account balance (50 percent times six, assuming a relatively constant balance).²⁴ For small accounts, the maximum penalty may be an even greater percentage. For example, someone with a total of \$10,000 in five different foreign accounts (\$2,000 in each) could be subject to a non-willful FBAR penalty of \$300,000 (six years times five accounts times \$10,000) or 30 times the account balance. If the IRS deems the violation willful, the penalty could rise to \$3 million (six years times five accounts times \$100,000) or 300 times the account balance.

Perhaps for this reason, the IRS has developed “mitigation guidelines” whereby it may impose smaller penalties—generally 5–10 percent of the account(s)—against those with accounts of \$1 million or less, provided the taxpayer meets certain threshold conditions.²⁵ Such conditions include a requirement that the taxpayer “cooperate” with the IRS during the examination (*e.g.*, the taxpayer responds to reasonable requests for documents, meetings, interviews, back-files corrected FBARs, and the IRS does not issue a

16 See, *e.g.*, JCT, *General Explanation of Tax Legislation Enacted in the 108th Cong.*, JCS-5-05, 377-378 (May 2005) (discussed above).

17 31 U.S.C. § 5321(a)(5).

18 *Id.*; 31 U.S.C. § 5321(b)(1) (six-year limitations period).

19 IRC § 6038D; IRC § 6662(j).

20 31 U.S.C. § 5321(a)(5)(C).

21 IRM 4.26.16.4(5) (July 1, 2008). This observation appears in a section of the IRM that discusses when it may be appropriate to apply a lesser penalty.

22 31 U.S.C. § 5321(a)(5)(B).

23 See, *e.g.*, IRM 4.26.16 4 (July 1, 2008).

24 A six-year statute of limitations applies to the civil FBAR penalty. See 31 U.S.C. § 5321(b)(1). Criminal penalties of up to \$500,000 and 10 years in prison may also apply. 31 U.S.C. § 5321(a)(5)(C) and 5322; 31 C.F.R. § 1010.840(b).

25 See, *e.g.*, IRM 4.26.16.4.6 (July 1, 2008); IRM Exhibit 4.26.16-2 (July 1, 2008).

summons).²⁶ Some commentators have speculated that without these guidelines, the FBAR penalty is so disproportionate it may violate the U.S. Constitution.²⁷

Related violations can stack penalties.

A taxpayer may also be subject to a tax penalty of \$10,000 or more per year for failing to report an account on another information return, Form 8938, *Statement of Specified Foreign Financial Assets*, which is filed with a tax return.²⁸ Although this penalty applies to the failure to file a different form, penalizing someone more than once for essentially the same mistake—failing to report a foreign account—may be considered stacking, which is generally not viewed as an effective way to promote compliance, in part because it is perceived as confusing, disproportionate, and unfair.²⁹

Moreover, both penalties may apply even if the taxpayer has paid all U.S. taxes and the government already knows about the account. They may also apply to the failure to report accounts in the jurisdiction where the taxpayer resides. Because of the Foreign Account Tax Compliance Act (FATCA), many banks will begin reporting the foreign accounts of U.S. persons to the IRS in 2015, further reducing the usefulness of also requiring taxpayers to report the same accounts on two different forms.³⁰

Other information reporting penalties are proportionate.

Other information reporting penalties are more proportionate than FBAR penalties. For example, there is no penalty for failing to file a U.S. income tax return if there is no unpaid tax.³¹ The penalty for failure to file most information returns and payee statements is generally \$100 per return, rising to 10 percent of the unreported amount for intentional violations.³² By contrast, the FBAR penalty may apply even if the FBAR is one day late and even if the taxpayer has no net underreported tax (*e.g.*, because of foreign tax credits) as a result of underreporting income from the account.³³

26 See, *e.g.*, IRM 4.26.16.4.6 (July 1, 2008); IRM Exhibit 4.26.16-2 (July 1, 2008).

27 See, *e.g.*, Steven Toscher and Barbara Lubin, *When Penalties Are Excessive — The Excessive Fines Clause as a Limitation on the Imposition of the Willful FBAR Penalty*, J. TAX PRAC. & PROC. 69-74 (Jan. 2010).

28 For an explanation of why the IRS believed it did not have discretion to allow consolidated reporting, see T.D. 9567, 76 Fed. Reg. 78553, 2012-8 I.R.B. 395 (Dec. 19, 2011) (preamble).

29 Accuracy-related penalties generally avoid stacking. See, *e.g.*, H.R. REP. NO. 101-386, at 662 (1989) (Conf. Rep.) (establishing “a new [accuracy-related penalty] structure that operates to eliminate any stacking.”). An IRS task force concluded that penalty stacking “seems to operate illogically and serve no important policy that could not be served in a simpler way. Stacking has a haphazard impact on proportionality unless carefully coordinated and thus should be avoided.” Executive Task Force for the Commissioner’s Penalty Study, IRS, *Report on Civil Tax Penalties*, reprinted in 89 Tax Notes Today 45-36 (Feb. 27, 1989) [*hereinafter* IRS 1989 Penalty Study]. The American Institute of Certified Public Accountants (AICPA) has observed that disproportionate penalties, unrelated to the degree of misconduct or harm, which can result from stacking, threatens to “undermine faith in the fairness of the system.” See AICPA, *Penalty Reform Task Force, Report on Civil Tax Penalties: The Need for Reform*, 7 (2009). Research suggests that faith in the fairness of the tax system promotes voluntary compliance. See, *e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-70; National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 34-56.

30 See, *e.g.*, T.D. 9658 (March 6, 2014) (preamble) (summarizing the reporting and withholding regime under FATCA); Notice 2013-43, 2013-2 C.B. 113 (requiring certain financial institutions to begin providing the IRS with foreign account data under FATCA by March 31, 2015).

31 IRC § 6651.

32 See, *e.g.*, IRC § 6721(a).

33 According to the IRS 1989 Penalty Study, penalties are proportionate if they vary based on the harm to the tax system and mitigation efforts, for example, by penalizing slightly-late filers owing little tax less than seriously-late filers (or nonfilers) owing more. The IRS currently allows certain people with delinquent FBARs who have no unreported income to file late without penalty. IRS, *Delinquent FBAR Submission Procedures* (Oct. 9, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/Delinquent-FBAR-Submission-Procedures>. The FBAR statute also allows the IRS to waive the penalty if the taxpayer has reported all of the income from the account and establishes reasonable cause. See 31 U.S.C. § 5321(a)(5)(B).

Like the FBAR penalty, the penalties for failure to report foreign entities on information returns can be severe.³⁴ Unlike the process of creating foreign bank accounts, however, taxpayers typically create foreign entities with the assistance of advisors to avoid information reporting delinquencies.

FBAR penalties are even more disproportionate when they apply to reasonable or minor mistakes.

If the tax avoided by the failure to report an offshore account and the income from the account is too minor to trigger an accuracy-related penalty under IRC § 6662, the failure is likely to have been unintentional or due to reasonable cause, particularly if there is no indication that the account was used in connection with a crime. Similarly, the failure to report accounts that have already been reported to the IRS by third parties is likely to be inadvertent,³⁵ as is the failure to report accounts in the jurisdiction where the taxpayer lives.³⁶ Taxpayers residing offshore have legitimate non-tax reasons for opening accounts where they reside.

The reasonable cause exception does not automatically cover these situations. Moreover, taxpayers have to provide evidence of reasonable cause, but it is difficult for them to prove a negative. For example, even if the IRS does not pursue willful penalties, it is difficult for taxpayers to show reasonable cause for failure to file a tax return based on ignorance of the law or reliance, as relevant authorities suggests they are essentially presumed to know about return filing requirements.³⁷ The IRS relies on these same authorities in determining reasonable cause for failure to file an FBAR.³⁸

EXAMPLE 1³⁹

When an engineer immigrated to the United States and became a resident, he retained a joint account with his family overseas containing proceeds from the sale of the family residence. He asked the bank not to send him statements because he treated the funds as belonging to his overseas relatives. He did not disclose the account when filling out a questionnaire for his U.S. tax return preparer because it did not occur to him that the small amount of earnings it generated might be taxable to him in the U.S. As a result, his preparer did not check the box on Schedule B to indicate he had a foreign account. He repeated this error

34 See, e.g., Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, Form 5472, *Information Return of a Foreign Owned Corporation*, Form 926, *Return by a U.S. Transferor of Property to a Foreign Corporation*, Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*, Form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, Form 3520-A, *Annual Return of Foreign Trust With a U.S. Owner*. The penalty for failure to file these information returns is generally \$10,000 per violation or a percentage of the funds transferred. See generally IRC §§ 6038, 6038B, 6038D, 6039F, 6048. Accord 2012 OVD FAQ #5. Another consequence of the failure to file these information returns (or Form 8938) is that the statute of limitations period for the related income tax return generally does not begin to run. See IRC § 6501(c)(8). Moreover, a 40 percent penalty may apply to the portion of any understatement attributable to a transaction involving an undisclosed foreign financial asset. IRC § 6662(j).

35 *But see United States v. Williams*, 489 Fed. Appx. 655 (4th Cir. 2012) (unpublished) (concluding an FBAR violation was willful notwithstanding evidence the government was already aware of the unreported account).

36 *C.f.*, IRC § 6038D(h); Treas. Reg. § 1.6038D-7T (providing that Form 8938 does not need to include accounts the taxpayer reported on certain other tax forms or that are held in the U.S. possession where the taxpayer resides).

37 See, e.g., *United States v. Boyle*, 469 U.S. 241, 251-252 (1985); IRM 20.1.1.3.2.2.6(3) (Nov. 25, 2011) (ignorance of the law); IRM 20.1.9.1.1(4) (Mar. 21, 2013) (reliance on preparer). The requirement to file an FBAR is not as widely known as the requirement to file a tax return. This should make it easier to show reasonable cause for failure to file an FBAR than for failure to file a tax return. See Treas. Reg. 1.6664-4(b)(1) (“Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer.”). But, the IRM seems to suggest the opposite. See e.g., IRM 20.1.9.1.1(4) (Mar. 21, 2013).

38 See IRM 4.26.16.4.3.1 (July 1, 2008).

39 All of the examples in this discussion are hypothetical.

on all subsequent returns. The taxpayer has never filed an FBAR because he was not aware of the filing requirement. The offshore account had a relatively constant balance of about \$100,000. The taxpayer underreported a very small amount of earnings from the account—not enough to trigger the substantial understatement penalty under IRC § 6662.⁴⁰

Because the statute of limitations for FBAR violations is six years, the FBAR penalty could be as high as \$600,000 (the greater of \$100,000 or 50 percent per year)—six times the balance—if the IRS deems the violation to be “willful” (and it might, as discussed below).⁴¹ By contrast, the maximum non-willful FBAR penalty could be \$60,000 (\$10,000 per year).⁴² The IRS would waive the penalty if it determined the taxpayer had reasonable cause and ultimately reported all of the income from the account.⁴³ In this case, however, the IRS does not agree that the violation was due to reasonable cause. It believes a reasonable person exercising ordinary business care and prudence would have either disclosed the account to the preparer or reviewed Schedule B, either of which would have alerted him or her to the FBAR filing requirement in the absence of any other impediment (*e.g.*, a mental impairment or malpractice by the preparer).⁴⁴

FBAR penalties may apply even if the IRS was already aware of the account (*e.g.*, because of third party filings from the foreign bank). Had violations occurred after the 2011 tax year, the taxpayer could also be subject to a penalty of \$10,000 per year for failing to report the same account on Form 8938 *Statement of Specified Foreign Financial Assets*.⁴⁵

40 An understatement is substantial, triggering an accuracy-related penalty, if it exceeds the greater of (i) 10 percent of the tax required to be shown on the return, or (ii) \$ 5,000. IRC § 6662(d).

41 The FBAR penalty could be an even greater percentage of the balance if the account value had fallen since the end of the sixth year (or if the account were less than \$200,000, as the maximum penalty is never less than \$100,000). See 31 U.S.C. § 5321(a)(5). As this example illustrates, the FBAR penalty can be much greater than the mere forfeiture of the unreported funds. Yet, the IRS has ceased using civil forfeiture provisions that would otherwise apply when people structure cash transactions to avoid BSA reporting, presumably because they were viewed as overly harsh. See Tax Analysts, *IRS Backs off Some Civil Forfeitures After Media Inquiries*, 2014 TNT 208-1 (Oct. 27, 2014).

42 *Id.*

43 *Id.* Assume the IRS's mitigation guidelines do not apply because the taxpayer did not timely respond to the examiner's request to provide voluminous historic account statements from a foreign bank translated into English, the IRS issued a summons, and as a result, the taxpayer was not deemed to have cooperated. See IRM Exhibit 4.26.16-2 (July 1, 2008).

44 See, *e.g.*, *United States v. Boyle*, 469 U.S. 241 (1985); IRM 20.1.9.1.1(4) (Mar. 21, 2013).

45 See IRC § 6038D; T.D. 9567, 76 Fed. Reg. 78,553, 2012-8 I.R.B. 395 (Dec. 19, 2011).

RECOMMENDATIONS

To address the disproportionality of the civil FBAR penalty, the National Taxpayer Advocate recommends legislation to:

1. Cap the civil FBAR penalty at the lesser of
 - (a) Ten percent of the unreported account balance or five percent for non-willful violations (similar to the IRS's mitigation guidelines), and
 - (b) Forty percent of the portion of any underpayment attributable to the improperly undisclosed accounts (similar to the penalty for undisclosed foreign financial assets (*e.g.*, assets not reported on Form 8938) under IRC § 6662(j)).⁴⁶
2. Eliminate or waive the civil penalty for failure to report an account on an FBAR if there is no evidence the account was used in connection with a crime and:⁴⁷
 - a. The account information was already provided to the IRS, for example, on a Form 8938, *Statement of Specified Foreign Financial Assets*, or by a third party (*e.g.*, a financial institution or government);⁴⁸
 - b. The amount of unreported income from the account does not create a substantial understatement under IRC § 6662(d);⁴⁹ or
 - c. The taxpayer resides in the same jurisdiction as the account.⁵⁰

⁴⁶ To avoid stacking, only one penalty should apply to understatements of income from foreign financial assets not disclosed on either a Form 8938 or an FBAR.

⁴⁷ Under this recommendation, the civil FBAR penalty could still be waived on the basis of reasonable cause as is the case under current law.

⁴⁸ Because the Financial Crimes Enforcement Network (FinCEN) may not be authorized to receive all of the account information provided to the IRS by third parties, it may be advisable for legislation to distinguish between information available to the IRS and information available to FinCEN. An alternative would be to have the disclosure of account information to the IRS by third parties create a presumption that, in the absence of evidence to the contrary, a taxpayer's failure to provide the same information was due to reasonable cause and was not willful.

⁴⁹ Even if the understatement is substantial, legislation could require the government to consider whether it was reasonable for the taxpayer to believe that any unreported income would be offset by foreign tax credits in connection with its reasonable cause determination.

⁵⁰ For similar proposals, see, *e.g.*, Christians, Allison, *Paperwork and Punishment: It's Time to Fix FBAR*, 73 TAX NOTES INT'L 147 (Oct.13, 2014).

PENALTIES: Require the Government to Prove Actual Willfulness Before Imposing the Penalty for Willful FBAR Violations

PROBLEM

Benign actors cannot be sure the IRS will not view their FBAR violations as “willful,” and attempt to impose severe penalties. This is because the government has eroded the distinction between willful and non-willful violations.

The IRS may meet its burden of proving willfulness if it establishes a “voluntary, intentional violation of a known legal duty.”⁵¹ Because Schedule B of Form 1040 (*U.S. Individual Income Tax Return*) asks if the taxpayer has a foreign account and references the FBAR filing requirement, however, the government has been successful in arguing—in cases involving bad actors—that the filing of a Schedule B can turn a subsequent failure to file an FBAR into a willful violation (called “willful blindness”), at least if combined with other circumstantial evidence such as efforts to conceal the account.⁵² It is unclear what other circumstantial evidence or factors the IRS will consider or if it will distinguish between efforts to conceal the account with the intent to evade U.S. taxes or conceal crimes,⁵³ as opposed to inadvertent concealment, or concealment based on reasonable concerns about financial privacy or fears of unwarranted persecution, seizure, or extortion by a government or others (*e.g.*, terrorists or organized criminals).⁵⁴ The IRS has

- 51 *Ratzlaf v. U.S.*, 510 U.S. 135, 142 (1994) (citing *Cheek v. U.S.*, 498 U.S. 192, 201 (1991)); IRM 4.26.16.4.5.3 (July 1, 2008). The government has the burden to prove the violation was willful by a preponderance of the evidence. See, *e.g.*, *United States v. McBride*, 908 F. Supp. 2d 1186 (D. Utah 2012). In connection with its streamlined program, however, the IRS stated on its website: “Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.” IRS, *Streamlined Domestic Offshore Procedures* (Oct. 9, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-in-the-United-States>.
- 52 See, *e.g.*, *Williams v. Comm’r*, 489 Fed. App’x. 655, 659 (4th Cir. 2012) (unpublished) (“Evidence of acts to conceal income and financial information, combined with the defendant’s failure to pursue knowledge of further reporting requirements as suggested on Schedule B, provide a sufficient basis to establish willfulness on the part of the defendant,” quoting *U.S. v. Sturman*, 951 F.2d 1466, 1476 (6th Cir. 1992)); *U.S. v. McBride*, 908 F. Supp. 2d 1186 (D. Utah 2012); IRM 4.26.16.4.5.3(6) (July 1, 2008) ([after filing a Schedule B,] “the failure to learn of the filing requirements coupled with other factors, such as the efforts taken to conceal the existence of the accounts and the amounts involved may lead to a conclusion that the violation was due to willful blindness.”). Under these authorities, a person might conclude that a reckless failure to read the instructions on Schedule B is akin to willfulness. In a criminal context, a person generally may be charged with knowledge of a violation by reason of willful blindness if he or she is aware of a “high probability” of its existence, unless he actually believes that it does not exist. See, *e.g.*, Jonathan L. Marcus, *Model Penal Code Section 2.02(7) and Willful Blindness*, 102 YALE L.J. 2231 (1993) (discussing various interpretations of the willful blindness standard).
- 53 At an American Bar Association (ABA) conference one IRS employee reportedly provided his personal view, that a person would not be deemed willful if he was concealing the account to evade foreign taxes. See Kristen A. Parillo, *ABA Meeting: More Guidance Coming on Modified OVDP and Streamlined Filing*, 2014 TNT 184-7 (Sept. 23, 2014) (quoting John McDougal as saying “the willfulness we’re trying to determine is with respect to U.S. obligations, not foreign obligations...[I]f ... I’m convinced he had no clue he had to file in the United States, then that seems to me to be the answer to the question”).
- 54 See *e.g.*, Patrick J. Smith, *District Court Misapplies APA in Florida Bankers Association*, 142 TAX NOTES 745 (2014) (suggesting residents of some U.S. treaty partners such as China, Egypt, Indonesia, Mexico, Pakistan, Panama, the Russian Federation, and Venezuela, might reasonably fear that information provided by the U.S. government to their governments under a treaty would not remain confidential, notwithstanding the confidentiality provisions of the treaty).

declined to provide guidance to the public that would clarify its interpretation of willfulness and potentially assuage these concerns.⁵⁵

For this reason, even a benign actor who inadvertently overlooked the requirement(s) cannot be sure the violation will be treated as non-willful or due to reasonable cause.⁵⁶ Because of this uncertainty, the OVD programs have pressured some benign actors into paying more than they would in an examination.⁵⁷

Legislation to clarify that only violations that the IRS proves are actually willful (without relying solely on circumstantial evidence) are subject to a willful FBAR penalty would reduce the excessive discretion afforded the IRS in determining what penalty to assert. It would also support the taxpayer's *right to be informed*, which includes the right to a clear explanation of the law.⁵⁸

EXAMPLE 2

Assume the same facts as Example 1 (in the Legislative Recommendation: *Improve the Proportionality of the Civil FBAR Penalty*, above). The IRS asserts the willful FBAR penalty because, although it cannot prove the taxpayer intentionally violated a known legal duty (*i.e.*, was willful), it may be able to establish willful blindness (by a preponderance of the evidence) based on circumstantial evidence, including the fact that the taxpayer asked the bank to hold his account statements, did not inform his preparer of the account, and did not check the box on Schedule B of his return to indicate he had foreign account(s).⁵⁹ Even though his violation was inadvertent, the taxpayer may not be able to avoid the willful FBAR penalty because he cannot prove he was unaware of the FBAR filing requirement (*e.g.*, has no documentation to establish a mental impairment or that he did not read Schedule B) or reasonably relied on inaccurate advice from his tax advisor.

RECOMMENDATION

To protect benign actors from having to prove their FBAR violations were nonwillful and to give everyone a better understanding about when a willful or nonwillful FBAR penalty applies, the National Taxpayer Advocate recommends legislation to clarify that the government has the burden to establish actual willfulness (*i.e.*, specific intent to violate a known legal duty, rather than mere negligence or recklessness) before asserting a willful FBAR penalty, and cannot meet this burden by relying solely on circumstantial evidence.⁶⁰

55 See, e.g., Amanda Athanasiou, *IRS Addresses Questions About OVDP and Streamlined Filing*, 2014 TNT 212-7 (Oct. 31, 2014); Amy S. Elliott, *IRS Working with SSA on Offshore Streamlined Filing Requirement*, 2014 TNT 216-3 (Nov. 6, 2014) (“[W]e made a deliberate decision not to define what constitutes non-willfulness, Best [Senior Advisor to the Deputy Commissioner (International), IRS Large Business and International Division], said. She added that while the IRS has ...provided training to agents, the training didn’t include specific guidance on non-willfulness.”). However, the IRS may be forced to disclose some of this material, at least to those willing to litigate. See, e.g., Marie Sapirie, *What the OVDP Training Materials Tell Us*, 2014 TNT 230-2 (Dec. 1, 2014) (discussing redacted training materials provided to one taxpayer who had to pursue litigation to obtain them).

56 See, e.g., Caroline Ciralo, *The FBAR Penalty: What Constitutes Willfulness?*, MD J. TAX’N (May 2013).

57 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress, *supra* (Most Serious Problem: *The OVD Programs Initially Undermined the Law and Still Violate Taxpayer Rights*); National Taxpayer Advocate 2013 Annual Report to Congress 228-237.

58 See IRS Pub. 1, *Your Rights as a Taxpayer* (2014).

59 IRM 4.26.16.4.5.3(6) (July 1, 2008).

60 Under current law, the government is only required to establish willfulness by a preponderance of the evidence. See, e.g., *United States v. McBride*, 908 F. Supp. 2d 1186 (D. Utah 2012) (applying the “preponderance” standard, rather than “clear and convincing,” or “beyond a reasonable doubt”).

CLOSING AGREEMENTS: Authorize the IRS to Modify Closing Agreements to Treat Taxpayers Who Correct Violations Early the Same as (or Better Than) Those Who Correct Them Later

PROBLEM

The IRS announced in June 2014, that it would accept more favorable settlement terms from those willing to certify their FBAR violations were not willful.⁶¹ When it had previously made taxpayer-favorable revisions to its OVD programs, the IRS allowed otherwise-qualifying taxpayers who had signed closing agreements to modify their agreements to benefit from the more lenient program terms.⁶² However, the IRS did not allow otherwise-qualifying taxpayers to modify their agreements to take advantage of the more lenient terms announced in 2014. It is not clear that the IRS is legally authorized to do so.

Before the IRS changed the OVD program in 2014, it encouraged benign actors who inadvertently failed to report foreign accounts to enter various OVD settlement programs, then “opt out” and be examined.⁶³ Instead of risking an examination, many agreed to pay a significant percentage of their offshore assets (typically 20 to 27.5 percent)—sometimes more than they would have been asked to pay had they been subject to examination.⁶⁴

Under OVD program changes announced in 2014, benign actors (*i.e.*, those who certify their violations were not willful) who are nonresidents may correct FBAR violations without penalty.⁶⁵ U.S. residents pay only five percent of the unreported account balance.⁶⁶

Taxpayers who agreed to pay more under a prior OVD program than they would pay under the current program(s) felt penalized for coming forward early.⁶⁷ It is difficult to see how such an approach will encourage future compliance by them or anyone else. Instead, it creates an incentive for anyone facing potentially severe penalties to wait for the government to become more reasonable, which is inconsistent with the objective of promoting voluntary compliance.

61 See 2014 streamlined program (explaining that the IRS may “incorporate the streamlined penalty terms in the OVD closing agreement,” but only for a taxpayer who applied to an OVD program before July 1, 2014 and “does not yet have a fully executed OVD closing agreement.”).

62 The IRS previously offered to amend 2009 OVD agreements for taxpayers who would qualify for the reduced 5 percent or 12.5 percent offshore penalty rates under the 2011 OVD. See 2011 OVD FAQ #52; 2011 OVD FAQ #53. Similarly, it allowed taxpayers to modify closing agreements in a manner consistent with the earlier (2012) streamlined program. See IRS, *Frequently Asked Questions Regarding the Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer Taxpayers*, FAQ #5 (Dec. 2013), <http://www.irs.gov/Individuals/International-Taxpayers/FAQReStreamlinedFilingComplianceProceduresNRNFTPs>.

63 See, e.g., 2011 OVD FAQ #51.

64 For a more detailed discussion of this problem, see, e.g., OVD Reports.

65 See 2014 streamlined program.

66 *Id.*

67 See Andrew Velarde, *Practitioners Disagree on Fairness of Lack of OVD Retroactivity*, 2014 TNT 152-2 (Aug. 7, 2014) (quoting one practitioner as saying, “[T]he OVD has many taxpayers with closing agreements who were non-willful but who were scared to opt out...If those same taxpayers had the choice to participate in the streamlined program as it is today back then, they would have never gone into OVD,” but offering a different view from another).

However, the IRS may not have the legal authority to modify OVD agreements. Closing agreements are generally governed by contract law principles,⁶⁸ under which an agreement can be modified with the consent of both parties.⁶⁹ However, section 7121(b) provides that closing agreements

shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact—(1) the case shall not be reopened as to the matters agreed upon or the agreement modified by any officer, employee, or agent of the United States...

Accordingly, the IRM states that the parties to a closing agreement cannot rescind or modify it by consent.⁷⁰ Thus, legislation to clarify that the parties can modify closing agreements by consent would empower the IRS to treat those who corrected violations early the same as those who corrected them later. It would also be consistent with a taxpayer's *right to a fair and just tax system*.⁷¹

EXAMPLE 3

Assume the taxpayer described in Example 1 (in the Legislative Recommendation: *Improve the Proportionality of the Civil FBAR Penalty*, above) entered the IRS's 2011 OVD program, which required him to amend eight returns, file six FBARs, and pay any unpaid tax, accuracy-related penalties, failure to pay penalties, and a 25 percent "offshore penalty" of \$25,000.⁷² Although he would owe much less—perhaps nothing—outside of the OVD program, he did not opt out (*i.e.*, he accepted these terms) because he was concerned that opting out could affect his immigration status, unsure about whether the IRS would deem his violations to be willful, and concerned about the cost, burden, and stress of an IRS examination and the potential for having to appeal and litigate the examination determination(s).

The taxpayer now wishes he had not come forward to correct the problem so quickly. Under the 2014 OVD program changes, he would have qualified for the terms of the streamlined program. Had his case still been open on July 1, 2014, the IRS would have accepted a closing agreement requiring him to pay only his unreported tax plus an offshore penalty of five percent or \$500. However, the IRS will not agree to amend his closing agreement to provide him with similar terms.

RECOMMENDATION

To empower the IRS to treat taxpayers consistently and fairly, the National Taxpayer Advocate recommends legislation to authorize the IRS to modify closing agreements with the taxpayer's consent, particularly when necessary to promote equity or public policy (including consistency). She also recommends directing the IRS to use this authority to amend OVD closing agreements to make them consistent with the terms of agreements publicly offered to similarly-situated taxpayers in subsequent IRS programs.

68 See, e.g., *U.S. v. National Steel Corp.*, 75 F3d 1146, 1150 (7th Cir. 1996); *Rink v. Comm.*, 47 F3d 168, 171 (6th Cir. 1995).

69 See, e.g., *Large v. Mobile Tool Int'l*, 724 F.3d 766, 772 (7th Cir. 2013) ("Parties are free to abrogate, change, modify, or substitute a primary contract with their mutual assent."). Treasury Regulation section 301.7121-1(b)(1) also contemplates "a series of closing agreements relating to the tax liability for a single period," but Rev. Proc. 68-16 § 3.02, 1968-1 C.B. 770 clarifies that "no such [subsequent closing] agreement may modify any matter previously determined by closing agreement except as provided by statute." See also IRM 8.13.1.1.1 (Nov. 9, 2007).

70 IRM 8.13.1.6.1 (Nov. 9, 2007).

71 See IRS Pub. 1, *Your Rights as a Taxpayer* (2014).

72 2011 OVD FAQ #7.

FBAR FORMS: Reduce the Burden of Foreign Account Reporting

PROBLEM

Foreign account reporting is unnecessarily burdensome and duplicative.⁷³ U.S. citizens and residents may be required to report foreign accounts on different forms (FBAR vs. Form 8938), at different times of the year (June 30th for FBAR vs. April 15th or September 15th for Form 8938), when they reach different thresholds (\$10,000 for FBAR vs. \$50,000 or more for Form 8938), using different definitions, and even though the government may already know about the accounts.⁷⁴ Requiring taxpayers to file forms on two different dates may increase preparation expenses and the chances of error, because taxpayers must remember two filing deadlines and potentially consult advisors twice.

The FBAR reporting threshold has declined in real terms.

Stakeholders have also argued that the FBAR reporting threshold is too low.⁷⁵ Although it has fluctuated over the years, today's \$10,000 threshold is the same as it was in 1970.⁷⁶ If indexed for inflation from 1970, \$10,000 would be more than \$61,000 in today's dollars—significantly more than the \$50,000 threshold for reporting on Form 8938.⁷⁷

Raising the FBAR threshold to \$50,000 could eliminate nearly one third of the forms.

Because there are fewer wealthy taxpayers with large accounts than middle-class taxpayers with smaller accounts, increasing the reporting threshold could significantly reduce the number of people who have to file FBARs. Over 30 percent of the FBARs the IRS received in calendar year 2012—nearly 250,000

73 TAS has repeatedly recommended that the IRS to address this unnecessary and duplicative burden. See National Taxpayer Advocate 2013 Annual Report to Congress 228-237; National Taxpayer Advocate 2013 Annual Report to Congress 238-248; National Taxpayer Advocate 2012 Annual Report to Congress 134-153; TAS Recommendations for Published Guidance under IRC §§ 6038D and 1471 (Apr. 24, 2014). The IRS has consistently declined. See, e.g., National Taxpayer Advocate 2015 Objectives Report to Congress 93-94, 99 (June 2014) (citing, in part, FinCEN's authority over the FBAR filing requirements).

74 For further discussion of these overlapping reporting requirements, see Treasury Inspector General for Tax Administration (TIGTA), *New Legislation Could Affect Filers of the Report of Foreign Bank and Financial Accounts, but Potential Issues are Being Addressed*, Ref. Num. 2010-30-125 (Sept. 2010); Government Accountability Office, GAO-12-403, *Reporting Foreign Accounts to IRS: Extent of Duplication Not Currently Known, but Requirements Can Be Clarified*, App. 2 (Feb. 2012); IRS, *Comparison of Form 8938 and FBAR Requirements*, at <http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements>. The IRS could reduce, but not eliminate, duplicative reporting by adding items reported on an FBAR to the existing list of items that taxpayers do not have to report on Form 8938. See Treas. Reg. § 1.6038D-7T. The IRS has access to the FinCEN Query System, which allows IRS employees direct electronic access to FBAR data.

75 See Recommendation by the Federation of American Women's Clubs Overseas, Inc. (FAWCO), Association of Americans Resident Overseas (AARO), and American Citizens Abroad (ACA) (Feb. 2012).

76 See, e.g., Form 4683, *U.S. Information Return on Foreign Bank, Securities & Other Financial Accounts* (1970) (\$10,000 threshold); Form 90.22-1, *Report of Foreign Bank and Financial Accounts* (1978) (\$1,000 threshold); Form 90.22-1, *Report of Foreign Bank and Financial Accounts* (1983) (\$5,000 threshold); 50 Fed. Reg. 42,691 (Oct. 22, 1985) (\$10,000 threshold); Bank Secrecy Act (BSA), *Electronic Filing Requirements for Report of Foreign Bank and Financial Accounts*, FinCEN Form 114 (2014) (\$10,000 threshold).

77 Dep't of Labor, Bureau of Labor Statistics, *CPI Inflation Calculator*, http://www.bls.gov/data/inflation_calculator.htm. We understand that FinCEN has opposed the suggestion to increase the FBAR filing threshold, in part, because \$10,000 may be more significant when denominated in certain foreign currencies. However, this was true in 1970 when the threshold was more than \$61,000 in today's dollars. *Id.*

forms—reported accounts of less than \$49,999.⁷⁸ Thus, assuming most taxpayers file only one form, coordinating the FBAR filing threshold with the Form 8938 threshold could reduce taxpayer burden by nearly one third.

In addition, if information about large offshore accounts is more useful to the government than information about those with small ones, then raising the threshold could ease taxpayer burden without significantly reducing the value of the FBAR to the government. Further, curtailing low-dollar FBAR filings would reduce the resources required to process them and help the government focus its limited resources on the higher-dollar filings—and higher-dollar non-filers.

One form would be better than two, if confidentiality concerns are addressed.

If it aligns the FBAR and Form 8938 thresholds and deadlines, Congress should also consider consolidating the reporting requirements. Indeed, between 1970 and 1977, the Treasury Department only required taxpayers to report foreign accounts under the BSA on tax returns using Form 4683, *U.S. Information Return on Foreign Bank, Securities & Other Financial Accounts*.

In 1977, after taxpayer privacy laws were expanded under IRC § 6103, the IRS required people to report these accounts on a different form—not part of the return—so it could share the information with other federal agencies such as FinCEN.⁷⁹ Therefore, if Congress requires the Treasury Department to combine these forms, it may also want to clarify that certain information on the combined form is not deemed part of the tax return and is not subject to IRC § 6103.

In connection with any such change, however, Congress should require the IRS to limit and prominently identify on the form, any information that may be disclosed to FinCEN.⁸⁰ Without transparency and specificity, some taxpayers might withhold other information from the IRS based on a concern that it could be disclosed to other agencies. Foreign account information may be distinguished from other tax-related information because it is already required to be reported to FinCEN.

78 IRS response to TAS information request (Nov. 20, 2014) (indicating the IRS received 807,040 FBARs in CY 2012 – 248,128 (31 percent) reporting accounts less than \$49,999, 521,244 (65 percent) reporting accounts of more than \$50,000, and 37,668 (5 percent) reporting no account values). Because this data reflects the number of FBARs and not the number of taxpayers, if one taxpayer filed two FBARs, each reporting accounts of \$30,000, this would be reflected as two FBARs with account values less than \$49,999. *Id.*

79 See, e.g., Treasury Inspector General for Tax Administration (TIGTA), *New Legislation Could Affect Filers of the Report of Foreign Bank and Financial Accounts, but Potential Issues are Being Addressed*, Ref. Num. 2010-30-125 (Sept. 2010); General Accounting Office (GAO), *Better Use of Currency and Foreign Account Reports by Treasury and IRS Needed for Law Enforcement Purposes*, GGD-79-224 3 (April 6, 1979), <http://archive.gao.gov/f0302/109024.pdf>. Because the IRS considers itself FinCEN's agent in administering the BSA, it segregates information obtained under Title 31 (e.g., the FBAR) and Title 26 (tax), and requires a "related statute" determination before allowing IRS employees to use Title 26 information in a BSA investigation under Title 31. IRM 4.26.14.2 (July 24, 2012). However, in one recent case where a taxpayer complained that the IRS opened an FBAR investigation without first making a "related statute" determination pursuant to IRS procedures, the court granted the government's motion to dismiss, concluding that the FBAR statute (31 USC § 5314) was a "related statute" for purpose of IRC § 6103. See *Hom v. United States*, 112 A.F.T.R.2d (RIA) 6271 (N.D. Cal. 2014). The court's reasoning may suggest that because the FBAR statute is a "related statute," the IRS may use tax information covered by IRC § 6103 in an FBAR investigation without first making a case-specific determination, but we are not aware of any current plans by the IRS to change its procedures.

80 This would be in accordance with the taxpayer *right to be informed*. IRS Pub. 1, *Your Rights as a Taxpayer* (2014). Retaining the confidentiality restrictions on the remainder of the return would also further the taxpayer *right to confidentiality*. *Id.*

EXAMPLE 4

Assume the taxpayer described in Example 1 (in the Legislative Recommendation: *Improve the Proportionality of the Civil FBAR Penalty*, above) retains the foreign account. In 2015, the foreign bank reports the account to the IRS. The taxpayer is nonetheless required to report the account on Form 8938, which he files with his tax return by April 15, though an extension may be available. He must also report the account on an FBAR by June 30. No FBAR filing extension is available. Even if he has already paid for tax preparation, he may have to pay another fee to discuss any FBAR questions with his advisor.⁸¹ Moreover, he may need to hire another advisor if his return preparer is not familiar with the FBAR rules.

RECOMMENDATION

To reduce taxpayer burden, the National Taxpayer Advocate recommends aligning the FBAR filing deadline and threshold(s) with the Form 8938 filing deadline and threshold(s). Specifically, she recommends increasing the \$10,000 FBAR filing threshold to match the threshold applicable to Form 8938 (*i.e.*, at least \$50,000), adjust it for inflation, and change the FBAR filing due date to coincide with the due date applicable to a taxpayer's federal income tax return and Form 8938 (including extensions).

If Congress aligns these due dates and thresholds, it should also consider requiring the Treasury Department to consolidate the reporting of foreign accounts (*i.e.*, the FBAR and Form 8938) so that taxpayers only have to report them on one form. To facilitate this change, legislation should clarify that the IRS may disclose certain account information to FinCEN without violating IRC § 6103. The legislation should require the IRS to highlight (on the new form) any information not subject to the normal confidentiality rules (*e.g.*, because it is not part of the tax return).⁸²

81 TAS has been informed that this fee could be substantial, particularly for persons overseas. TAS meeting with representatives of the American Citizens Abroad (Sept. 4, 2014).

82 Congress might also clarify that taxpayers not otherwise required to file a tax return could, nonetheless, use the same form to satisfy their reporting obligations under the BSA.

LR #7 **FILING STATUS: Clarify the Definition of “Separate Return” in IRC § 6013 and Allow Taxpayers Who Petition the Tax Court to Change Their Filing Status to Married Filing Jointly in Accordance with the Tax Court’s Rules of Practice and Procedure**

PROBLEM

Internal Revenue Code (IRC) § 6013 precludes a married taxpayer who filed a “separate return,” an undefined term, from filing an amended return electing Married Filing Jointly (MFJ) status for the same tax year once either spouse has filed a Tax Court petition in response to a statutory notice of deficiency (SNOD).¹ In *Glaze v. United States*, the Fifth Circuit Court of Appeals held that the term “separate return” in IRC § 6013(b) means only a return filed with a status of married filing separately (MFS).² The Court of Appeals for the Eleventh Circuit follows the reasoning in *Glaze*.³ The Tax Court, however, interprets the term “separate return” to mean any return except for a MFJ return.⁴ Thus, whether a taxpayer may change his or her filing status to MFJ depends on the location of the Court of Appeals that would hear an appeal of a Tax Court decision.⁵

In addition, taxpayers who are unaware that the Code allows for changes in filing status, but that limitations apply, may pay taxes at a higher effective rate and experience financial hardship. Taxpayer rights, including *the right to be informed, the right to pay only the amount of tax legally due, and the right to fair and just tax system are negatively affected*.⁶

- 1 IRC§ 6013(b)(1), (b)(2)(B), and Treas. Reg. § 1.6013-2(b)(3). IRC § 6213(c) provides, “... the deficiency, notice of which has been mailed to the taxpayer, shall be assessed, and shall be paid upon notice and demand from the Secretary.” The SNOD currently does not inform taxpayers that they may file an amended return prior to filing a petition with the Tax Court. TAS is working with the IRS on updating the IRM and SNOD language to inform taxpayers about this rule and acting on TAS’s recommendation, the IRS has recently updated IRM 4.19.3.20.7.4 (6)(b), *Referrals*, (Nov. 4, 2014). The IRS updated the IRM adding that if taxpayers intended to change their filing status to Married Filing Jointly they must do so prior to filing their petition with the Tax Court. See Servicewide Electronic Research Program Alert 14U1560 (Nov. 04, 2014), available at <http://serp.enterprise.irs.gov/databases/irm.dr/current/4.dr/4.19.dr/4.19.3.dr/4.19.3.20.7.4.htm> (last visited Dec. 6, 2014).
- 2 *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981).
- 3 The 11th Circuit adopted all prior decisions of the Court of Appeals for the 5th Circuit in *Bonner v. City of Prichard*, 661 F.2d 1206 (11th Cir. 1981).
- 4 See, e.g., *Currie v. Comm’r*, T.C. Memo. 1986–71; *Blumenthal v. Comm’r*, T.C. Memo. 1983–737; *Saniewski v. Comm’r*, T.C. Memo. 1979–337. The Tax Court does not follow *Glaze* for appeals that would lie with courts of appeal outside the Fifth and Eleventh Circuit under the *Golsen* rule. See *Golsen v. Comm’r*, 54 T.C. 742, 757 (1970), *aff’d*, 445 F.2d 985 (10th Cir. 1971). See also *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981), *action on dec.*, 1981-140 (June 2, 1981); CC-2006-010 (Mar. 2, 2006). The IRS Office of Chief Counsel notice took the position that the *Glaze* holding was, “inconsistent with Tax Court cases that applied the limitations under § 6013(b)(2) when a married person has erroneously filed an earlier return as a single taxpayer or head of household, and later wishes to file an amended joint return.”
- 5 See IRC § 7482(a) and (b) for appellate jurisdiction and venue to review the decisions of the Tax Court. The venue for an appeal of the Tax Court’s decision would generally be in the court of appeals for the circuit in which the taxpayer resides. See IRC § 7482(b)(1)(A).
- 6 On June 10, 2014, the IRS formally adopted the TBOR. See IRS, *IRS Adopts “Taxpayer Bill of Rights;” 10 Provisions to be Highlighted on IRS.gov*, in Publication 1, IR-2014-72 (June 10, 2014), available at <http://www.irs.gov/uac/Newsroom/IRS-Adopts-Taxpayer-Bill-of-Rights;-10-Provisions-to-be-Highlighted-on-IRSGov,-in-Publication-1>.

EXAMPLE

M and F, a married non-English speaking immigrant couple with limited education and tax knowledge reside in Massachusetts⁷ and go to a return preparer to have their 2011 tax returns prepared. The couple prepared and filed timely returns. The preparer incorrectly advised M to elect “head of household” filing status and claim his two minor children as dependents.⁸ M also claimed an earned income tax credit (EITC) resulting in a refundable credit, which M asked to be refunded.

The IRS audited M’s return, treated M’s return status as MFS, disallowed the claimed EITC, and issued a SNOD to M.⁹ M was unaware that he and his wife could amend their filing status to MFJ before petitioning the Tax Court, which would make M and W eligible for the disallowed credits. M filed a petition in Tax Court and thus is precluded from changing his filing status to MFJ, even though there was no dispute that M was ineligible as “head of household” and is legally married. The Tax Court treated M’s return status as Married Filing Separately (MFS,) citing the limitations of IRC § 6013(b)(1) and 6013(b)(2)(B), resulting in a deficiency rather than a refund.

RECOMMENDATION

To address the inconsistent application of IRC § 6013 by courts, the National Taxpayer Advocate recommends that Congress:

- Amend IRC § 6013(b)(1) by clarifying the term “separate returns” means any return that is not a joint return, and
- Amend IRC § 6013(b)(2)(B) to allow taxpayers the right to change their filing status to MFJ after filing a Tax Court petition in response to a SNOD, in accordance with rules of practice and procedure of the Tax Court or, in the alternative, eliminate IRC § 6013(b)(2)(B).¹⁰

PRESENT LAW

In 1939, Congress added IRC § 51(b), which allowed a married couple that lived together to include their separate incomes “in a single return made by them jointly.”¹¹ At that time, a married couple could not file a joint return if one of the spouses had made a separate return and the time for filing the return for the other spouse had expired.¹² In 1948 and later years, Congress extensively revised IRC § 51(b), now IRC § 6013(b)(1), to balance the disparities between married and unmarried individuals, as well as concerns about surviving spouses of service members.¹³ In 1951, Congress added IRC § 51(g), the

7 The taxpayers reside within the Court of Appeals for the First Circuit. The First Circuit includes the Districts of Maine, Massachusetts, New Hampshire, Puerto Rico, and Rhode Island.

8 Generally, married individuals are precluded from claiming head of household unless they meet certain exceptions not present here. See IRC § 2(b). See also IRS Pub. 504, *Divorced and Separated Individuals* 5-6 (Oct. 31, 2013).

9 The funds were never released to the taxpayer; however for the deficiency calculation the EITC amount is included creating a larger deficiency balance. MFS taxpayers cannot claim the EITC. See IRC § 32(d).

10 United States Tax Court, *Rules of Practice and Procedure*, available at <https://www.ustaxcourt.gov/notice.htm> (last visited Dec 5, 2014).

11 Internal Revenue Code of 1939, Pub. L. No. 76-1, § 51(b), 53 Stat. 27 (1939). The return filed had joint and several liability for the couple.

12 Revenue Act of 1948, Pub. L. No. 80-471, § 303, 61 Stat. 110, H.R. REP. No. 1274, at 50 (1049).

13 Revenue Act of 1948, Pub. L. No. 80-471, § 202(c)(1), 203, 303, 305, 61 Stat. 110 (1948); Revenue Act of 1951, Pub. L. No. 82-183, § 312(g), 65 Stat. 488 (1951); and Internal Revenue Code of 1954, Pub. L. No. 83-591, § 6013, 68 Stat. 730 (1954). The initial change occurred in 1948 and addressed the income splitting. Later changes in 1951 and 1954 address additional concerns of disparities and fairness as well as the estate and gift tax concerns.

current IRC § 6013(b)(2)(B), with no explanation for the exception created in limiting a change of filing status after a petition with the Tax Court has been filed.¹⁴

Married taxpayers who filed returns with a status of MFS, single, or head of household are allowed to change their filing status to MFJ subject to certain limitations of IRC § 6013.¹⁵ Pursuant to IRC § 6013(b), married taxpayers who do not initially file a joint return may change their filing status to MFJ as long as:

- One of the spouses filed a “separate return,” which is not defined in the statute or applicable regulations;¹⁶
- The couple was eligible to file a joint return for the tax year in which the “separate return” was filed;¹⁷
- The time limit for filing a joint return has not expired;¹⁸ and
- Neither spouse has filed a Tax Court petition in response to a statutory notice of deficiency.¹⁹

The courts have reached different conclusions as to the interpretation of IRC § 6013(b). In *Glaze v. United States*, the Court of Appeals for the Fifth Circuit held that only a return filed with a filing status of MFS is a “separate return” for purposes of IRC § 6013(b).²⁰ Thus, IRC § 6013(b), including the limitations of IRC § 6013(b)(2), were inapplicable.²¹ The Court of Appeals for the Eleventh Circuit follows the reasoning of *Glaze*.²² The Tax Court, however, interprets the term “separate return” to mean any filing status other than MFJ. Thus, the Tax Court does not follow the *Glaze* decision except in cases where an

14 Revenue Act of 1951, Pub. L. No. 82-183, § 312(g), 65 Stat. 488 (amended Internal Revenue Code of 1939, § 51(b), added new subsection 51(g)); H.R. REP. NO. 82-1179, at 71 (1951); S. REP. NO. 82-781, Part 2, at 25-27 (1951); H.R. REP. NO. 82-1213, at 72 (1951); and *Summary of the Provisions of the Revenue Act of 1951 (H.R. 4473) as Agreed by the Conferees*, Joint Committee on Internal Revenue Taxation, at 25, 82nd Cong. (1951).

15 IRC§ 6013(b)(1), (b)(2)(B). See also IRS Pub. 504, *Divorced and Separated Individuals 4* (Oct. 31, 2013).

16 See IRC § 6013(b)(1), 6013(b)(2)(B), and Treas. Reg. § 1.6013-2.

17 Either spouse has the option to change their status to MFJ after a separate return has been filed. IRS Pub. 504, *Divorced and Separated Individuals 5* (Oct. 31, 2013).

18 Taxpayers have three years from the due date (not including extensions) of the separate return or returns to amend their returns because the IRS cannot assess the taxpayer after three years. IRC § 6013(b)(2)(A), § 6501. See also IRS Pub. 504, *Divorced and Separated Individuals 5* (Oct. 31, 2013). Furthermore, the taxpayer will be unable to request a refund after three year under IRC § 6511(a), but the taxpayer could file Form 656-L, *Offer in Compromise (Doubt as to Liability)* (Feb. 2012) based on the correct filing status and compromise the tax based on the calculated amount of the tax as if the amended return were filed and offering the result as a compromise of debt.

19 IRC § 6013(b)(1), (b)(2)(B). Taxpayers may make this change by filing IRS Form 1040X, *Amended U.S. Individual Income Tax Return* (Dec. 2013).

20 *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981). In this case, a taxpayer filed a return as a single taxpayer in 1970 (she was cohabitating with a male partner) and in 1971 the executor of her decedent partners’ estate filed a single return. The taxpayer sued in state court claiming a share of the decedent’s estate as his common law wife. It was determined that she and the decedent were in a common law marriage and in 1974 the taxpayer amended her 1970 tax return with a filing status of MFJ and requested a refund.

21 *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981).

22 The 11th Circuit adopted all prior decisions of the Court of Appeals for the 5th Circuit in *Bonner v. City of Prichard*, 661 F.2d 1206 (11th Cir. 1981).

appeal would lie in the Fifth or Eleventh Circuits based on the *Golsen* rule.²³ The Court of Appeals for the Eighth Circuit is currently considering the same issue on appeal in *Ibrahim v. Commissioner*.²⁴

REASONS FOR CHANGE

Neither the IRC nor the regulations define “separate return,” and the case law is inconsistent as to the meaning of that phrase. Decisions differ depending on the Court of Appeals for the circuit in which an appeal from a Tax Court decision would lie, based upon the taxpayer’s legal residence.²⁵ Furthermore, the SNOD presently fails to clarify that taxpayers may change their filing status to MFJ by amending their returns prior to filing a petition with the Tax Court, which could reduce taxpayers’ confusion and burden.²⁶ The taxpayer’s *right to be informed* is impaired when taxpayers do not “know what they need to do to comply with the tax laws” and are unable to obtain “clear explanations of the laws and IRS procedures ...”²⁷ Inconsistent application of IRC § 6013(b) as to what constitutes a separate return and when the taxpayer may change filing status to MFJ, compounded by the lack of clear explanations in the SNOD, prevents taxpayers from obtaining this clear understanding of what they must do to comply with tax laws and procedures.²⁸

The conflicts between some appellate courts and the Tax Court result in similarly situated taxpayers being treated disparately. Married taxpayers filing MFS may face certain disadvantages compared to those filing MFJ. For example, they may be generally:

- Subject to a higher tax rate;
- Entitled to a lower exemption amount for the alternative minimum tax (AMT) purposes;
- Not eligible for refundable credits, such as the child tax credit and the earned income tax credit;
- Not eligible for the exclusion or credit for adoption expenses in most cases;
- Not eligible for higher education expenses credits (*e.g.*, American opportunity and lifetime learning credits), the deduction for student loan interest, or the tuition and fees deduction; or
- Unable to exclude the interest from qualified savings bonds used for higher education expenses.

Depending on the jurisdiction, similarly-situated taxpayers may pay different amounts of tax based solely on which Circuit Court of Appeals the Tax Court is required to follow. This may force taxpayers to accept and pay the amount in the SNOD, which may be more than they would otherwise owe, but for the conflict in interpretation. Thus, taxpayers who fail to change their filing status prior to filing a petition

23 *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981), *action on dec.*, 1981-140 (June 2, 1981). See, *e.g.*, *Currie v. Comm’r*, T.C. Memo.1986-71; *Blumenthal v. Comm’r*, T.C. Memo.1983-737; *Saniewski v. Comm’r*, T.C. Memo.1979-337. See *Golsen v. Comm’r*, 54 T.C. 742, 757 (1970), *aff’d*, 445 F.2d 985 (10th Cir. 1971) (the Tax Court follows its own precedent unless the Court of Appeals for the circuit to which the case would be appealable has ruled to the contrary).

24 T.C. Memo. 2014-8, *appeal docketed*, No. 14-2070 (8th Cir. 2014). The issue is whether the interpretation of “separate” applies to all types of returns filed or is it limited to Married Filing Separately (MFS) filers.

25 See IRC § 6013(b)(1), 6013(b)(2)(B), and Treas. Reg. § 1.6013-2. See also *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981) and *Ibrahim v. Comm’r*, T.C. Memo. 2014-8, *appeal docketed*, No. 14-2070 (8th Cir. 2014). IRC § 7482(b)(1)(A) provides that in cases where a petitioner, other than a corporation, seeks redetermination of a tax liability, venue for review by the United States Court of Appeals lies with the Court of Appeals for the circuit based upon the taxpayer’s legal residence.

26 See IRC § 6013(b)(1), 6013(b)(2)(B), and Treas. Reg. § 1.6013-2.

27 IRS, *Taxpayer Bill of Rights*, <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014). *The Right to Be Informed* states, “Taxpayers have the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.”

28 *Id.*

with the Tax Court may end up paying more than the correct amount of tax, resulting in a violation of the *right to pay only the amount of tax legally due*.²⁹

By adopting the National Taxpayer Advocate’s legislative recommendation to clarify the term “separate return” as any return that is not a joint return, and allow taxpayers to change their filing status to MFJ after a petition has been filed with the Tax Court in accordance with rules of practice and procedure of the court, Congress would:

- Reduce burden for taxpayers unwary of the complex IRC § 6013(b)(2)(B) rule that precludes taxpayers petitioning the Tax Court in response to a SNOD from changing their filing status to MFJ;
- Achieve consistent application of the change in filing status rules across the country; and
- Provide meaning to the taxpayer’s right to a fair and just tax system, specifically, that taxpayers “have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely.”³⁰

EXPLANATION OF RECOMMENDATION

The proposal would amend IRC § 6013(b)(1) and clarify that “separate returns” include any filing status (except MFJ). The proposal would also amend IRC § 6013(b)(2)(B) to allow taxpayers who petition the Tax Court in response to a SNOD to change their filing status to MFJ in accordance with the practices and procedures of the Tax Court.³¹ This proposal may also resolve filing status issues such as the eligibility for certain credits, exemptions, and deductions for which the taxpayer would not otherwise be eligible; thus reducing litigation.

This legislative change will also clarify and simplify the change in filing status rule, reduce taxpayer burden, and enhance the taxpayer’s *right to pay no more than the correct amount of tax and to a fair and just tax system*.³² Finally, the legislative recommendation will result in consistent application of the change in filing status rules across the country.³³

29 IRS, *Taxpayer Bill of Rights*, <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014). *The Right to Pay No More than the Correct Amount of Tax* states, “Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties, and to have the IRS apply all tax payments properly.”

30 IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014). *The Right to Fair and Just Tax System*, “Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers have the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.”

31 Changing the language of IRC § 6013(b)(2)(B) or deleting it has the same result in our recommendation. See United States Tax Court, *Rules of Practice and Procedure*, available at <https://www.ustaxcourt.gov/notice.htm> (last visited Dec 5, 2014).

32 See IRS, *2013 Tax Table* (Oct. 10, 2014), available at <http://www.irs.gov/pub/irs-pdf/i1040tt.pdf>. As the IRS Sample Table shows a married couple with combined income of \$25,300 that file MFJ have taxable income of \$2,906; however, if the couple filed MFS their taxable income would be \$3,353, a difference of \$447.

33 Cf. *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981) and *Ibrahim v. Comm’r, T.C.* Memo. 2014-8, *appeal docketed*, No. 14-2070 (8th Cir. 2014).

LR #8 **ERRONEOUS REFUND PENALTY: Amend Section 6676 to Permit “Reasonable Cause” Relief**

PROBLEM

A taxpayer who claims a tax credit or refund that the IRS disallows may be liable for a penalty under Internal Revenue Code (IRC) § 6676 unless the taxpayer had a “reasonable basis” for the claim.¹ Section 6676 does not appear to require the IRS to take into account all the facts and circumstances, including the taxpayer’s knowledge and experience with tax law and his or her efforts to comply with the law, in determining whether there was such reasonable basis. Taxpayers may satisfy the reasonable basis standard if they have “substantial authority” for their return position, but substantial authority does not include IRS forms or accompanying instructions, IRS publications, or IRS answers to Frequently Asked Questions—materials that many individual taxpayers rely on for guidance.

While the section 6676 penalty does not apply to erroneous claims for the Earned Income Tax Credit (EITC), it may apply to disallowed claims for other social benefits, such as the additional child tax credit and the new Premium Tax Credit under the Affordable Care Act (ACA).² The rules for claiming these income-based refundable credits, available to low income taxpayers who face unique obstacles in understanding and substantiating eligibility, are complex and varied, which raises the likelihood of mistakes.³ Other tax penalties, including the civil fraud penalty, contain an exception for “reasonable cause.”⁴ Determining whether there was “reasonable cause” for a claim requires consideration of all of the taxpayer’s facts and circumstances.⁵

According to the Taxpayer Bill of Rights (TBOR), taxpayers have the *right to a fair and just tax system*—“the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities ...”⁶ Subjecting taxpayers to a penalty for claiming a disallowed refund without taking into account their facts and circumstances impairs their right to a fair and just tax system. For these reasons the National Taxpayer Advocate reiterates her 2011 recommendation that Congress amend IRC § 6676 to allow a reasonable cause exception.⁷

- 1 See IRC § 6676 (a), imposing the penalty on “a claim for refund or credit with respect to income tax” made “for an excessive amount.” Under IRC § 6676(b), the amount of the penalty is 20 percent of the excessive (*i.e.*, disallowed) amount.
- 2 See IRC § 6676(a) (excluding the earned income tax credit under IRC § 32); IRC § 24 (providing for the child tax credit and the additional child tax credit, which is the part of the credit that is refundable); IRC § 36B (providing for the premium tax credit). There has been at least one legislative proposal to remove the exclusion of EITC claims. See H.R. 5070, 113th Cong., 2d Sess. § 6 (July 10, 2014).
- 3 See National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2 at 93. (Research Study: *Running Social Programs Through the Tax System*); National Taxpayer Advocate 2009 Annual Report to Congress 110-13 (Most Serious Problem: *Beyond EITC: The Needs of Low Income Taxpayers Are Not Being Adequately Met*) (“Although a diverse population, low income taxpayers do share common characteristics. Low income taxpayers are found more frequently among the elderly, the disabled, Native Americans, and taxpayers who may have limited English proficiency (LEP) relative to the general Wage and Investment (W&I) taxpayer population. Many require extra assistance to understand tax law changes, as demonstrated by the widespread confusion about the 2008 Economic Stimulus Payment (ESP) and the resulting flood of calls to the IRS toll-free line. Low income taxpayers tend to be more transitory than the general population, with 27.5 percent of those below the poverty level moving in 2007 while only 15 percent of the general population moved during the same time.” (fn refs. omitted)).
- 4 See IRC § 6664(c).
- 5 See, *e.g.*, Treas. Reg. § 1.6664-4(b)(1).
- 6 Taxpayer Bill of Rights, *available at* <http://taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights#rights>.
- 7 National Taxpayer Advocate 2011 Annual Report to Congress 544 (Legislative Recommendation: *Amend the Erroneous Refund Penalty to Permit Relief in Case of Reasonable Cause for Claim to Refundable Credits*).

EXAMPLE

During tax year 2014, X and Y, high school graduates with no significant tax law knowledge or experience, have two dependent children and household income of around \$45,000. X and Y paid a commercial return preparer to prepare their joint federal tax return for 2013, which they decide to use as a starting point for preparing their own 2014 return. X and Y learn that because both their children are under 19 in 2014, they will be responsible for the Shared Responsibility Payment (SRP) if their children do not have required health insurance.⁸ After X and Y obtain insurance for the family, they predict the amount of their household income for the year and find that, based on their projections, they qualify for advanced premium tax credits (APTC). These credits are paid directly to their insurer throughout 2014.

As in 2013, X and Y's 2014 tax liability was paid through wage withholding, so their 2014 return properly shows no tax due. Like the 2013 return, the 2014 return claims a refund for EITC and an additional \$2,000 refund for the additional child tax credit (\$1,000 for each child). Because X and Y actually earned slightly less than the amount they projected, they are entitled to an additional premium tax credit which they calculated to be \$1,500. Thus, their total refund claim on their 2014 return is \$3,500, not counting EITC. The IRS examines the return and determines X and Y are entitled to the claimed EITC, but not the child tax credit for their child who turned 17 years old in 2014.⁹ The IRS also determines that although X and Y are entitled to a refund for the additional premium tax credit, they miscalculated the amount, which should be \$1,000. Thus, X and Y are entitled to a total refund of \$2,000, not counting EITC. The IRS denies \$1,500 of X and Y's original \$3,500 refund claim and assesses a \$300 penalty despite the couple's good faith efforts to comply with the tax law and their lack of education, knowledge, or experience with taxes. There is no authority that would support X and Y's claim for \$1,500 of the refund shown on their tax return (and X and Y concede their error). X and Y would not be able to show they had a reasonable basis for their claim and would not be eligible for relief from the penalty under IRC § 6676. If there were a reasonable cause exception to the penalty, X and Y might be able to show that taking into account all their facts and circumstances, they are eligible for penalty relief.

RECOMMENDATION

To allow for consideration of taxpayers' facts and circumstances before imposing a penalty for erroneously claiming a credit or refund, the National Taxpayer Advocate recommends that Congress amend IRC § 6676 to permit relief from the penalty for individual taxpayers who acted with reasonable cause and in good faith.

8 Per Treas. Reg. § 1.5000A-1(c)(2), "if the nonexempt individual is a dependent (as defined in section 152) of another individual for the other individual's taxable year including that month, the other individual is liable for the shared responsibility payment attributable to the dependent's lack of coverage. An individual is a dependent of a taxpayer for a taxable year if the individual satisfies the definition of dependent under section 152, regardless of whether the taxpayer claims the individual as a dependent on a Federal income tax return for the taxable year." Under IRC § 152(c)(3), X and Y's children will be dependents until they are 19 or, if students, age 24.

9 Under IRC § 24(c)(1), the term "qualifying child" for purposes of the child tax credit means a qualifying child of the taxpayer (as defined in section 152(c)) who has not attained age 17.

PRESENT LAW

Section 6662 imposes an accuracy-related penalty applicable to underpayments of income tax.¹⁰ In simplified terms, “underpayment” means the excess of a taxpayer’s actual liability over his or her reported liability—“*i.e.*, tax ‘imposed’ minus tax ‘shown’ equals ‘underpayment’.”¹¹

The accuracy-related penalty does not apply where the taxpayer acted with reasonable cause and in good faith.¹² According to the applicable Treasury regulation:

[t]he determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances ... Generally, the most important factor is the extent of the taxpayer’s effort to assess the taxpayer’s proper tax liability. Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer.¹³

Until 2013, the IRS successfully asserted the accuracy-related penalty with respect to disallowed credits claimed on original returns, whether the credit only reduced tax or also resulted in a claim for refund.¹⁴ Taxpayers could avoid imposition of the penalty by demonstrating they had reasonable cause for claiming the disallowed credit.¹⁵ As discussed below, these procedures have changed in light of the Tax Court’s decision in *Rand v. Commissioner*.¹⁶

In the meantime, in 2007 Congress filled a perceived gap in the penalty framework by enacting section 6676, which imposes a penalty of 20 percent of an excessive claim for refund or credit.¹⁷ To the extent a disallowed credit other than EITC generates a refund, it may be subject to a penalty under section 6676.¹⁸

10 IRC § 6662 penalizes underpayments of tax otherwise owed attributable to negligence or disregard of rules or regulations, substantial understatements of tax (*i.e.*, failing to show ten percent of the correct tax or \$5,000, whichever is more), or certain other factors. The amount of the penalty is 20 percent of the amount of the underpayment.

11 *Rand v. Comm’r*, 141 T.C. 376, 399 (2013) (Gustafson, J., dissenting).

12 IRC § 6664(c).

13 Treas. Reg. § 1.6664-4(b)(1).

14 See *Rand v. Comm’r*, 141 T.C. 376 (2013) and cases cited therein at p. 389, n. 10. See also IRS Program Manager Technical Advice (PMTA) 2012-016, 2012 TNT 163-18 (Aug. 22, 2012), explaining that the IRS would continue to seek imposition of the accuracy-related penalty for disallowed claims for refundable credits, except where the IRS did not actually pay a refund or approve the credit.

15 Because deficiency procedures apply to imposition of the penalty under section 6662, taxpayers could contest liability for the penalty in the Tax Court before being required to pay it. IRC § 6665.

16 141 T.C. 376 (2013).

17 According to the Department of Treasury, “[d]isallowing a refund or credit claim does not result in an underpayment. Absent a frivolous position evident on the face of the return, there is no accuracy-related penalty applicable to disallowance of a refund or credit claim.” Dept. of Treas., *Gen. Explanations of the Admin’s FY 2008 Rev. Proposals* (Feb. 2007) at 82, available at <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2008.pdf>. Consequently, a taxpayer with a return position (such as a claim for a tax credit) believed to increase exposure to the accuracy-related penalty under section 6662 might bifurcate his or her tax reporting. An original return omitting the credit and showing zero tax due, followed by an amended return claiming the credit results in neither return containing an underpayment, even if the claimed credit on the amended return generated a refund that was paid and the credit then disallowed. See National Taxpayer Advocate 2011 Annual Report to Congress 544, 546 (Legislative Recommendation: *Amend the Erroneous Refund Penalty to Permit Relief in Case of Reasonable Cause for Claim to Refundable Credits*); Sharyn M. Fisk and Heather Kim Lee, *Section 6676 Erroneous Claim For Refund Or Credit Penalty: The Penalty Has No Reasonable Basis* 9 (prepared for the Taxation Procedure & Litigation Committees of the Taxation Sections of the State Bar of California and the Los Angeles County Bar Association), available at <http://www.lacba.org/Files/Main%20Folder/Sections/Taxation/Files/2008%20Fisk-Lee%206676%20Washington%20Paper%20Corrected%20May%206,%202008.pdf>. IRC § 6676 was added by Pub. L. No. 110-28, § 8247, 121 Stat. 112, 204 (2007). It does not apply where the accuracy-related penalty under section 6662 applies. IRC § 6676(d).

18 *Rand v. Comm’r*, 141 T.C. 376, 395 (2013).

However, section 6676 does not include a reasonable cause exception.¹⁹ Rather, it provides an exception where there was a “reasonable basis” for the claim.²⁰ Neither section 6676 nor the regulations under that section define “reasonable basis,” but a regulation under section 6662 provides in pertinent part:

Reasonable basis is a relatively high standard of tax reporting, that is [sic], significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. If a return position is reasonably based on one or more of the authorities set forth in § 1.6662-4(d)(3)(iii) (taking into account the relevance and persuasiveness of the authorities, and subsequent developments), the return position will generally satisfy the reasonable basis standard ...²¹

In the years following enactment of section 6676, means-tested refundable credits proliferated.²² As noted above, however, the IRS continued to assert the accuracy-related penalty on disallowed refunds under section 6662 rather than asserting the penalty under section 6676.²³ In 2013, the Tax Court in *Rand v. Commissioner* interpreted the definition of “underpayment” in the Treasury regulations under section 6664 and held that the “amount shown as tax on the return” takes into account the EITC, additional child tax credit, and recovery rebate credit, but these refundable credits do not reduce the amount shown as tax below zero.²⁴ Thus, these erroneously claimed credits may be subject to an accuracy-related penalty under section 6662 only to the extent they reduced a tax liability. Except for disallowed EITC, they may be subject to the penalty under section 6676 to the extent they generated a refund.²⁵ While section 6676 may have filled a perceived gap in the penalty framework, it was not clear until 2013 that some disallowed refundable credits could *only* be penalized pursuant to section 6676, rather than pursuant to section 6662.

19 As originally proposed, the new penalty contained a reasonable cause exception. See Dept. of Treas., *Gen. Explanations of the Admin’s FY 2008 Rev. Proposals* (Feb. 2007) at 82, available at <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2008.pdf>. After enactment, the IRS Office of Chief Counsel, Procedure and Administration, recommended adding a reasonable cause exception to the section 6676 penalty in its suggestions for the U.S. Department of the Treasury’s FY 2012 Green Book, which provides explanations of the Administration’s fiscal year revenue proposals.

20 IRC § 6676(a).

21 Treas. Reg. § 1.6662-3(b)(3). The authorities set forth in the cited Treas. Reg. § 1.6662-4(d)(3)(iii) include “[a]pplicable provisions of the Internal Revenue Code and other statutory provisions; proposed, temporary and final regulations construing such statutes; revenue rulings and revenue procedures; tax treaties and regulations thereunder, and Treasury Department and other official explanations of such treaties; court cases; congressional intent as reflected in committee reports, joint explanatory statements of managers included in conference committee reports, and floor statements made prior to enactment by one of a bill’s managers; General Explanations of tax legislation prepared by the Joint Committee on Taxation (the Blue Book); private letter rulings and technical advice memoranda issued after October 31, 1976; actions on decisions and general counsel memoranda issued after March 12, 1981 (as well as general counsel memoranda published in pre-1955 volumes of the Cumulative Bulletin); Internal Revenue Service information or press releases; and notices, announcements and other administrative pronouncements published by the Service in the Internal Revenue Bulletin.” The list of authorities does *not* include IRS publications or instructions to IRS forms—materials average individual taxpayers would consult and rely on in preparing their returns—or even legal opinions or opinions of tax professionals.

22 Credits that were enacted or made refundable after 2007 include the first-time homebuyer credit (IRC § 36), the making work pay credit (IRC § 36A), the premium tax credit (IRC § 36B), the adoption credit (IRC § 23), the American opportunity tax credit (IRC § 25A), and the recovery rebate credit (IRC § 6428).

23 According to the Treasury Inspector General for Tax Administration (TIGTA), the IRS assessed only 84 erroneous refund penalties totaling \$1.9 million between May 2007 and May 2012. TIGTA, Ref. No. 2013-40-123, *The Law Which Penalizes Erroneous Refund and Credit Claims Was Not Properly Implemented* (Sept. 26, 2013), available at <http://www.treasury.gov/tigta/auditreports/2013reports/201340123fr.html>.

24 For a complete discussion of the *Rand* case, see Most Litigated Issue: *Accuracy-Related Penalty Under IRC § 6662(b)(1), (2), and (3)*, *infra*.

25 *Rand v. Comm’r*, 141 T.C. 376, 395 (2013). As noted above, at least one congressional bill proposes removing the exclusion for EITC under section 6676. See H.R. 5070, 113th Cong., 2d Sess. § 6 (July 10, 2014).

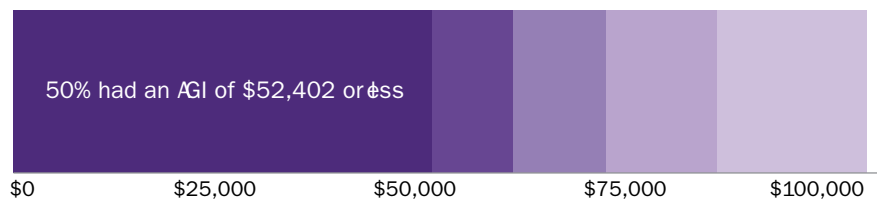
On June 10, 2014, the IRS adopted the TBOR. Among taxpayer rights is the *right to a fair and just tax system*, which includes taxpayers' "right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely."²⁶

REASONS FOR CHANGE

Unlike the "reasonable cause" exception to liability under section 6662, the "reasonable basis" standard under section 6676 does not appear to require the IRS to take into account all the facts and circumstances, including the taxpayer's knowledge and experience with tax law and his or her efforts to comply with the law, and is thus inconsistent with taxpayers' right to a fair and just tax system. Section 6676 appears to contemplate a sophisticated taxpayer with access to technical authorities on which to construct a return position, who then disregards those authorities. Taxpayers who claim the benefits of at least one social program delivered through refundable tax credits, the additional child tax credit, do not generally fit this description. To begin with, as Figure 2.8.1 shows, half the 2012 returns on which taxpayers claimed the child tax credit that generated a refund showed adjusted gross income (AGI) under \$53,000.²⁷

FIGURE 2.8.1

Adjusted gross income shown on 2012 returns claiming Additional Child Tax Credit that generated a refund, by percentile



Taxpayers who claimed the additional child tax credit and whose refunds were then disallowed were even worse off. Of these taxpayers, half the 2012 returns showed adjusted gross income under \$22,000.²⁸

26 Taxpayer Bill of Rights, available at <http://taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights#rights>.

27 TAS Research, based on data from the Individual Returns Transaction File (IRTF) on the IRS Compliance Data Warehouse (CDW), for tax year 2012 taxpayers claiming the additional child tax credit and a refund. The data for 2013 returns is similar, with AGI at the 50th percentile equal to \$52,714.

28 TAS Research, based on data from the IRTF and Exam Operational Automation Database on CDW, for tax year 2012. According to the Department of Health and Human Services, the 2014 poverty guideline for a four-person household in the 48 contiguous states and the District of Columbia is \$23,850. Dept. of Health and Human Services, Annual Update of the Poverty Guidelines, 79 Fed. Reg. 3593-3594 (Jan. 22, 2014), available at <http://aspe.hhs.gov/poverty/14poverty.cfm>.

FIGURE 2.8.2

**Adjusted gross income shown on 2012 returns claiming
Additional Child Tax Credit where refund was disallowed, by percentile**



Moreover, taxpayers who erroneously claim refundable credits are subject to different standards depending on unrelated characteristics of their returns. A taxpayer who erroneously claims a refundable credit that reduces his or her tax liability but does not generate a claim of refund would be subject to the penalty under section 6662, but could avoid the penalty by demonstrating reasonable cause. A different taxpayer who erroneously claims the same refundable credit, where the credit not only reduces his or her tax liability but also results in a claim of refund, would be subject to the penalty under section 6676, and could avoid the penalty only by showing “reasonable basis” for the claim.

EXPLANATION OF RECOMMENDATION

The proposal would amend section 6676 to clarify that the penalty does not apply to individual taxpayers who acted with reasonable cause and in good faith in erroneously claiming a credit or refund. Taking into account all of taxpayers’ facts and circumstances in determining whether they had such reasonable cause would bring this statutory penalty into conformity with the TBOR right to a fair and just tax system. This approach reflects recent judicial interpretations of sections 6662 and 6676, is consistent with the accuracy-related penalty provisions of section 6662, avoids subjecting unsophisticated taxpayers to a penalty intended to reach taxpayers who take calculated risks in their reporting positions, and permits consistent treatment of similarly situated taxpayers.

LR
#9

ACCESS TO THE IRS: Require the IRS to Publish a Public Phone Directory and Report on Implementing an Operator System Similar to “311” Lines

PROBLEM

The IRS Restructuring and Reform Act of 1998 (RRA 98) required the IRS to publish the phone number and address for each local office in local phone books across the country.¹ Since this provision was enacted in 1998, much has changed about the way the IRS is organized and about how people find other people and businesses. RRA 98 called for the IRS to reorganize by moving away from a structure based on regions and districts to one organized around the types of taxpayers,² and so when the law was passed, it was foreseeable that local offices would handle fewer issues for taxpayers after the reorganization. However, Congress may not have anticipated how few services local offices would come to provide for taxpayers³ and to the great extent taxpayers would rely on written or phone communication with offices scattered around the country.⁴ Furthermore, there has been a movement away from using physical phone books in recent years.⁵

Even if the IRS meets the requirement of RRA 98 by effectively publishing the numbers for local offices in phone books, the IRS is not achieving the purpose of the provision—to make itself accessible to taxpayers. Taxpayers do not know how to reach a specific department within the IRS, if they are even able to identify the department with which they need to talk. When taxpayers call the IRS, they often must navigate an extended phone tree before being transferred, and at times, they are transferred to a recorded message without the ability to speak to a live person. Taxpayers have the *right to quality service*—to receive prompt, courteous, and professional assistance, and to speak to a supervisor about inadequate service. When taxpayers cannot find the right employee or manager to speak to about their issues, or cannot speak to an employee at all, their *right to quality service* is compromised.

1 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3709, 112 Stat. 685, 779 (1998) 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.” For a detailed discussion of the IRS’s implementation of this provision and the problems taxpayers have trying to reach the IRS, see Most Serious Problem: *ACCESS TO THE IRS: Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*, *supra*.

2 Pub. L. No. 105-206, § 1001(a), 112 Stat. 685, 689 (1998).

3 During the 2014 filing season, local walk-in sites known as Taxpayer Assistance Centers (TACs) stopped offering any kind of return preparation for taxpayers and the IRS stopped answering complex tax law questions, and stopped answering any tax law questions at all after the filing season. See IRS, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (last updated Feb. 3, 2014), available at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.

4 See Most Serious Problem: *IRS LOCAL PRESENCE: The Lack of Cross-functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*, *supra*.

5 A recent survey found that almost seven out of 10 people rarely use a paper phone book and 60 percent of those surveyed had looked online for contact information. See MSN Money, *Phone books are nearly obsolete* (Feb. 19, 2013), available at <http://money.msn.com/saving-money-tips/post.aspx?post=39cb1c6f-a937-4d5f-852b-0326187c72c9> (citing a survey conducted by White Pages).

EXAMPLE

The IRS levies the wages of a taxpayer with a balance due. The taxpayer submits a request for an offer in compromise (OIC)⁶, which would allow him to settle his liability for less than the full amount due and pay it in installments. When he does not hear anything in response to his offer, he calls the main IRS toll-free line.⁷ The taxpayer spends six minutes answering questions⁸ through an interactive voice response system. Instead of speaking to an employee in the OIC unit, the phone prompts transfer the taxpayer to a Customer Service Representative (CSR) trained to use an application that is used for not only OICs, but also 22 other types of calls according to the Telephone Transfer Guide. The CSR tells the taxpayer that his offer was rejected.

The taxpayer tries to explain that he has unique monthly expenses due to medical problems, and using the standard guidelines for basic costs of living will leave him without enough money to pay his basic expenses.⁹ However, the phone assistor, who handles a wide range of issues, incorrectly tells the taxpayer that the IRS is required to use the standard amounts for all taxpayers. The taxpayer asks to speak to a manager. The taxpayer never receives a call back from a manager. In the meantime, the IRS continues to levy the taxpayer's wages.

RECOMMENDATION

To address the problem of taxpayers not being able to reach the right person at the IRS, the National Taxpayer Advocate recommends that Congress enact legislation to require the IRS, within 180 days, to:

1. Publish, on IRS.gov, its current Practitioner Directory¹⁰ or a similar directory that provides the same detailed information regarding the names and contact information for managers of local IRS groups or territories for different functions of the IRS, as well as managers of service and compliance functions located in IRS campuses. Require the IRS to provide an electronic or paper copy of the directory for a particular state or geographic area, if requested by a taxpayer.
2. Develop a report detailing the administrative steps necessary to implement an operator system for its main toll-free phone line, similar to a 311 telephone line.¹¹ Under such a system, all taxpayers would call a single nationwide toll-free phone number and answer a limited number of questions through an interactive voice response system before being transferred to an operator. If the taxpayer were requesting a specific piece of information such as an account balance or transcript, the operator would provide the information to the taxpayer. For calls regarding other IRS functions and offices, the operator would transfer the taxpayer to the specific office handling the taxpayer's individual issue or case. Such report should be provided to the Senate Committee on Finance and the House Committee on Ways and Means.

6 See IRC § 7122.

7 1-800-829-1040 (TTY/TDD 1-800-829-4059).

8 For a detailed description of the phone prompts for a taxpayer to speak with someone about a payment plan, see Most Serious Problem: ACCESS TO THE IRS: *Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*, *supra*.

9 Generally, when determining how much a taxpayer can pay, the IRS uses guidelines for standard allowances for cost of living expenses. However if using the guidelines would result in a taxpayer not being able to pay his or her basic living expenses, then the IRS must consider that taxpayer's actual expenses. See IRC § 7122(d)(2).

10 The Practitioner Directory is a directory of commonly used local phone numbers and websites that IRS employees can distribute to practitioners. See IRM 11.53.5.3.1 (June 24, 2013).

11 A 311 telephone line is a special phone number supported in many communities to provide access to non-emergency municipal services.

PRESENT LAW

Section 3709 of RRA 98 requires the IRS to “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.”¹² The RRA 98 Senate Finance Committee Report reflects the intent that “every taxpayer should have convenient access to the IRS.”¹³ Section 3705(d) of RRA 98 requires the IRS to “provide, in appropriate circumstances, on telephone helplines of the Internal Revenue Service an option for any taxpayer to talk to an Internal Revenue Service employee during normal business hours.”¹⁴ It further specifies: “The person shall direct phone questions of the taxpayer to other Internal Revenue Service personnel who can provide assistance to the taxpayer.”¹⁵

REASONS FOR CHANGE

Changes in technology and the way the IRS is organized have made the RRA 98 requirement for publication in phone books outdated. Publishing the number for local offices is of little help to taxpayers because the IRS does not answer the phone calls to local offices and does not allow taxpayers to leave a message.¹⁶ Furthermore, taxpayers often need to reach a specific department within a local office, such as the local examination or appeals office, and these numbers are not published. Although the IRS does not need statutory authority in order to publish its Practitioner Directory for public use, a directive from Congress is necessary to push the IRS to make this resource available to all taxpayers and ensure it does so in a timely manner.

Although section 3705(d) of RRA 98 requires the IRS to provide the option to speak to a live person on helplines, taxpayers are not given this option when they call the main toll-free line.¹⁷ Even if the taxpayer is able to reach a live person, the taxpayer may not be able to talk to an employee working in the unit that handles the taxpayer’s issue, or be transferred to that unit.¹⁸ The IRS’s procedure for answering, screening, and working phone calls needs to be updated to provide the taxpayer with the opportunity to speak to an employee within the office handling the taxpayer’s issue. The IRS does not need any legislative authority at this time to transition to a 311 system, but a congressional directive to prepare a report would prod the IRS to begin looking into what kinds of preparations it must undertake to implement such a system. Furthermore, congressional oversight would ensure that the system operates as intended and meets the current requirements of RRA 98.¹⁹ For example, congressional oversight might encourage the IRS to define what a helpline is for the purpose of RRA 98 § 3705(d) and ensure that all such phone lines on the 311 system advertise to the taxpayer the option to speak to a live person.

12 Pub. L. No. 105-206, § 3709, 112 Stat. 685, 779 (1998). For more a more detailed discussion regarding the legislative history of this provision, see Most Serious Problem: ACCESS TO THE IRS: *Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*, *supra*.

13 S. REP. No. 105-174, at 106 (1998).

14 Pub. L. No. 105-206, § 3705(d), 112 Stat. 685, 777 (1998).

15 *Id.*

16 See Most Serious Problem: ACCESS TO THE IRS: *Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*, *supra*.

17 *Id.*

18 *Id.*

19 For example, RRA 98 also established the specific goal that, by 2007, 80 percent of tax and information returns would be electronically filed. Pub. L. No. 105-206, § 2001(a)(2), 112 Stat. 685, 723 (1998). As part of this legislation, Congress required the IRS Oversight Board, as well as the Electronic Tax Administration Advisory Committee, to report to Congress annually on the progress toward the goal. *Id.* at § 2001(d), 112 Stat. 685, 723 (1998). The IRS did not meet the target in 2007, but the 80 percent electronic filing goal was extended to 2012, at which point it was reached. IRS Oversight Board, *Electronic Filing 2012 Annual Report to Congress*, 5 (2012).

EXPLANATION OF RECOMMENDATIONS

The National Taxpayer Advocate recommends the IRS provide a directory of key contacts to the public. The IRS currently publishes a “Practitioner Directory” for each state, which includes key contact information for specific offices, such as the local area directors and territory managers for different departments, such as the offer in compromise unit, as well as some national numbers, such as the number for lien releases. An expanded version of this directory, including numbers and contacts for service and compliance functions within each IRS campus, could be published on IRS.gov and provided to any taxpayer who requests a copy for his or her state or geographic area.

The National Taxpayer Advocate also recommends that Congress require the IRS to prepare a report outlining the administrative steps necessary to implement a 311 telephone system, including a draft timeline for operation. Under such a system, all taxpayers would call a single nationwide toll-free phone number when calling the IRS. Callers would answer a limited number of questions through an interactive voice response system before being transferred to an operator. A 311 system has three options to handle the call: provide the information requested, process the service request, or transfer the caller to the appropriate department or function. If the taxpayer were requesting a specific piece of information such as an account balance or transcript, the operator would provide the information to the taxpayer. For calls regarding other IRS functions and offices, the operator would transfer the taxpayer to the specific office handling the taxpayer’s issue or handling the taxpayer’s individual case.

Currently, the IRS’s phone system requires callers to navigate an extended interactive voice response system. Current procedures also provide that calls are transferred to employees who are trained to use a broad application handling a number of issues, instead of to an employee in the department handling the issue. When a referral to a specific department is necessary, the employee may have to send a written referral to the department and tell the taxpayer he or she will receive a return call days later. The report would detail how these procedures would be replaced with a streamlined system to transfer calls to the appropriate department and how the IRS would track and measure response rates, effectiveness, and taxpayer satisfaction.

LR #10 IRS CORRESPONDENCE: Codify § 3705(a)(1) of RRA 98, Define “Manually Generated,” and Require Contact Information on Certain Notices in All Cases

PROBLEM

Concerned about taxpayer access to employees both knowledgeable about and accountable for actions taken on their cases, Congress required the IRS in the IRS Restructuring and Reform Act of 1998 (RRA 98) to include employee contact information on “manually generated correspondence.”¹ The IRS has failed to meaningfully implement the requirements of § 3705(a)(1) of RRA 98. Congress did not define the term “manually generated;” instead, the IRS created its own definition in the Internal Revenue Manual (IRM).² However, the IRS does not follow its own manual and fails to include appropriate employee contact information on most computer-generated notices,³ even when a particular employee has worked on the case⁴ or exercised judgment and made a decision.⁵ Consequently, IRS correspondence procedures fail to address Congress’s concerns⁶ about the inability of taxpayers to contact an IRS employee who is knowledgeable about, and accountable for, their case.⁷

In its recent adoption of the Taxpayer Bill of Rights, the IRS affirmed its commitment to many of the principles underlying the implementation of RRA 98, including rights impacted by § 3705(a)(1)—*the right to quality service, the right to be informed, and the right to a fair and just tax system.*⁸ By not providing appropriate contact information to taxpayers who receive important IRS notices—including those that impact taxpayers’ legal rights—the IRS erodes the meaning and value of these fundamental taxpayer rights.

- 1 Pub. L. No. 105-206, § 3705(a)(1), 112 Stat. 685, 777 (1998). For a full discussion of the National Taxpayer Advocate’s concerns regarding contact information on audit notices, see Most Serious Problem: *Audit Notices: The IRS’s Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability*, *supra*.
- 2 The IRM defines manually generated correspondence as “correspondence issued as a result of an IRS employee exercising his/her judgment in working/resolving a specific taxpayer case or correspondence, or where the employee (Tax Examiner, Revenue Agent, Revenue Officer, etc.) is asking the taxpayer to provide additional case-related information.” IRM 21.3.3.4.16.1(2), *Preparation of Outgoing Correspondence* (Oct. 25, 2007).
- 3 The IRS’s definition of manually generated correspondence is broad and includes “CORRESPONDEX letters, local letters, quick notes, and some computer generated letters.” IRM 21.3.3.4.16.1(3), *Preparation of Outgoing Correspondence* (Oct. 25, 2007).
- 4 IRM 21.3.3.4.16.1(2), *Preparation of Outgoing Correspondence* (Oct. 25, 2007).
- 5 See IRM 4.19.10.1.6(6), *Correspondence Examination Letters* (Jan. 1, 2013). Sixty-nine letters are listed which will only contain generic contact information when issued on campus exam inventory.
- 6 See, e.g., 144 CONG. REC. S7717-04 (1998) (statement of Sen. Domenici), and *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 105-190 (1997) at 97, 213-14; *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 105-190 (1997) (questions of Chairman Roth) at 214.
- 7 For a complete discussion of the National Taxpayer Advocate’s concerns regarding the failure of the IRS to include contact information on audit notices, see Most Serious Problem: *Audit Notices: The IRS’s Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability*, *supra*.
- 8 The IRS adopted the Taxpayer Bill of Rights on June 10, 2014. See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. See also Publication 1, *Your Rights as a Taxpayer* (2014).

EXAMPLE

A taxpayer who has three children has moved twice during the tax year. When she files her return, the taxpayer claims all her children for the purposes of the Earned Income Tax Credit (EITC). Shortly after filing her return, she receives a CP 75 – *Exam Initial Contact Letter – EIC – Refund Frozen*, which says the IRS needs more information about her children and has frozen her EITC pending the results of the audit. It provides a form listing potential documentation the taxpayer can submit to substantiate her claim,⁹ but does not include the contact information for a specific employee.¹⁰

The taxpayer reviews the list of acceptable documentation and sends what she thinks will show that the children lived with her and she provided more than half the cost of maintaining a household for the children since she claimed head of household status,¹¹ including school records and a current lease. However, the lease does not list her children and the school records only show partial-year attendance for one child who was not old enough to attend school in the previous school district, but was old enough in the new district.

The taxpayer then receives a Letter 105C, *Claim Disallowance*, indicating the IRS will not allow the EITC for her third child because the records submitted are not sufficient. Even though an employee had to review the documentation the taxpayer provided and input specifics about that documentation into the 105C, the letter does not list specific contact information for that employee nor does it explain why the documentation was insufficient. As a result, the taxpayer cannot reach the employee who made the decision to ask for an explanation.¹²

In an attempt to resolve the issue, the taxpayer calls the general operating division toll-free number listed on the 105C. The taxpayer must take time off work to make this call. After she waits on the phone for 22 minutes, she reaches an IRS employee, who indicates that he does not see any notation of what was insufficient about the records and that the taxpayer should file an appeal. The taxpayer calls the IRS again, trying to reach someone who can tell her what documentation would prove her claim, and waits another 34 minutes on the phone, only to be disconnected. The taxpayer is frustrated because she cannot afford to take more time off to make phone calls and just wants to resolve the issue, but cannot speak to the employee who made the decision on her case. She decides not to file an appeal because she is afraid she will lose her job if she takes off more time, and does not receive the EITC even though she would have been eligible had she been able to provide appropriate documentation.

RECOMMENDATION

To provide taxpayers with access to IRS employees knowledgeable about and accountable for their cases, the National Taxpayer Advocate recommends that Congress:

- Codify RRA 98 § 3705(a)(1).
- Define the term “manually generated correspondence” as correspondence issued as a result of an IRS employee exercising his or her judgment in working or resolving a specific taxpayer case or correspondence, or where the employee is asking the taxpayer to provide additional case-related information.

9 IRS, CP 75 - *Exam Initial Contact Letter – EIC – Refund Frozen* (Feb. 2012).

10 IRM 4.19.10.1.6(6), *Correspondence Examination Letters* (Jan. 1, 2013).

11 See IRC §§ 32(c)(3) and 152(c) (definitions of qualifying child).

12 For a complete discussion of the National Taxpayer Advocate’s concerns regarding explanations in refund disallowance notices, see Most Serious Problem: *NOTICES: Refund Disallowance Notices Do Not Provide Adequate Explanations*, *supra*.

- Require the IRS to provide the name, telephone number, and unique identification number of an IRS manager on notices with legal impact, such as those that start the running of a statute of limitations or trigger appeal rights (such as the Statutory Notice of Deficiency), where such notices have been automatically generated without employee review.

PRESENT LAW

Section 3705(a)(1) of RRA 98 provides “The Secretary of the Treasury or the Secretary’s delegate shall provide that—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.”¹³

REASONS FOR CHANGE

The Joint Committee on Taxation reported the reason for the inclusion of § 3705(a)(1) in RRA 98 was so taxpayers could receive prompt answers to questions about their tax liabilities, as many expressed frustration at not knowing which employee to contact.¹⁴ The IRS defines the phrase “manually generated correspondence” in the Internal Revenue Manual (IRM) as “correspondence issued as a result of an IRS employee exercising his/her judgment in working/resolving a specific taxpayer case or correspondence, or where the employee (Tax Examiner, Revenue Agent, Revenue Officer, *etc.*) is asking the taxpayer to provide additional case-related information.”¹⁵

Although the IRS defines “manually generated” in the IRM in a manner in which it would seem taxpayers would receive such contact information, in practice, taxpayers do not receive this information on most notices, even where an employee had reviewed and made determinations on the outcome of the case. IRS practices also do not address congressional concerns about IRS employee accountability.¹⁶

TAS reviewed and analyzed a sample of 100 Letters 105C, *Claim Disallowance*.¹⁷ None contained contact information for a specific employee; instead, each was “signed” by a high-level manager or program director and listed only an operating division toll-free number.¹⁸ While many of these letters resulted from a mismatch between information provided by the taxpayer and information the IRS had in its systems and were issued without an employee ever looking at the case, five of the letters contained non-standardized paragraphs with information specific to the taxpayer’s situation that had to have been crafted manually by an employee.¹⁹ The IRM seems to require that these notices, where an employee has worked a case and made case specific decisions, thus “exercising judgment” on the case, contain employee contact information. However, our sample suggests this information is not included despite the IRM requirement.²⁰

13 Pub. L. No. 105-206, § 3705(a)(1), 112 Stat. 685, 777 (1998).

14 J. Comm. on Tax’n, *General Explanation of Tax Legislation Enacted in 1998*, 128 (Nov. 24, 1998).

15 IRM 21.3.3.4.16.1(2), *Preparation of Outgoing Correspondence* (Oct. 25, 2007).

16 See, e.g., *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 105-190 (1997) (questions of Chairman Roth) at 214.

17 Sample on file with TAS Attorney Advisor Group.

18 *Id.*

19 *Id.*

20 IRM 21.3.3.4.16.1(3), *Preparation of Outgoing Correspondence* (Oct. 25, 2007).

Even where a taxpayer has corresponded with the IRS regarding his or her correspondence exam, IRS procedures provide that in most cases, the case can be returned for automatic processing after the correspondence has been reviewed.²¹ The Automated Correspondence Examination (ACE) program exists solely to conduct examinations with little or no human involvement.²² The result of a taxpayer continuing to receive automated correspondence with no specific employee contact information even after corresponding with the IRS fails to address Congress's concerns about access to knowledgeable and accountable employees. Where a taxpayer's audit is conducted solely through ACE, taxpayers will receive no notice with any appropriate contact information, up to and including the Statutory Notice of Deficiency (SNOD), after which the taxpayer has limited time to address the issue directly with the IRS or petition the United States Tax Court, which results in an increase in taxpayer burden.²³

In the discussions leading up to the enactment of RRA 98, several Senators indicated concerns about taxpayer access to the IRS and, in particular, accountability for employees who made decisions on cases.²⁴ Despite these concerns, the IRS implementation of § 3705(a)(1) fails to provide taxpayers greater access to employees both knowledgeable about and accountable for actions taken on cases.

While it may be unnecessary or impractical to include contact information for a specific employee on all notices, particularly before a case is assigned, failing to do so after a taxpayer has communicated with the IRS may violate the law and contradict the IRS's own Internal Revenue Manual. The codification of RRA 98 § 3705 with a specific definition of manually generated notices and specific requirements about when the contact information must be included will ensure the IRS's accountability and provide real meaning to the taxpayer *rights to quality service, to be informed, and to a fair and just tax system.*

EXPLANATION OF RECOMMENDATION

Left to define “manually generated” on its own, the IRS does not report either seeking an official Chief Counsel opinion on the meaning of the term nor performing a comprehensive, principled review of notices to determine which should include contact information to address Congress' concerns about employee access and accountability.²⁵ While its own IRM may suggest that notices resulting from an employee working on a case would include specific employee contact information, many of these notices do not, as the IRS does not follow its IRM.²⁶

The National Taxpayer Advocate and other stakeholders have continued to raise concerns regarding the lack of access to knowledgeable and accountable employees despite Congress's enactment of RRA 98,

21 IRM 4.19.20.1(1), *Automated Correspondence Examination Overview (ACE)* (May 21, 2013). (“Using the ACE, Correspondence Examination can process specified cases with minimal to no tax examiner involvement until a taxpayer reply is received. Because the ACE system will automatically process the case through creation, statutory notice and closing, tax examiner 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.”)

22 IRM 4.19.20.1, *Automated Correspondence Examination Overview (ACE)* (May 21, 2013).

23 See, e.g., Letter 531, *General Statutory Notice of Deficiency*. For a discussion of the National Taxpayer Advocate's concerns about SNOD compliance with RRA 98, see 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*, *supra*.

24 See, e.g., 144 CONG. REC. S7717-04 (1998) (statement of Sen. Domenici), and *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 105-190 (1997) at 97, 213-14; *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 105-190 (1997) (questions of Chairman Roth) at 214.

25 IRS, Office of Legislative Affairs, *Enacted Law Report for the Restructuring and Reform Act of 1998* (May 28, 2014). The record of IRS actions taken to implement RRA 98 shows no comprehensive review of notices or Counsel opinion sought regarding § 3705(a)(1).

26 IRM 21.3.3.4.16.1, *Preparation of Outgoing Correspondence* (Oct. 25, 2007).

suggesting that meaningful change did not result from the IRS's implementation of §3705(a)(1).²⁷ Congress should address this failure by codifying RRA 98 §3705(a)(1) and adopting the IRM's definition of "manually generated correspondence" as that issued as a result of an IRS employee exercising his or her judgment in working or resolving a specific taxpayer case or correspondence, or where the employee is asking the taxpayer to provide additional case-related information. Congress should also require the IRS to provide specific manager contact information in automatically generated notices where the legal rights of taxpayers are impacted, such as the Statutory Notice of Deficiency.²⁸

27 See, e.g., National Taxpayer Advocate, *Are IRS Correspondence Audits Really Less Burdensome for Taxpayers?*, available at <http://www.taxpayeradvocate.irs.gov/Blog/are-irs-correspondence-audits-really-less-burdensome-for-taxpayers> (last visited Nov. 26, 2014), National Taxpayer Advocate 2011 Annual Report to Congress Vol. 2 63-90 (Research Study: *An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*), *IRS Oversight Board Public Forum: Panel 1: How Can Correspondence Audits Be More Effective for the IRS and Less Burdensome for Taxpayers?* (Feb. 28, 2012).

28 A taxpayer has only 90 days from the date on the Statutory Notice of Deficiency (150 days if the Statutory Notice of Deficiency is mailed to the taxpayer outside the United States) to file a petition with the U.S. Tax Court. Because a taxpayer has a limited amount of time to file a petition, if the taxpayer has questions about the Statutory Notice of Deficiency, contact information for a manager would be helpful.

LR
#11**ANNUAL NOTICES: Require the IRS to Provide More Detailed Information on Certain Annual Notices It Sends to Taxpayers****PROBLEM**

Section 3506 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) requires the IRS to send annual statements to taxpayers who have an installment agreement (IA) in effect under Internal Revenue Code (IRC) § 6159.¹ This statement must provide a taxpayer's initial balance at the beginning of the year, payments made during the year, and the remaining balance as of the end of the year.² However, the IRS is not currently required to and does not provide a detailed breakdown of accrued interest and penalties (and the type of penalty), or how payments (including refund offsets) are applied to tax, penalties, and interest.

Section 1204 of the Taxpayer Bill of Rights (TBOR) 2 added § 7524 to the IRC.³ This section requires the IRS to send to taxpayers with delinquent accounts an annual reminder notice that sets forth the amount of the tax delinquency as of the date of the notice.⁴ Again, however, the IRS is not required to and does not provide a detailed breakdown on the notice showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), and how payments (including refund offsets) are applied to tax, penalties, and interest.

The lack of detailed information on both of these notices undermines taxpayers' *right to be informed*, which entitles taxpayers to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence.⁵ Specifically, the IRS's failure to provide detailed information prevents taxpayers from having a complete and accurate picture of their tax accounts and making informed economic decisions about their tax debt.

The lack of detailed information on these notices also undermines taxpayers' *right to pay no more than the correct amount of tax*, which is the right to pay only the amount legally due, including interest and penalties, and to have the IRS apply all tax payments properly.⁶ If the IRS fails to provide a breakdown of how payments are applied, then taxpayers cannot determine that their payments have been applied properly and that they are paying no more than the amount of tax legally due.

1 Pub. L. No. 105-206, § 3506, 112 Stat. 685, 771 (1998). Under IRC § 6159, the IRS may enter into installment agreements with taxpayers if it believes that the agreement will facilitate full or partial collection of the tax liability.

2 This requirement was never codified in the IRC. In 2009, the IRS and the Department of Treasury amended the regulations under § 6159 to formalize this requirement. See Treas. Reg. § 301.6159-1(h); T.D. 9473, 2009-52 I.R.B. 945. The IRS sends this statement using Notice CP 89, *Annual Installment Agreement Statement*. See Internal Revenue Manual (IRM) 21.3.1.4.52, *CP 89 Annual Installment Agreement Statement* (Oct. 1, 2004).

3 Pub. L. No. 104-168, § 1204, 110 Stat. 1452, 1471 (1996).

4 The IRS sends this notice using CP 71, *Reminder Notice*. See IRM 21.3.1.4.44, *CP 71 Reminder Notice* (Oct. 19, 2010). There are a few variations of this notice, depending on the status of a taxpayer's account. See IRM 21.3.1.4.45, *CP 71A Reminder Notice* (Oct. 1, 2012); IRM 21.3.1.4.46, *CP 71C and CP 171 Annual Reminder Notices* (Oct. 1, 2012); IRM 21.3.1.4.47, *CP 71D Reminder Notice – Balance Due* (July 9, 2013).

5 See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>; IRS Publication 1, *Your Rights as a Taxpayer* (June 2014).

6 *Id.*

EXAMPLE

Because she cannot pay her \$5,000 tax liability in full, a taxpayer completes a Form 433-D, *Installment Agreement*, enters into an IA with the IRS, and makes monthly payments throughout the year. The IRS sends her a required annual statement about her IA. While this provides certain information about payments made, it does not break down the accrued interest and penalties (and the type of penalty) and how payments (including refund offsets) are applied to tax, penalties, and interest.⁷ Because there is no detailed breakdown on this notice, the taxpayer does not have a complete picture of her account and may not be able to make an informed decision about her debt, including whether an IA is the most economically sound option for her and whether the IRS has properly applied her payments.

The taxpayer also has overdue tax liabilities for several other tax years, including some in which the statute of limitations on collection is close to expiring.⁸ The taxpayer has been making periodic voluntary payments on these liabilities, designating them for the more recent liabilities.⁹ The IRS sends her statutorily required reminder notices of her tax delinquency for these years. While these notices provides certain basic information about the liabilities,¹⁰ they do not show the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), and how payments (including refund offsets) are applied to tax, penalties, and interest.

Once again, because there is no detailed breakdown, the taxpayer does not have a complete picture of her tax account and may not be able to make informed decisions about her debt, including whether she is repaying it in an economically efficient manner and whether the IRS has properly applied her designated payments.¹¹ Were the taxpayer able to see the cumulative effect of penalty and interest and track the application of her payments, she might decide to resolve her tax liability through an offer in compromise or by obtaining a less costly loan from another source.

RECOMMENDATION

To address the lack of detailed information in certain notices sent to taxpayers, the National Taxpayer Advocate recommends that Congress:

- Amend IRC § 6159 to require the IRS to provide on annual installment agreement statements sent to taxpayers, within one year of the enactment date, a detailed breakdown of information

7 The annual statement, Notice CP 89, contains two main sections: 1) “Payment Detail” – provides the monthly payment date, applied amount, the tax form to which payment was applied, and the tax period; and 2) “Installment Agreement Activity” – provides a yearly summary of the tax period of the liability, form number, beginning balance of the tax period (includes unpaid tax, penalty, and interest), payments received during the annual period, total penalty, interest, and other charges added, and an ending balance. In addition, in the “Payment Detail” section, the notice provides that payments are applied first to tax, then penalty, then interest, and other charges. However, the notice does not provide a numerical breakdown of these categories.

8 Under IRC § 6502(a)(1), the IRS generally has ten years from the date of assessment to collect the tax due.

9 Taxpayers have the right to request designation of voluntary payments made to the IRS. See Rev. Proc. 2002-26, 2002-1 C.B. 746; IRM 5.1.2.8, *Designated Payments* (June 20, 2013); *United States v. Energy Res. Co.*, 495 U.S. 545, 548 (1990). If taxpayers do not provide specific written instructions when they provide a payment, the IRS will apply the payment in a manner that best serves its interests, to older tax periods first, and to tax, penalties, and interest (in that order). See Rev. Proc. 2002-26, 2002-1 C.B. 746; IRM 20.1.2.2.8.2, *Application of Payments* (Apr. 19, 2011).

10 The Notice CP 71 provides a “Billing Summary” section that lists an “amount you owed” and “Interest charges.” The last page of Notice CP 71, in the “Interest charges” section, lists the interest rates used to calculate the interest on the amount due.

11 If the IRS does not properly apply her designated tax payments to the appropriate years, the taxpayer may wind up paying tax liabilities that would otherwise not be legally due because the statute of limitations has run. In addition, a taxpayer may be able to obtain a bankruptcy discharge of older tax liabilities. See Legislative Recommendation: *LATE-FILED RETURNS: Clarify the Bankruptcy Law Relating to Obtaining a Discharge, infra.*

showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalties, and interest.

- Amend IRC § 7524 to require the IRS to provide on annual reminder notices sent to taxpayers with delinquent accounts, within one year of the enactment date, a detailed breakdown of information showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalty, and interest.

PRESENT LAW

Section 3506 of RRA 98 requires the IRS to send annual statements to taxpayers who have an installment agreement in effect IRC § 6159.¹² This statement must provide a taxpayer's initial balance at the beginning of the year, payments made during the year, and the remaining balance as of the end of the year.¹³ The legislative history indicates Congress believed that “taxpayers who enter into an installment agreement should be kept informed of [the] amounts applied towards the outstanding tax liability and [the] amounts remaining due.”¹⁴

Section 1204 of the Taxpayer Bill of Rights (TBOR) 2 added § 7524 to the IRC.¹⁵ This section requires the IRS to send to taxpayers with delinquent accounts an annual reminder notice that sets forth the amount of the tax delinquency as of the date of the notice.¹⁶ The legislative history explains the reason for the new requirement:

[T]he IRS generally pursues larger tax deficiencies first, and then it pursues small deficiencies. Because of the limited amount of IRS resources to work collection cases, cases with smaller deficiencies may not be addressed for years. In the meantime, the taxpayer may come to believe that the apparent lack of IRS collection activity means that it has abandoned its claim against the taxpayer. The taxpayer may be surprised when the IRS resumes collection action years later, when the 10-year statute of limitations on collection is close to expiring.¹⁷

12 Pub. L. No. 105-206, § 3506, 112 Stat. 685, 771 (1998). This provision required the IRS to begin sending such statements no later than July 1, 2000. Under IRC § 6159, the IRS may enter into installment agreements with taxpayers if it believes that the agreement will facilitate full or partial collection of the tax liability.

13 This requirement was never codified in the IRC. In 2009, the IRS and the Department of Treasury amended the regulations under § 6159 to formalize this requirement. See Treas. Reg. § 301.6159-1(h); T.D. 9473, 2009-52 I.R.B. 945. The IRS sends this statement using Notice CP-89, *Annual Installment Agreement Statement*. See IRM 21.3.1.4.52, *CP 89 Annual Installment Agreement Statement* (Oct. 1, 2004).

14 S. REP. No. 105-174, at 98 (1998).

15 Pub. L. No. 104-168, § 1204, 110 Stat. 1452, 1471 (1996).

16 The IRS sends this notice using CP 71, *Reminder Notice*. See IRM 21.3.1.4.44, *CP 71 Reminder Notice* (Oct. 19, 2010). There are a few variations of this notice, depending on the status of a taxpayer's account. See IRM 21.3.1.4.45, *CP 71A Reminder Notice* (Oct. 1, 2012); IRM 21.3.1.4.46, *CP 71C and CP 171 Annual Reminder Notices* (Oct. 1, 2012); IRM 21.3.1.4.47, *CP 71D Reminder Notice – Balance Due* (July 9, 2013).

17 H.R. REP. No. 104-506, at 46-47 (1996).

REASONS FOR CHANGE

Congress has already recognized the need for taxpayers to be informed about their IAs and delinquent accounts. However, if the IRS were required to provide more detailed information, it would keep taxpayers *better informed* about their tax liabilities, which is consistent with congressional intent behind the enactment of these two provisions. A more informed taxpayer accomplishes two goals of a fair and just tax administration: first, the taxpayer is better equipped to make economic decisions about how best to pay his or her tax liability (through IA, offer in compromise, or borrowing from an external source); and second, the taxpayer possesses the information with which to determine the accuracy of the IRS's accounting for payments.

In the context of annual installment agreements, a statement that provides a detailed breakdown of information showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalties, and interest, would allow taxpayers to get a better picture of their accounts and how much they are actually paying. It may also encourage speedier repayment of IAs because taxpayers will be made aware of how much they are paying in interest and penalties and will have an incentive to repay their tax obligations more promptly to reduce these amounts.¹⁸ A more detailed statement would also help taxpayers keep track of the proper crediting and application of their payments, ensuring that they *pay no more than the correct amount of tax*.

Similarly, in the context of annual delinquency notices, a notice that provides a detailed breakdown of information showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalty, and interest, would allow taxpayers to be *better informed* about their outstanding tax liabilities. In addition, it would help taxpayers keep track of the proper crediting and application of their payments, ensuring that they *pay no more than the correct amount of tax*.

Congress has already determined that providing detailed information is important in other contexts. For example, Congress passed legislation requiring periodic statements for residential mortgage loans.¹⁹ Regulations issued by the Consumer Protection Financial Bureau require that this periodic statement contain, among other things, a breakdown of how mortgage loan payments are applied to principal, interest, escrow, fees, and charges.²⁰ Congress should similarly require the IRS to provide a more detailed breakdown of information on certain annual notices it sends to taxpayers. In short, Congress should provide taxpayers with at least the same level of information and consumer knowledge with regard to their federal tax liabilities as is afforded borrowers with respect to residential mortgage loans.

¹⁸ Taxpayers who are provided a complete picture of their tax liabilities may see a benefit in refinancing their tax debt through other means to reduce the amount of interest and penalties they pay.

¹⁹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1420, 124 Stat. 1376, 2155 (2010). This legislation amended § 128 of the Truth in Lending Act (15 U.S.C. § 1638) to add a new subsection, 15 U.S.C. § 1638(f), which requires a creditor, assignee, or servicer of any residential mortgage loan to transmit to the consumer, for each billing cycle, a periodic statement that sets forth certain specified information in a conspicuous and prominent manner.

²⁰ See 12 C.F.R. § 1026.41(d) (2013). Congress has also taken action to require credit card companies to provide more detailed disclosures to consumers on credit card statements. See also Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act of 2009), Pub. L. No. 111-24, § 201, 123 Stat. 1734, 1743 (2009). This statute requires, among other things, several detailed payoff timing disclosures, such as the total cost to the consumer (including interest and principal) if he makes only the minimum required payments.

EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate recommends that Congress require the IRS to provide on certain annual notices, within one year of the enactment date, a detailed breakdown of information showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalty, and interest.²¹ This change will allow taxpayers to *be better informed* about their tax liabilities and ensure that they *pay no more than the correct amount of tax*.

21 While Notice CP 89, *Annual Installment Agreement Statement*, already contains some suggested changes (such as the taxpayer's initial balance at the beginning of the year) in this legislative recommendation, the IRS should continue to provide all of the information required by § 3506 of RRA 98. In addition, requiring the two notices to have similar content and structure would provide taxpayers with the benefit of uniformity.

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EO JUDICIAL AND ADMINISTRATIVE REVIEW: Allow IRC § 501(C)(4), (C)(5), or (C)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status

PROBLEM

Taxpayers seeking exemption as Internal Revenue Code (IRC) § 501(c)(3) organizations may request a declaratory judgment on their exempt status if they meet the requirements of IRC § 7428.¹ Generally, if their applications have been denied or if the IRS fails to make a determination after 270 days, or the IRS has revoked their exempt status, they may request that a court determine whether they are exempt.² In contrast, civic leagues and social welfare organizations seeking exemption as IRC § 501(c)(4) organizations; labor, agricultural and horticultural organizations seeking exemption as IRC § 501(c)(5) organizations; and business leagues, chambers of commerce, real estate boards, or boards of trade seeking exemption as IRC § 501(c)(6) organizations are not entitled to such a declaratory judgment.³ Consequently, there is comparatively little judicial guidance about the requirements for exempt status under IRC § 501(c)(4), (c)(5), and (c)(6), less IRS accountability for delays in processing applications for exempt status under those subsections, and no venue where organizations that disagree with the IRS can directly challenge the IRS's determination.

Organizations whose exempt status is automatically revoked for failing to file required returns or notices for three consecutive years also cannot obtain a declaratory judgment.⁴ Because the IRS has not adopted a meaningful process for administrative review of automatic revocations, these organizations may have no venue, either administrative or judicial, in which to demonstrate the IRS erred in treating them as no longer exempt.

According to the Taxpayer Bill of Rights the IRS adopted on June 10, 2014, taxpayers have the *right to be informed*.⁵ For organizations seeking tax exempt status, the right to be informed means receiving sufficient explanation and guidance about the IRS's—and the courts'—positions as applied to similar facts and circumstances. This in turn allows organizations to determine how to proceed and operate. Taxpayers also have the *right to appeal an IRS decision in an independent forum*, including the IRS Office of Appeals, and they generally have the right to take their cases to court.⁶ By extending declaratory judgment rights to IRC § 501(c)(4), (c)(5), and 501(c)(6) organizations and requiring that the IRS adopt

1 A declaratory judgment is “[a] binding adjudication that establishes the rights and other legal relations of the parties without providing for or ordering enforcement.” *Black’s Law Dictionary* (10th ed. 2014).

2 See IRC § 7428, providing for judicial review upon exhaustion of administrative remedies. An organization will be deemed to have exhausted its administrative remedies at the expiration of 270 days “if the organization has taken in a timely manner, all reasonable steps to secure such determination.” IRC 7428(b)(2). An important exception, discussed below, is that organizations whose exempt status was automatically revoked pursuant to IRC § 6033(j)(1) are prohibited from bringing an action under the provisions of IRC § 7428. IRC § 7428(b)(4).

3 IRC § 7428. As discussed below, although these organizations are not specifically excluded from the provisions of IRC § 7428, they are not included, and there is no other statutory provision allowing them to obtain declaratory judgment relief.

4 IRC § 7428(b)(4).

5 Taxpayer Bill of Rights, available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>, describing taxpayers’ right to be informed.

6 *Id.*, describing taxpayers’ right to appeal an IRS decision in an independent forum.

an administrative review process for automatically revoked organizations, Congress can provide these organizations with a readily accessible remedy to enforce these rights where today there is none.

EXAMPLE 1

XYZ, Inc. applies for recognition of exempt status as an IRC § 501(c)(4) social welfare organization. The IRS denies the application on the grounds that XYZ has not demonstrated it is “primarily engaged in promoting in some way the common good and general welfare of the people of the community” as required by the applicable Treasury regulation.⁷ No statutory, regulatory, or judicial authority establishes:

- How to measure the extent of an entity’s social welfare activity;
- Whether exempt status requires a minimum percentage of such activity;
- Whether to consider multiple factors; and if so
- Whether such factors should receive equal weight.

XYZ may administratively appeal the IRS’s determination, but it cannot seek a declaratory judgment from a court that it is exempt. Without exempt status, XYZ will be treated as a taxable entity and will be required to file federal tax returns, and may have to report contributions as income. It may not qualify for state tax exemptions and mailing privileges that would otherwise be available. The absence of public recognition as an exempt organization may deter potential donors from contributing to XYZ in favor of other social welfare organizations whose exempt status has been acknowledged. The cumulative effect of these consequences may be devastating for XYZ.

EXAMPLE 2

ABC, Inc. applied for and was granted exempt status as an IRC § 501(c)(3) organization, but four years later was notified that its exempt status had been automatically revoked for failing to file annual information returns or notices for three consecutive years.⁸ ABC believes the revocation is erroneous. Like XYZ, ABC cannot seek a declaratory judgment from a court regarding its exempt status. Unlike XYZ, ABC does not even have access to an administrative review procedure in which to demonstrate its exempt status was not automatically revoked. As a taxable entity, ABC may also need to report contributions as income on federal tax returns and may no longer qualify for the state tax exemptions and mailing privileges. Donors will no longer be able to claim the charitable contribution deduction for their contributions to ABC, which will severely limit its ability to attract funding compared to when it was exempt. Even those willing to make nondeductible contributions might select another organization acknowledged by the IRS as exempt. The consequences may devastate ABC, even if it later obtains reinstatement of its exempt status.

⁷ Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).

⁸ See IRC § 6033(j), providing for automatic revocation of tax-exempt status of organizations that fail to file required returns or notices for three consecutive years.

RECOMMENDATIONS

To address the lack of judicial review that would provide guidance about the requirements for exempt status as an IRC § 501(c)(4), (c)(5), or (c)(6) organization, and to remedy the lack of administrative appeal procedures in the context of automatic revocations, the National Taxpayer Advocate recommends that Congress:

- A. Amend IRC § 7428 to allow taxpayers seeking exempt status as IRC § 501(c)(4), (c)(5), or (c)(6) organizations to seek a declaratory judgment on the same footing as currently allowed for taxpayers seeking exempt status as IRC § 501(c)(3) organizations.
- B. Amend IRC § 6033(j) to require the IRS to adopt administrative review procedures for organizations treated as having had their exempt status automatically revoked.

PRESENT LAW

Judicial Review of Applications for Exempt Status

Organizations exempt from tax and described under IRC § 501(c)(3) are generally not required to pay tax on income related to their exempt purpose, and may receive tax-deductible contributions.⁹ They must generally apply to the IRS for recognition of exempt status, and if their applications are denied or if the IRS fails to make a determination on their applications after 270 days, or if their exempt status is revoked, they may, under IRC § 7428, seek a declaratory judgment on their status.¹⁰ IRC § 501(c)(4), (c)(5), and (c)(6) organizations are also generally exempt from federal income tax, but contributions to these organizations are generally not tax-deductible.¹¹ These organizations are not required to apply for recognition of exempt status, although many do so by filing Form 1024, *Application for Recognition of Exemption Under Section 501(a)*.¹² They may seek review of a denial of exempt status from the IRS Office of Appeals, but do not have the same right to seek a declaratory judgment as organizations seeking status as an organization described in IRC § 501(c)(3).¹³

A fundamental difference between taxpayers seeking exemption as IRC § 501(c)(3) organizations on the one hand and those seeking exempt status as IRC § 501(c)(4), (c)(5), or (c)(6) organizations on the other hand concerns the amount of permissible lobbying, participation in political campaign activity, or

9 See IRC §§ 501 and 170(c)(2). Unrelated business income may be subject to tax. See IRC § 511 *et seq.*

10 See IRC §§ 508 and 7428.

11 See IRC § 501. Unrelated business income may be subject to tax. See IRC § 511 *et seq.*

12 The IRS instructions for Form 1024 note that an organization may want to file for recognition in order to obtain certain benefits such as public recognition of tax-exempt status; exemption from certain state taxes; advance assurance to donors of deductibility of contributions (in certain cases); and nonprofit mailing privileges. Some organizations may file because they do not realize they are not required to apply for recognition of exempt status.

13 If the IRS Office of Appeals agrees that the organization is not tax exempt, the organization may challenge its non-exempt status by petitioning the U.S. Tax Court for relief following the issuance of a notice of deficiency, if any, or paying any tax owed and seeking a refund in a U.S. district court or the U.S. Court of Federal Claims. IRC §§ 6212, 6213, 7422; 28 U.S.C. § 1346. But by that point, the loss of tax-exempt status may be a fatal blow to the operations of the organization.

engagement in political action.¹⁴ Section 501(c)(3) organizations are permitted to engage generally in only “insubstantial” lobbying activity, and are prohibited from *any* participation or intervention in political campaigns on behalf of (or in opposition to) candidates for public office.¹⁵ IRC § 501(c)(4), (c)(5), or (c)(6) organizations do not face the same statutory or regulatory limitation or prohibition. Generally, they may engage in lobbying without losing their exempt status so long as they primarily engage in activities that further their exempt purpose.¹⁶ They may also participate or intervene in political campaigns so long as they are “*primarily* engaged in promoting in some way the common good and general welfare of the people of the community” (for organizations exempt under IRC § 501(c)(4)). Organizations will not qualify for exempt status under IRC § 501(c)(4), (c)(5), or (c)(6) if their “*primary* purpose or activity” is to engage in political action.¹⁷ There is no statutory or regulatory quantification of the term “*primarily*” or “*primary*” for these purposes.¹⁸

Section 7428 allows section 501(c)(3) organizations to seek a declaratory judgment as to their exempt status if the IRS denies an organization’s application for exemption, fails to act on it, or revokes an organization’s exempt status. The provision was prompted in large part by the Supreme Court’s decisions in two exempt organization cases, *Bob Jones University v. Simon* and *Alexander v. ‘Americans United’ Inc.*¹⁹ The Senate and House reports both quote the Supreme Court’s decision in *Bob Jones University v. Simon* as follows:

Congress has imposed an especially harsh regime on Sec. 501(c)(3) organizations threatened with loss of tax-exempt status and with withdrawal of advance assurance of deductibility of contributions. * * * The degree of bureaucratic control that, practically speaking, has

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- 14 Because the regulations that apply to organizations exempt under other provisions of IRC § 501(c) do not cross reference the regulations under IRC § 501(c)(4) or use the terms “primary” or “primarily” in the same manner (except for the regulations applicable to certain war veterans organizations exempt under IRC § 501(c)(19) which have additional membership requirements) and thus may not be as affected by the attendant lack of judicial interpretation of those terms, we limit this legislative recommendation to IRC § 501(c)(4), (5), and (6) organizations. Moreover, that the IRS has issued guidance on whether public advocacy activities of IRC § 501(c)(4), (5), and (6) organizations constitute exempt function expenditures under IRC § 527(e)(2) and would therefore not be subject to tax under IRC § 527(f)(1) suggests that these organizations are more apt to engage in political activity and would consequently benefit most from the availability of judicial review. See Rev. Rul. 2004-6, 2004-1 C.B. 328.
- 15 See Treas. Reg. § 1.501(c)(3)-1(b)(3)(i), providing that an organization “is not organized exclusively for one or more exempt purposes if its articles expressly empower it: (i) To devote more than an insubstantial part of its activities to attempting to influence legislation by propaganda or otherwise”; IRC § 501(c)(3), providing that a charity may “not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”
- 16 See Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations After Citizens United*, 10 Elec. Law J. 363, 376 (2011), noting “Thus, under various administrative authorities of various official weights, section 501(c)(4), (5), and (6) organizations can all lobby without limit, so long as they can show that such lobbying is related to their exempt purposes.”
- 17 See IRC § 501(c)(4)(A), allowing an exemption for organizations “operated exclusively for the promotion of social welfare”; Treas. Reg. § 1.501(c)(4)-1(a)(2)(i), providing that “an organization is operated exclusively for the promotion of social welfare if it is *primarily* engaged in promoting in some way the common good and general welfare of the people of the community.” (emphasis added); Treas. Reg. § 501(c)(4)-1(a)(2)(ii), providing that promoting social welfare does not include participation or intervention in political campaigns; General Counsel Memorandum 34,233 (Dec. 3, 1969), noting that an organization would not qualify for exempt status under section 501(c)(5) or (c)(6) “if the *primary* purpose or activity of an organization is to engage in political action.” (emphasis added).
- 18 See Legislative Recommendation: SECTION 501(c)(4) POLITICAL CAMPAIGN ACTIVITY: Enact an Optional “Safe Harbor” Election That Would Allow IRC § 501(c)(4) Organizations to Ensure They Do Not Engage in Excessive Political Campaign Activity, *supra*.
- 19 S. REP. No. 94-938, at 586 (1976); H.R. REP. No. 94-658, at 283 (1975), referencing *Bob Jones University v. Simon*, 416 U.S. 725 (1974) and *Alexander v. ‘Americans United’ Inc.*, 416 U.S. 752 (1974). See also Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 94th Cong., 2d Sess. 401 (Dec. 29, 1976) (same). The reports all also note that Congress had recently given the Tax Court jurisdiction to hear declaratory judgment suits as to the status of certain employee retirement plan status in the Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, § 1041, 88 Stat. 829, 949 (1974), adding IRC § 7476.

been placed in the Service over those in petitioner's position (*i.e.*, the position of Bob Jones University) is susceptible to abuse, regardless of how conscientiously the Service may attempt to carry out its responsibilities. Specific treatment of not-for-profit organizations to allow them to seek pre-enforcement review may well merit consideration.²⁰

Both reports also contain the following note:

The Court's opinion [in *Bob Jones University v. Simon*] noted that former Internal Revenue Commissioner Thrower had criticized the present system for resolving such disputes between the Service and the organization.

This is an extremely unfortunate situation for several reasons. First, it offends my sense of justice for undue delay to be imposed on one who needs a prompt decision. Second, in practical effect it gives a greater finality to IRS decisions than we would want or Congress intended. Third, it inhibits the growth of a body of case law interpretative of the exempt organization provisions that could guide the IRS in its further deliberations. (*Thrower, IRS Is Considering Far Reaching Changes in Ruling on Exempt Organizations*, 34 *Journal of Taxation* 168 (1971).)²¹

In other words, the House and Senate reports suggest that Congress believed the absence of judicial review of IRC § 501(c)(3) determinations left organizations subject to undue delay, conferred too much power on the IRS, and impeded interpretive case law. And Commissioner Thrower's remarks show that the IRS, at least in 1971, agreed.

In 1976, Congress enacted IRC § 7428, giving organizations seeking exempt status as an IRC § 501(c)(3) organization the right to obtain a declaratory judgment from the United States Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia.²² The question had been raised whether to extend the availability of declaratory judgment suits to other types of exempt organizations ("such as... a social welfare organization under 501(c)(4), a fraternal organization under 501(c)(8), or a cemetery company under 501(c)(13)"), but the statute as enacted did not provide for such access.²³

20 S. REP. No. 94-938, at 586 (1976); H.R. REP. No. 94-658, at 284 (1975). See also Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 94th Cong., 2d Sess., 401-402 (Dec. 29, 1976) (same).

21 S. REP. No. 94-938, at 586 n. 649 (1976); H.R. REP. No. 94-658, at 284 n. 216 (1975). See also Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 94th Cong., 2d Sess., 401-402 n. 4 (Dec. 29, 1976) (same).

22 Tax Reform Act of 1976, Pub. L. No. 94-455, §1306(a), 90 Stat. 1520, 1717 (1976). Though not articulated in the statute, the legislative history makes clear that the Tax Court would have flexibility in assigning petitions for declaratory judgments to special trial judges. See S. REP. No. 94-938, at 591 (1976); H.R. REP. No. 94-658, at 288 (1975). See also Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 94th Cong., 2d Sess., 406 (Dec. 29, 1976) (same).

23 See Joint Comm. on Int. Rev. Tax'n, 94th Cong. 2d Sess., *Tax Revision Issues - 1976 (H.R. 10612)*, No. 6, *Administrative Matters* 5-6, (Comm. Print 1976) available at <https://www.jct.gov/publications.html?func=startdown&id=3848>.

No explanation for the omission appears in the legislative reports.²⁴ However, the legislative history makes clear that Congress intended to monitor this aspect of exempt organization law.²⁵

Perhaps for the same reasons Congress established judicial review of IRC § 501(c)(3) applications, some members have concluded judicial review should be extended, at least to IRC § 501(c)(4) applicants. Early in 2014, the Chairman of the House Ways and Means Committee released draft legislation that contained such a provision.²⁶

Administrative Review of Automatic Revocations

In 2006, Congress enacted section 1223 of the Pension Protection Act of 2006 (PPA), imposing reporting requirements on certain organizations not previously required to file returns, and providing for automatic revocation of exempt status for failing to file required returns or notices for three consecutive years.²⁷ The PPA amended IRC § 7428 to specifically preclude organizations whose tax-exempt status was automatically revoked from bringing declaratory judgment actions.²⁸ The PPA does not prohibit administrative review of an IRS conclusion that an organization's exempt status was automatically revoked. However,

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- 24 Some insight about the reason for the omission may be found in the explanation the Tax Section of the American Bar Association (Tax Section) provided for its 1974 recommendation that IRC § 7428 be amended to allow IRC § 501(c)(3) organizations to obtain declaratory judgments. The Tax Section noted that it had considered expanding the remedy to all exempt organizations, but concluded that because IRC § 501(c)(3) organizations may receive deductible contributions and are therefore more directly harmed by doubts regarding their status than other exempt organizations to which contributions are not tax deductible, “such an expansion is not required at this time.” As for other types of IRC § 501(c) organizations that may receive deductible contributions (e.g., veterans’ organizations, fraternal lodges, or cemetery societies), they would not be as affected by doubt about their status as 501(c)(3) organizations because “[c]ontributions to this type of organization are typically made by a membership group which is likely to continue to support the organization even if a question is raised as to its status.” American Bar Association Tax Section Recommendation No. 1974-17, reported in 28 *Tax. Law.* No. 3, 431, 434 (Spring 1975).
- 25 The House and Senate reports both noted: “In connection with this, and as an aid to proper oversight and to future decision-making in this area, the committee intends that the Internal Revenue Service report annually to the tax-writing committee of the Congress on the Service’s activities with regard to organizations exempt under section 501(a), including the following: (1) the number of organizations that applied for recognition of exempt status, (2) the number of organizations whose applications were accepted and the number of organizations whose applications were denied, (3) the number of organizations whose prior favorable ruling letters were revoked, (4) the number of organizations that were audited during the year, and (5) the number of organizations that the Service regards as being exempt. To the extent possible, these statistics should be broken out by type of organization (e.g., public charity, private foundation, social welfare organization, fraternal beneficial association, and veterans’ organization).” S. REP. No. 94-938, at 586 (1976), H.R. REP. No. 94-658, at 285 (1975). The IRS reported some of this data in 1976 and each year thereafter in its annual Statistics of Income Data Book. See IRS Statistics of Income Data Book available at <http://www.irs.gov/uac/SOI-Tax-Stats-IRS-Data-Book>. The reports include the number of applications processed (rather than the number received) and do not include the number of revocations.
- 26 See U.S. Congress, House Committee on Ways and Means, The Tax Reform Act of 2014, § 6002, 113 Cong., 2 sess., Feb. 2014, available at http://waysandmeans.house.gov/uploadedfiles/statutory_text_tax_reform_act_of_2014_discussion_draft_022614.pdf.
- 27 Pension Protection Act of 2006, Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 (2006), adding to IRC § 6033 subsections (i) and (j).
- 28 Pension Protection Act of 2006, Pub. L. No. 109-280, § 1223(c), 120 Stat. 780, 1090 (2006), adding to IRC § 7428 subsection (b)(4), providing that “[n]o action may be brought under this section with respect to any revocation of status described in section 6033(j)(1).”

despite the National Taxpayer Advocate's repeated recommendations to the IRS to do so, the IRS does not provide such review.²⁹

On June 10, 2014, the IRS adopted the Taxpayer Bill of Rights. These rights include taxpayers' *right to be informed*, *i.e.*, "the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes."³⁰ Taxpayers also have the *right to appeal an IRS decision in an independent forum*, *i.e.*, they are entitled to "a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals' decision. Taxpayers generally have the right to take their cases to court."³¹

REASONS FOR CHANGE

Judicial Review of Applications for Exempt Status

Congress enacted IRC § 7428 in the light of Supreme Court cases that involved IRC § 501(c)(3) organizations. Lack of access to a declaratory judgment would indeed be a "harsh regime" for section 501(c)(3) organizations, contributions to which may be deductible, but this lack of access may also cause hardship on other section 501(c) organizations. A potential contributor to a section 501(c)(4), (c)(5), or (c)(6) organization would not generally expect his or her contribution to be deductible. Thus, in choosing among organizations to receive a nondeductible contribution, public recognition of exempt status may be the *only* basis for selecting one organization over another. The donor is assured that the contribution will not be a taxable receipt, and public recognition that results from IRS vetting may increase his or her confidence in the organization's legitimacy. Thus, IRS recognition may be just as vital to the continued existence of section 501(c)(4), (c)(5), or (c)(6) organizations as it is for section 501(c)(3) organizations, and doubt about exempt status just as harmful.

In any event, as noted above, Congress intended to monitor the volume and type of exempt organization applications "as an aid to proper oversight and to future decision-making in this area."³² A significant increase in volume would presumably indicate that additional or different oversight would be appropriate. As the Treasury Inspector General for Tax Administration (TIGTA) reported, over the four-year period

29 See National Taxpayer Advocate 2013 Annual Report to Congress 165, 172 (*Most Serious Problem: EXEMPT ORGANIZATIONS: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*); 2012 Annual Report to Congress 192, 200 (*Most Serious Problem: Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*); National Taxpayer Advocate 2011 Annual Report to Congress 442, 444 (*Most Serious Problem: The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*); National Taxpayer Advocate 2011 Annual Report to Congress 562 (*Legislative Recommendation: Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing Cyber Assistant*). See, e.g., Automatic Exemption Revocation for Non-Filing: Frequently Asked Questions (rev. Sept. 23, 2014), available at <http://www.irs.gov/Charities-&-Non-Profits/Automatic-Exemption-Revocation-for-Non-Filing:-Revocation-Cannot-Be-Appealed>, answering the question "May my organization appeal its automatic revocation?" with "No, the law provides no appeals process for automatic revocations. To have its tax-exempt status reinstated, the organization must file an application for exemption. An organization may also request retroactive reinstatement as part of its application." Organizations that believe the IRS erroneously listed them as having had their exempt status automatically revoked are advised to simply contact the IRS. There is no mechanism for review of disputed cases.

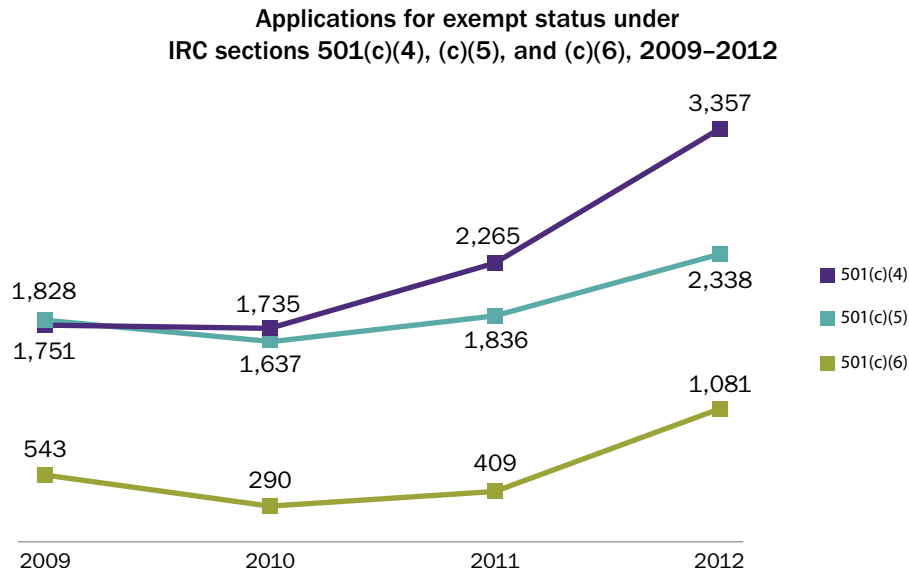
30 Taxpayer Bill of Rights, available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>, describing taxpayers' right to be informed.

31 *Id.*, describing taxpayers' right to appeal an IRS decision in an independent forum.

32 See S. REP. NO. 94-938, at 586 (1976), H.R. REP. NO. 94-658, at 285 (1975).

from 2009 to 2012, the number of taxpayers seeking exempt status as IRC § 501(c)(4), (c)(5), and (c)(6) organizations increased 92 percent, 99 percent, and 28 percent, respectively, as shown in Figure 2.12.1.³³

FIGURE 2.12.1



More importantly, as TIGTA also reported, lack of guidance may have contributed to the IRS's adoption of inappropriate procedures for evaluating IRC § 501(c)(4) applications and a 13-month processing stoppage, conditions that increases in application volume only exacerbated.³⁴ The availability of declaratory judgments would have allowed judicial guidance to emerge where administrative guidance was lacking or inappropriate, preventing the violation of taxpayers' *right to be informed*.³⁵

33 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review 3* (Figure 2) (May 14, 2013), reporting the number of applications for exempt status under IRC § 501(c)(4) was 1,751 in fiscal year (FY) 2009; 1,735 in FY 2010; 2,265 in FY 2011, and 3,357 in FY 2012. Applications for exempt status under IRC § 501(c)(5) were 543, 290, 409, and 1,081; and under IRC § 501(c)(6) were 1,828, 1,637, 1,836, and 2,338 in the same respective periods. The number of applications for exempt status under IRC § 501(c)(3) increased only two percent from FY 2009 to FY 2012, with 65,179 applications in FY 2009; 59,486 in FY 2010; 58,712 in FY 2011; and 66,543 applications in FY 2012.

34 *Id.* at 12-13. See also United States Senate, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, *IRS And TIGTA Management Failures Related To 501(c)(4) Applicants Engaged In Campaign Activity* at 17 (Sept. 5, 2014), available at <http://www.hsgac.senate.gov/subcommittees/investigations/reports>, noting that “[m]ost of the court decisions have interpreted the law with respect to 501(c)(3) charities as opposed to social welfare organizations, or examined the term ‘exclusively’ in other contexts.” (Fn. ref. omitted).

35 It is for this reason that the National Taxpayer Advocate, in her FY 2014 Objectives Report to Congress, included a Special Report, *Political Activity and the Rights of Applicants for Tax-Exempt Status* (Special Report), in which she further analyzed the causes of the problems TIGTA identified and suggested that Congress “[c]onsider legislation to provide applicants for exemption under IRC § 501(c)(4) with the ability to seek a declaratory judgment if denied or unanswered after nine months so that more judicial guidance can develop.” Special Report at 15-16.

Administrative Review of Automatic Revocations

Organizations whose exempt status (under any subparagraph of 501(c)) was automatically revoked not only cannot seek a declaratory judgment under IRC § 7428, but also cannot access an administrative review procedure. The IRS has erroneously treated thousands of organizations as having had their exempt status automatically revoked and has adopted computer programming that will lead to additional erroneous revocations.³⁶ Despite the urging of the National Taxpayer Advocate and the IRS's adoption of the Taxpayer Bill of Rights (TBOR), which includes “administrative appeal of most IRS decisions ...,” the IRS refuses to develop procedures that would allow organizations to demonstrate they remain exempt before the IRS erroneously lists them on public databases as non-exempt. The consequences of being listed as no longer exempt, such as declining contributions and a loss of credibility, and the time and expense of seeking reinstatement, may devastate an organization.

EXPLANATION OF RECOMMENDATIONS

The first proposal, consistent with taxpayers' *rights to be informed* and *to appeal an IRS decision in an independent forum*, would amend IRC § 7428 to allow taxpayers seeking exemption as IRC § 501(c)(4), (c)(5), or (c)(6) organizations to seek a declaratory judgment on the same footing as those seeking exempt status as IRC § 501(c)(3) organizations. This would ensure that these non-501(c)(3) organizations could obtain relief if their applications remain unaddressed for nine months, increase IRS accountability for delays, and allow judicial guidance to develop. The recommendation is limited to IRC § 501(c)(4), (5), and (6) organizations, who are most affected by the lack of judicial guidance in this area.

The second proposal, consistent with taxpayers' *right to appeal an IRS decision in an independent forum*, would amend IRC § 6033(j) to require the IRS to adopt administrative review procedures for organizations whose tax-exempt status is treated as automatically revoked. This would provide organizations with a venue in which to raise their concerns and help the IRS avert errors that could prove fatal to the organizations. Instituting such a procedure would be good tax administration, especially in the absence of access to a judicial forum under IRC § 7428 in which an organization can show an automatic revocation was erroneous.

36 National Taxpayer Advocate 2013 Annual Report to Congress 165 n. 5, 169-171, Most Serious Problem: *EXEMPT ORGANIZATIONS: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status* (noting that TE/GE estimates it erroneously treated about 9,000 organizations as having had their exempt status automatically revoked and will continue to measure the three year nonfiling period from the time an organization obtains its employer identification number, whether or not the organization had a filing requirement).

LR
#13

STANDARD OF REVIEW: Amend IRC § 6330(d) to Provide for a De Novo Standard of Review of Whether the Collection Statute Expiration Date is Properly Calculated by the IRS

PROBLEM

Collection Due Process (CDP) hearings were created by the IRS Restructuring and Reform Act of 1998 (RRA 98).¹ 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. At the hearing, the Appeals officer is required to “obtain verification from the Secretary that the requirements of any applicable law or administrative procedure have been met.”² One element of the analysis is verifying that the calculation of the collection statute expiration date (CSED) is accurate.

The taxpayer may appeal an unfavorable CDP hearing determination to the U.S. Tax Court.³ How the court reviews the determination depends on whether the taxpayer contests the underlying liability. The Tax Court applies the abuse of discretion standard to determinations made by Appeals that deal with issues other than the underlying liability.⁴ Under this standard, the court must give deference to an IRS Office of Appeals determination unless it is “arbitrary, capricious, clearly unlawful, or without sound basis in fact or law.”⁵ When the taxpayer is raising arguments related to the underlying liability, the Tax Court applies the *de novo* standard of review.⁶

Legislative history does not address whether CSED issues under Internal Revenue Code (IRC) § 6330(c)(1) relate to the taxpayer's underlying liability. In a series of decisions, the Tax Court has held that issues related to IRC § 6330(c)(1) can be both related and not related to the underlying liability.⁷ This inconsistency creates a situation where similarly situated taxpayers are treated differently. Recently, the IRS Office of Chief Counsel issued guidance stating that verification of CSED calculation should receive abuse of discretion review, which is limited in its scope, based on the premise that CSED does not affect the underlying liability.⁸

1 RRA 98, Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

2 IRC § 6330(c)(1).

3 *Id.*

4 *Jones v. Comm'r*, 338 F.3d 463, 466 (5th Cir. 2003); *Craig v. Commis'r*, 119 T.C. 252, 260 (2002); *Sego v. Comm'r*, 114 T.C. 604, 610 (2000); H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess. Part 2, at 266 (1998) (“Where the liability is not properly at issue, the appeals officer's determinations should be reviewed for an abuse of discretion.”)

5 See *Duarte v. Comm'r*, T.C. Memo 2014-176 at *10. See, e.g., *Bartley v. United States*, 343 F. Supp. 2d 649, 652 (N.D. Ohio 2004); *Robinette v. Comm'r*, 123 T.C. 85, 93 (2004), rev'd, 439 F.3d 455 (8th Cir. 2006); *Woodral v. Comm'r*, 112 T.C. 19, 23 (1999); *Blondheim v. Comm'r*, T.C. Memo. 2006-216.

6 H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess. Part 2, at 266 (1998) (“Where the validity of the tax liability was properly at issue in the hearing, and where the determination with regard to the tax liability is a part of the appeal ... [t]he amount of the liability will in such cases be reviewed by the appropriate court on a *de novo* basis.”).

7 See, e.g., *Rosenbloom v. Comm'r*, T.C. Memo. 2011-140, at *22-23 (holding that since the taxpayer was not challenging the underlying liabilities, the court would review with the abuse of discretion standard); *Roberts v. Comm'r*, T.C. Memo. 2004-100, at *11-12 (holding that a petitioner's challenge to the expiration of the CSED does not challenge the underlying liability and will receive abuse of discretion review); *Jordan v. Comm'r*, 134 T.C. 1, 15-16 (2010) (holding that since a challenge to the CSED is a challenge to the underlying liability and the petitioners did not have a previous opportunity to raise the issue, the court would review the validity of a signature on Form 900, Tax Collection Waiver, with the *de novo* standard); *Boyd v. Comm'r*, 117 T.C. 127 (2001) (where the taxpayer raises an argument that the IRS is time barred from collecting a tax liability, the court will review the matter *de novo*).

8 Office of Chief Counsel, Notice CC-2014-002, *Proper Standard of Review for Collection Due Process Determinations* 4 (May 5, 2014).

The Tax Court's review under the abuse of discretion standard is generally limited to what is in the taxpayer's administrative file, which will include issues raised at the CDP hearing. However, taxpayers do not have easy access to records related to the calculation of their CSED, as this information is held by the IRS. Although Appeals is required to verify the accuracy of the CSED, taxpayers may not know how to bring particular concerns about the CSED to the Appeals officer's attention. Additionally, the IRS's CSED calculation is not always accurate.⁹ Moreover, a review of the CDP program by the Treasury Inspector General for Tax Administration (TIGTA) in 2013 found that approximately 21 percent of CSED calculations were not accurate because Appeals did not accurately input the CSED suspension code related to the CDP hearing.¹⁰ The incorrect calculation of the CSED has the potential to result in unlawful collection activity against taxpayers.

The limited review of CSED issues based on the abuse of discretion standard and the inconsistency of Tax Court treatment of CSED issues as both related and not related to the underlying liability impairs the *right to a fair and just tax system*, which among other things, recognizes the right "to expect the tax system to consider facts and circumstances that might affect [a taxpayer's] underlying liabilities."¹¹ The deferential abuse of discretion standard of review may be detrimental to the full exercise of *the right to challenge the IRS's position and be heard*, which in part includes "the right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions."¹² If the taxpayer does not have easy access to the records, then he or she cannot make an effective objection. *The right to pay no more than the correct amount of tax* may be violated when the CSED has expired but the CDP hearing upholds a proposed levy or lien. In this situation the taxpayer is paying more than is legally due. It also violates the *right to finality* because the CSED imposes a set period of time within which the IRS can collect the tax. Lastly, the *right to appeal an IRS decision in an independent forum* is negatively affected because the taxpayer cannot adequately develop a case. By itself, this provision affects half of the rights afforded to taxpayers in the Taxpayer Bill of Rights and as such, this recommendation will go a long way in acknowledging taxpayer rights.

EXAMPLE

Taxpayer A reported a \$1,000 liability on his 2002 return and entered into an installment agreement but could not keep up with the payments. He then submitted an offer in compromise (OIC), the processing of which extended the CSED. While the IRS was considering his offer, Taxpayer A deployed to a combat zone for a brief period, which suspended his CSED. Following his return, the IRS rejected his offer and eventually proposed a levy on his wages.

Taxpayer A requested a CDP hearing. Unbeknownst to Taxpayer A, an error occurred in the IRS's calculation of his CSED, but because of the miscalculation, the IRS continued to collect the debt. In fact, the CSED had expired and Taxpayer A no longer owed this debt. Taxpayer A, who is unrepresented, did not know that he should question the collectability of the unpaid tax. When Appeals reviewed his transcript, it did not detect anything amiss with the accuracy of the CSED. Taxpayer A filed a petition in Tax Court

9 See *Reinhart v. Comm'r*, T.C. Memo 2014-218 (applying *de novo* standard of judicial review the court held that the IRS was time barred from collecting a trust fund recovery penalty and filing a Notice of Federal Tax Lien because of CSED expiration; CSED was not suspended because the taxpayer did not live outside of the United States).

10 This number is projected based on a statistically valid sample of CDP and equivalent hearing cases closed between October 1, 2011 and September 30, 2012. Based on the review, TIGTA determined that 10,151 of the 47,855 CDP cases closed in FY 2012 may have had an incorrect CSED. TIGTA, Ref. No. 2013-10-103, *The Office of Appeals Continues to Experience Difficulties in the Handling of Collection Due Process Cases 4* (Sept. 17, 2013).

11 IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

12 *Id.*

and retained *pro bono* representation through a Low Income Taxpayer Clinic,¹³ but because the CSED is reviewed with the abuse of discretion standard, the court will limit its review to the administrative record, which does not contain an argument or any evidence from Taxpayer A with respect to that issue.

RECOMMENDATION

To address the inequity faced by taxpayers whose CSEDs have expired but who may face an enforced collection action based on miscalculated statutes of limitations and to enhance taxpayer protections contemplated by the Taxpayer Bill of Rights, the National Taxpayer Advocate recommends that Congress:

Amend IRC § 6330(d) to provide for a *de novo* standard of review by the Tax Court of whether the CSED is properly calculated by the IRS pursuant to IRC § 6330(c)(1).

PRESENT LAW

Once a tax liability is assessed, the IRS generally has ten years to collect the tax, which is known as the collection statute expiration date (CSED).¹⁴ Calculating the correct CSED is not always an easy task. Many events can extend the CSED, including:

- Litigation;¹⁵
- Pending installment agreement or offer in compromise;¹⁶
- CDP appeal;¹⁷ and
- Military-related service conducted in a combat zone¹⁸

In every CDP hearing, the Appeals officer is required to “obtain verification from the IRS office collecting the tax that the requirements of any applicable law or administrative procedure with respect to the proposed levy have been met.”¹⁹ Ensuring that the CSED has not expired is a legal requirement that

13 Low Income Taxpayer Clinics (LITCs) represent low income individuals in disputes with the Internal Revenue Service, including audits, appeals, collection matters, and federal tax litigation. LITCs can also help taxpayers respond to IRS notices and correct account problems. These services are offered for no more than a nominal fee. See IRC § 7526.

14 IRC § 6502.

15 See, e.g., IRC §§ 6502(a)(2); 6503(h).

16 IRC § 6331(k)(3).

17 The statute of limitation is extended from the date a timely hearing is requested until the date the IRS receives the taxpayer's written withdrawal of the request for a CDP hearing by Appeals or the determination resulting from the CDP hearing becomes final by expiration of the time for seeking judicial review or the exhaustion of the right of judicial review, including review by a federal court of appeals. Treas. Reg. 301.6330-1(g)(3).

18 IRC § 7508(a)(1)(I).

19 See Treas. Reg. § 301.6330-1(e)(1). See also Treas. Reg. § 301.6320-1(e)(1). The Collection function is responsible for sending the case file to Appeals. IRM 8.22.4.2.1(3) (Nov. 5, 2013). It is the job of the Appeals officer to review part 5 of the IRM (Collecting Process) “to verify whether administrative procedures were followed in issuing a Notice of Intent to Levy and/or filing a Notice of Federal Tax Lien (NFTL).” IRM 8.22.4.2.1(5) (Nov. 5, 2013). Appeals officers also receive guidance on CSED issues. For example, see IRM 8.21.5.1.2 (Apr. 20, 2012).

the Appeals officer must consider under IRC § 6330(c)(1).²⁰ This is in addition to any issues that the taxpayer may raise.²¹

Verifying the CSED under § 6330(c)(1) does not require the IRS to rely on a particular document.²² In fact, Appeals may use transcripts of the account to satisfy the verification requirement under IRC § 6330(c)(1) unless the taxpayer can identify an irregularity in the assessment process or other irregularity.²³

Standards of Review Used by the Tax Court

Generally, the court will only review issues that the taxpayer raises in the CDP hearing; however, Appeals' verification under IRC § 6330(c)(1) that all legal and administrative requirements have been satisfied are reviewed by the court in all cases even if the taxpayer does not raise a verification issue during the hearing.²⁴ How a court will review a particular CDP determination depends on the applicable standard of review. When the existence or amount of underlying tax liability is properly at issue under section 6330(c)(2)(B), the court will review the issue *de novo*,²⁵ which means the court will conduct a trial "as if there had been no trial in the first instance."²⁶ However, in order for a court to consider an issue related to the underlying liability or a relevant issue under section 6330(a)(2)(A), it must also be raised during the CDP hearing.²⁷ A taxpayer is also limited to raising issues related to the underlying liability only if the taxpayer "did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability."²⁸

When the validity of the underlying liability is not at issue, the court reviews the determination for abuse of discretion.²⁹ Unlike *de novo* review, reviewing for abuse of discretion means the extent of the court's review is limited to determining whether the Appeals officer's decision was "arbitrary, capricious, or without sound basis in fact or law."³⁰

20 See *Beeler v. Comm'r*, T.C. Memo. 2009-266, at *6, vacated and remanded on other grounds, 434 Fed. Appx. 41 (2d Cir. 2011).

21 IRC § 6330(c)(2)(A). The taxpayer may raise "any relevant issue relating to the unpaid tax or the proposed levy," including appropriate spousal defenses, challenges to the appropriateness of collection actions, and offers of collection alternatives. IRC § 6330(c)(2)(A). Additionally, if the taxpayer has not already received a notice of deficiency or otherwise have an opportunity to dispute the liability, he or she may raise issues at the hearing that challenge the existence or amount of the underlying liability. IRC § 6330(c)(2)(B).

22 *Roberts v. Comm'r*, 118 T.C. 365, 371 (2002).

23 See, e.g., *McLaine v. Comm'r*, 138 T.C. 10 (2012); *Clayton v. Comm'r*, T.C. Memo. 2009-114.

24 *Hoyle v. Comm'r*, 131 T.C. 197, 201-202 (2008); *Crites v. Comm'r*, T.C. Memo 2012-267.

25 *Sego v. Comm'r*, 114 T.C. 604, 610 (2000).

26 A trial *de novo* will consider both questions of fact and issues of law. *Black's Law Dictionary* (9th ed. 2009).

27 Treas. Reg. 301.6330-1(f), Q&A-F3. See also, *Giamelli v. Comm'r*, 129 T.C. 107 (2007).

28 IRC § 6330(c)(2)(B).

29 Non-liability issues are reviewed for an abuse of discretion. *Jones v. Comm'r*, 338 F.3d 463, 466 (5th Cir. 2003); *Craig v. Comm'r*, 119 T.C. 252, 260 (2002); *Sego v. Comm'r*, 114 T.C. 604, 610 (2000); H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess. Part 2, at 266 (1998).

30 *Murphy v. Comm'r*, 125 T.C. 301, 320 (2005).

Some Tax Court decisions have held that an Appeals officer's IRC § 6330(c)(1) verification regarding CSED does not relate to the underlying liability.³¹ Other decisions have held that CSED issues do relate to the underlying liability.³²

Recently, IRS Counsel issued a notice indicating that the proper standard of review for CDP determinations related to statutes of limitations is abuse of discretion. Counsel concluded that “[t]he existence or amount of an underlying tax liability, an issue the taxpayer may raise in appropriate circumstances in a CDP hearing, does not encompass procedural requirements, such as assessment, necessary for administrative collection.”³³ As a result, the Counsel notice advises attorneys to argue that CSED verification and other procedural requirements under IRC § 6330(c)(1) should be reviewable for abuse of discretion.³⁴ To treat a CSED issue as affecting the taxpayer's underlying liability, the CSED issue would receive *de novo* review by the court, but this review would only be available to taxpayers who did not previously receive a statutory notice of deficiency or otherwise have an opportunity to dispute the liability.³⁵ Taxpayers would also have to raise the issue themselves or otherwise the CSED would not be part of the administrative record review.

REASONS FOR CHANGE

Procedural issues such as CSED go to the heart of the case. In particular, IRC § 6330(c)(1) requires that “The appeals officer *shall* at the hearing obtain verification from the Secretary that the requirements of any applicable law or administrative procedure have been met” (emphasis added).³⁶ This makes sense because if a CSED has expired, there is no longer a liability to collect. Given the importance of this verification to the case, it should be reviewed by the court and it should receive *de novo* review.

Despite the CSED being critical to a case, the calculation of the CSED is not always exact. In fact, employees are informed that the “CSED reflected on ICS and IDRS may not always be correct because, at times, actions that suspend or extend the CSED occur simultaneously, increasing the complexity of computing the CSED and requiring manual recalculation.”³⁷

Under the new guidance, Counsel attorneys will not argue that a taxpayer who received a notice of deficiency or had a previous opportunity to raise a CSED argument should be barred from raising a CSED challenge during litigation, because the guidance does not treat the CSED as an issue pertaining to the underlying liability.³⁸ However, Counsel attorneys may object to taxpayer attempts to introduce evidence

31 *Beeler v. Comm'r*, T.C. Memo. 2009-266, at *6, vacated and remanded on other grounds, 434 Fed. Appx. 41 (2d Cir. 2011). See also, *Rosenbloom v. Com'r*, T.C. Memo. 2011-140, at *5-6; *Roberts v. Comm'r*, T.C. Memo. 2004-100, at *11-12.

32 *Jordan v. Comm'r*, 134 T.C. 1, 15-16 (2010) (holding that since a challenge to the CSED is a challenge to the underlying liability and the petitioners did not have a previous opportunity to raise the issue, the court would review the validity of a signature on Form 900, *Tax Collection Waiver*, with the *de novo* standard). See also, *Boyd v. Comm'r*, 117 T.C. 127 (2001) (where the taxpayer raises an argument that the IRS is time barred from collecting a tax liability, the court will review the matter *de novo*).

33 Office of Chief Counsel, Notice CC-2014-002, *Proper Standard of Review for Collection Due Process Determinations* 3 (May 5, 2014).

34 *Id.* at 4.

35 See IRC § 6330(c)(2)(B).

36 Also, the court in *Crites* commented “[W]e held that issues that an Appeals officer has to consider under section 6330(c)(1) are the issues raised at the hearing, even if it's the Code and not the taxpayer that raises them.” *Crites v. Comm'r*, T.C. Memo 2012-267 at 8 (Sept. 17, 2012) (citing *Hoyle v. Comm'r*, 131 T.C. 197, 201-202 (2008)).

37 IRM 5.1.19.1.1(3) (Nov. 22, 2013). IDRS is the IRS's Integrated Data Retrieval System, ICS is the Integrated Collection System.

38 Office of Chief Counsel, Notice CC-2014-002, *Proper Standard of Review for Collection Due Process Determinations* 4 (May 5, 2014).

outside of the administrative record.³⁹ Moreover, the court's review will focus on whether the Appeals officer's determination was arbitrary, capricious, or without sound basis in fact or law, and not whether calculation of the CSED was correct.

The abuse of discretion standard is deferential to the government and requires the court to limit its review of CSED issues to the administrative record, regardless of its accuracy. However, as noted above, a miscalculated CSED is not unheard of.⁴⁰

In addition, the CSED records are in the custody of the IRS. It is not information that is readily available to taxpayers for review. If the court is limited to the abuse of discretion standard of review, this error may never be uncovered, much less corrected.

It is also important to address inconsistent treatment by the Tax Court. In some cases, the Tax Court views the CSED as affecting the underlying liability and in other cases it does not.⁴¹ This may leave similarly situated taxpayers receiving different levels of review by the court. If all CSED issues obtained *de novo* review, there would be a uniform standard for review enhancing existing taxpayer protections and the *right to fair and just tax system* from the Taxpayer Bill of Rights recently adopted by the IRS.

The current system may impose a burden on taxpayers who have an incorrect CSED calculation and may lead to unfair determinations for those who do not know to raise this argument. This result also would impact the taxpayer's *right to challenge the IRS's position and be heard*, which requires, among other things, that taxpayers have the right "to raise objections and provide additional documentation in response to formal IRS actions or proposed actions."⁴² When taxpayers cannot fully develop their cases, *the right to appeal an IRS decision in an independent forum* is eroded. *The right to pay no more than the correct amount of tax* is violated when the CSED has expired but the CDP hearing upholds a proposed levy or lien. In this situation the taxpayer is paying more than is legally allowed. It also violates the *right to finality* because the CSED imposes a set period of time within which the IRS can collect the tax.

EXPLANATION OF RECOMMENDATION

As described in *Reinhart v. Comm'r* and the TIGTA report, it is possible that the calculation of a CSED is not always accurate.⁴³ Requiring that verification of the CSED calculation receive *de novo* review will protect taxpayers from IRS errors. Without this review, errors in the administrative file may never be realized and the IRS may be permitted to take unlawful actions to collect unenforceable tax liabilities. When

39 Office of Chief Counsel, Notice CC-2014-002, *Proper Standard of Review for Collection Due Process Determinations 4* (May 5, 2014). If the administrative file does not contain sufficient evidence or inadequate information regarding a CSED issue, Counsel is advised to consider a motion to remand. Office of Chief Counsel, Notice CC-2014-002, *Proper Standard of Review for Collection Due Process Determinations 4* (May 5, 2014).

40 IRC § 7433(a) allows taxpayers to bring civil actions for damages when "any officer or employee of the Internal Revenue Service recklessly or intentionally, or by reason of negligence, disregards any provision of this title, or any regulation promulgated under this title." Taxpayers could consider this option when the IRS collects on a liability with an expired CSED. However, relying on this option is a burden to taxpayers and the IRS because it creates a second round of expensive (and unnecessary) litigation. Other options include requesting return of levy proceeds under IRC §6343(d)(2)(D) or filing a refund claim with Form 843-A, *Claim for Refund and Request for Abatement*. The recommendation here provides an efficient resolution, since the parties are already before the court.

41 See footnote 7, *supra*.

42 IRS, Pub. 1, *Your Rights as a Taxpayer* (June 2014).

43 See *Reinhart v. Comm'r*, T.C. Memo 2014-218. See also TIGTA, Ref. No. 2013-10-103, *The Office of Appeals Continues to Experience Difficulties in the Handling of Collection Due Process Cases 4* (Sept. 17, 2013).

the court uses the abuse of discretion standard of review, it is less likely to discover such errors. Without discovery, there is no reliable remedy in the CDP proceeding.

This legislative change will allow the Tax Court to review the IRS CSED calculations based on the *de novo* standard and will allow taxpayers to raise objections or provide additional evidence regarding the proper calculation of CSED in CDP cases. The *de novo* standard will enhance and make meaningful core taxpayer rights such as the *right to challenge the IRS's position and to be heard*, the *right to appeal an IRS decision in an independent forum*, and the *right to a fair and just tax system*.

LR
#14

APPELLATE VENUE IN NON-LIABILITY CDP CASES: Amend IRC § 7482 to Provide That The Proper Venue to Seek Review of a Tax Court Decision in All Collection Due Process Cases Lies With the Federal Court of Appeals for the Circuit in Which the Taxpayer Resides

PROBLEM

Byers v. Commissioner recently considered the issue of proper appellate venue in Collection Due Process (CDP) cases that do not involve a redetermination of liability.¹ The court concluded the proper venue for appealing United States Tax Court decisions in non-liability CDP cases lies with the Court of Appeals for the District of Columbia Circuit (D.C. Circuit) unless the case type falls under one of the rules specified in Internal Revenue Code (IRC) § 7482(b)(1) or (b)(3) or the parties both stipulate in writing.² Prior to this decision, taxpayers, tax practitioners, and the government adhered to a general practice of appealing all Tax Court decisions involving IRC §§ 6320 and 6330 to the court of appeals for the circuit in which the taxpayer lived (regional court).³

The *Byers*⁴ decision may create confusion among taxpayers and practitioners regarding the proper venue for appeals of non-liability CDP determinations from the Tax Court. In addition, it may create uncertainty for the Tax Court, which follows its own precedent unless the court of appeals to which the case would be appealable has ruled to the contrary under the *Golsen* rule.⁵ Additionally, *Byers* did not provide any guidance as to what will happen when there is a non-liability CDP appeal filed in a regional court without stipulation to venue.

Finally, the *Byers* decision may result in some forum shopping by litigants who are aware of its implications.⁶ This could mean that taxpayers with similar procedural issues residing in the same place could get vastly different results, if one taxpayer challenging the underlying liability obtains review by the regional circuit, and the other taxpayer not challenging liability obtains review by the D.C. Circuit. The difference in results could lead to an increased perception of the unfairness of the tax system. This could also lead to an increase in unwarranted challenges to a taxpayer's underlying liability and unnecessary litigation because the taxpayer wants to create a clear path to the regional circuit court. Having all cases go to the regional court could avoid these problems.

Absent congressional clarification,⁷ the confusion about proper venue may impact taxpayers' *right to be informed*, which provides that taxpayers "have the right to know what they need to do to comply with the

1 740 F.3d 668 (D.C. 2014), *aff'g* T.C. Memo. 2012-27. For a detailed discussion of the case, see Most Litigated Issue: *Appeals from Collection Due Process Hearings Under IRC §§ 6320 and 6330, infra*.

2 IRC § 7482(b)(2).

3 See James Bamberg, *A Different Point of Venue: The Plain Meaning of Section 7482(b)(1)*, 61 TAX LAW. 445 (Winter 2008).

4 *Byers v. Comm'r*, 740 F.3d 668 (D.C. 2014), *aff'g* T.C. Memo. 2012-27.

5 *Golsen v. Comm'r*, 54 T.C. 742 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971).

6 Having a choice of the D.C. Circuit or the regional circuits by stipulation may lead one party to have an advantage during litigation. Either the IRS or the taxpayer can now file motions to transfer venue or block requests to stipulate a change in venue, depending on what benefits the case.

7 The taxpayer filed a petition for certiorari, which the Supreme Court denied. See *Byers v. Comm'r*, 740 F.3d 668 (D.C. 2014), *cert. denied*, 83 U.S.L.W. 3189 (U.S. Oct. 6, 2014) (No. 14-74).

tax laws.”⁸ Additionally, the *Byers* interpretation of IRC § 7482(b)(1) may foster a system where represented taxpayers are better equipped to navigate the appeal process, negatively affecting the *right to a fair and just tax system* for unrepresented taxpayers.⁹

EXAMPLE

Taxpayer A files a petition in Tax Court to appeal a CDP determination, with the appeal involving an IRS decision to reject an offer in compromise. The taxpayer does not contest the tax liability. The Tax Court upholds the IRS’s determination. However, the unrepresented taxpayer is unaware that the D.C. Circuit has held that it provides proper venue for her case. She files her appeal in the circuit court of appeals for the state in which she resides. The government does not contest venue. In light of the *Byers* decision, it is unclear what the regional court should do with her case.

RECOMMENDATION

To address the proper venue for appealing Tax Court determinations under IRC §§ 6320 and 6330 that do not involve liability issues, the National Taxpayer Advocate recommends that Congress:

- Amend IRC § 7482(b)(1)(A) to provide that proper appellate venue for all CDP cases lies with the circuit court of appeals based on the taxpayer’s legal residency.

PRESENT LAW

A court must have jurisdiction and venue to hear a case.¹⁰ If the court does not have jurisdiction, it must dismiss the case.¹¹ However, if venue is incorrect, the court may dismiss the case *or* transfer the case to the correct venue.¹² Generally, the correct venue for appeals from the Tax Court is the D.C. Circuit unless one of the rules specified in IRC § 7482(b)(1) or exceptions specified in IRC § 7482(b)(2) or (b)(3) applies. For instance, IRC § 7482(b)(1)(A) provides that in cases where a petitioner, other than a corporation, seeks redetermination of a tax liability, venue for review by the United States Court of Appeals lies with the Court of Appeals for the circuit based upon the taxpayer’s legal residence.¹³ Pursuant to IRC § 7482(b)(2), the taxpayer and the IRS may stipulate the venue for an appeal in writing.

8 IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

9 Between June 1, 2013 and May 31, 2014, *pro se* taxpayers constituted 63 percent of litigated CDP cases. See Most Litigated Issue: *Appeals from Collection Due Process Hearings Under IRC §§ 6320 and 6330*, *infra*.

10 Jurisdiction is defined generally as “A court’s power to decide a case or issue a decree.” *Black’s Law Dictionary* (9th ed. 2009), available at Westlaw BLACKS. Venue is defined as the “proper or a possible place for a lawsuit to proceed.” *Black’s Law Dictionary* (9th ed. 2009), available at Westlaw BLACKS.

11 See *Ex parte McCordle*, 74 U.S. 506, 514 (1869) (“Without jurisdiction the court cannot proceed at all in any cause. Jurisdiction is power to declare the law, and when it ceases to exist, the only function remaining to the court is that of announcing the fact and dismissing the cause.”).

12 See *Georgia-Pacific Corp. v. Federal Power Com.*, 512 F.2d 782, 783-784 (5th Cir. 1975) (citing *Koehring Co. v. Hyde Constr. Co.*, 382 U.S. 362 (1966)).

13 IRC § 7482(b)(1) also provides that the proper venue lies with the court of appeals for the circuit in which it is located: B) in the case of a corporation seeking redetermination of tax liability, the principal place of business or principal office or agency of the corporation, or, if it has no principal place of business or principal office or agency in any judicial circuit, then the office to which was made the return of the tax in respect of which the liability arises, C) in the case of a person seeking a declaratory decision under IRC § 7476, the principal place of business, or principal office or agency of the employer, D) in the case of an organization seeking a declaratory decision under IRC § 7428, the principal office or agency of the organization, E) in the case of a petition under IRC §§ 6226, 6228(a), 6247, or 6252, the principal place of business of the partnership, and F) in the case of a petition under section IRC § 6234(c), (i) the legal residence of the petitioner if the petitioner is not a corporation, and (ii) the place or office applicable under subparagraph (B) if the petitioner is a corporation. IRC § 7482(b)(1).

Deciding the issue of proper venue in *Byers v. Commissioner*, the D.C. Circuit held it would not transfer cases to regional courts unless the parties stipulate. In *Byers*, the taxpayer timely requested a CDP hearing in response to a levy notice. The proposed levy action was sustained by the Appeals Officer (AO). The taxpayer appealed to the Tax Court, which granted summary judgment to the IRS, whereupon the taxpayer appealed the grant of summary judgment to the D.C. Circuit.

The IRS argued that since CDP hearings often include challenges to the underlying liabilities, venue is properly placed in the circuit where the taxpayer resides under IRC § 7482(b)(1)(A).¹⁴ The IRS made a motion to transfer the case to the Eighth Circuit. However, the court determined that IRC §7482(b)(1)(A) was not applicable since the taxpayer was not challenging the underlying liability. Thus, the proper venue was in the D.C. Circuit.¹⁵

REASONS FOR CHANGE

The *Byers* decision will have several ramifications. For instance, the court does not answer the question of whether another court of appeals could hear an appeal of a non-liability CDP decision without stipulation of the venue.¹⁶ Without congressional action, this issue will likely be addressed by other circuit courts separately and may result in a split in circuits.¹⁷ In the meantime, taxpayers will be left with uncertainty, which impacts *the right to be informed*.

Byers will also create complications for how the Tax Court hears its cases. Under the *Golsen* rule, the court follows its own precedent unless the court of appeals to which the case would be appealable has ruled to the contrary.¹⁸ How will the Tax Court know which circuit's law to apply if the taxpayer has a choice in venue? As noted above, this could mean that taxpayers with similar procedural issues residing in the same place could get vastly different results, if one taxpayer challenged the underlying liability and the other taxpayer did not. The difference in results could lead to an increased perception of the unfairness of the tax system. This could also lead to an increase in unwarranted challenges to a taxpayer's underlying liability and unnecessary litigation because the taxpayer wants to create a clear path to the regional circuit court.

14 At a CDP hearing, the taxpayer may raise challenges to the existence or amount of the underlying tax liability for any tax period, if the taxpayer did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability. IRC § 6330(c)(2)(B). Such challenges would fall under the exception in IRC § 7482(b)(1)(A). However, taxpayers may also raise any relevant issue relating to the unpaid tax or the proposed levy, including (i) appropriate spousal defenses; (ii) challenges to the appropriateness of collection actions; and (iii) offers of collection alternatives, which may include the posting of a bond, the substitution of other assets, an installment agreement, or an offer-in-compromise. IRC § 6330(c)(2)(A). Certain issues, such as the rejection of a collection alternative, do not challenge the underlying liability and therefore, the taxpayer is not seeking a redetermination of the liability when they raise such issues.

15 The Court held “[v]enue cannot be proper in the Eighth Circuit unless the parties so stipulate in writing.” *Byers v. Comm’r*, 740 F.3d 668 at 675.

16 The court notes “we have no occasion to decide in this case whether a taxpayer who is seeking review of a CDP decision on a collection method may file in a court of appeals other than the D.C. Circuit if the parties have not stipulated to venue in another circuit.” *Byers*, 740 F.3d at 677. This language leaves it open for interpretation whether venue would be proper in another circuit court when neither party addresses it, such as the appellate cases decided prior to *Byers*.

17 Legislation has also been proposed to address this issue. J. Comm. on Tax’n, *Technical Explanation Of The Senate Committee On Finance Chairman’s Staff Discussion Draft Of Provisions To Reform Tax Administration*, JCX-16-13,39-40 (November 20, 2013). The legislation provides that cases under IRC §§ 6015, 6320, and 6330 will be appealable to the circuit in which is located the petitioner’s legal residence (in the case of an individual). While this provision has appeared in several bills, it has gained little traction.

18 *Golsen v. Comm’r*, 54 T.C. 742 (1970), *aff’d*, 445 F.2d 985 (10th Cir. 1971).

In a Tax Court case subsequent to *Byers*, also involving a non-liability CDP hearing, the Tax Court applied the rules of the appellate court based on the residence of the taxpayer (in this instance the Ninth Circuit), stating:

In light of *Byers*, we are mindful of the uncertainty of appellate venue and the controlling law in this case. We further note, however, that we have not found a case wherein the Court of Appeals for the District of Columbia Circuit has either adopted or rejected the administrative record rule in a collection case under sec. 6320 or sec. 6330.¹⁹

The changes in practice brought by *Byers* mean that taxpayers and practitioners appealing a non-liability CDP case must now understand the type of case they have and whether it involves liability redetermination, so that they obtain the appropriate venue. The court in *Byers* was not concerned with taxpayer confusion over types of CDP cases, explaining instead:

[j]ust as we see in this case, it normally will be obvious from the taxpayer’s statement of the issues whether an appeal involves a challenge to a redetermination decision, a CDP decision on a collection method, or both. Therefore, it will not be difficult for this court to distinguish between the two types of cases to determine whether venue is proper in the D.C. Circuit.²⁰

In practice, making the distinction between liability and non-liability CDP hearings could prove difficult for taxpayers, especially *pro se* taxpayers. Taxpayers should also be prepared for litigation over the meaning of “redetermination.”²¹

If the regional circuit courts of appeal agree with *Byers*, and hold that the D.C. Circuit is proper venue for CDP cases in which taxpayers are not seeking a redetermination of liability, such holding would require all of these cases to be appealed to the D.C. Circuit. This holding would disproportionately burden low-income taxpayers who do not have the means to travel to the District of Columbia or the means to pay someone to travel to the District of Columbia if the case is scheduled for oral argument.

If the regional circuit courts of appeals find that venue is proper in their courts when the taxpayer only disputes a non-liability issue, taxpayers (and the IRS) may now be able to “forum shop.” Taxpayers may consider how their regional circuit would handle their non-liability CDP case in comparison to the D.C. Circuit. For instance, in *Robinette v. Comm’r*, the Tax Court held that it could consider evidence that was not part of the administrative record when it reviews an AO’s determination for abuse of discretion.²² This decision was overturned by the Eighth Circuit, which held that evidence is limited to what is in the administrative record.²³

It is possible that the D.C. Circuit could rule in a way opposite to the Eighth Circuit in regards to evidence at trial. If that happens, taxpayers wishing to submit new evidence during a trial may benefit from

19 *Boulware v. Commr*, T.C. Memo 2014-80 at 19, n. 4, *appeal docketed*, No. 14-1147 (D.C. Cir. Aug. 4, 2014). For a discussion on how this can affect the outcome of a case, see *Robinette v. Comm’r*, *infra*.

20 *Byers*, 740 F.3d at 676.

21 It is not always clear whether the taxpayer is seeking a redetermination of the tax liability. For instance, some court cases have held that issues related to the collection statute expiration date (CSED) relate to the underlying debt and others have held that CSED issues do not relate to the underlying debt. See Legislative Recommendation: *STANDARD OF REVIEW: Amend IRC § 6330(d) to Provide for a De Novo Standard of Review of Whether the Collection Statute Expiration Date Is Properly Calculated by the IRS*, *supra*.

22 *Robinette v. Comm’r*, 123 T.C. 85 (2004).

23 *Robinette v. Comm’r*, 439 F.3d 455 (8th Cir. 2006).

having their non-liability CDP appeal heard by the D.C. Circuit. Both the IRS and the taxpayer would be free to either file a motion to transfer venue or block a stipulation, depending on what forum they wanted. In the event the D.C. Circuit Court of Appeals approves the Tax Court's position articulated in *Robinette*, taxpayers challenging a non-liability issue may ask the D.C. Circuit to remand the case and order the Tax Court to permit the parties to submit evidence outside the administrative record. If the taxpayer does not reside in the District of Columbia and chooses not to stipulate to the court of appeals based on his or her residence, the taxpayer will have to incur the travel costs associated with trying the case in the D.C. Circuit. This creates an obstacle for low income taxpayers who cannot use the potentially more advantageous forum.

EXPLANATION OF RECOMMENDATION

While the *Byers* decision now realigns practice with the law, it has created many unanswered questions that could negatively impact taxpayers. In particular, it places a burden on unrepresented taxpayers who must now understand what type of appeal they have so that they can file their appeal with the court with the proper venue. They must have an understanding of how their choice in venue will affect the outcome of their case. Although the court in *Byers* finds this impact to be minimal on taxpayers, the National Taxpayer Advocate respectfully disagrees, particularly with respect to *pro se* taxpayers, who constituted 63 percent of litigated CDP cases between June 1, 2013 and May 31, 2014.²⁴ The Tax Court is also affected because in some cases it may have a difficult time ascertaining which law to apply to their analysis. In the absence of congressional action, these issues may continue to linger.

24 See Most Litigated Issue: *Appeals from Collection Due Process Hearings Under IRC §§ 6320 and 6330* at 19, *infra*.

LR
#15

OFFERS IN COMPROMISE: Authorize the National Taxpayer Advocate to Determine Whether an Offer in Compromise Submitted by a Victim of Payroll Service Provider Fraud Is “Fair and Equitable”

PROBLEM

Many small businesses outsource payroll and related tax duties to third-party payroll service providers (PSPs). If a PSP fraudulently fails to pay the IRS, the business owner remains responsible for unpaid tax, interest, and penalties. PSP fraud often results in significant hardship for the business, which (from its perspective) must pay the tax twice—once to the PSP that dissipated the funds, and again to the IRS.¹

The IRS has the discretionary authority to accept taxpayers’ offers to compromise their tax debts for less than the full amount owed if certain conditions are met.² Under its guidelines for evaluating offers in compromise (OICs) based on effective tax administration (ETA) submitted by victims of PSPs, the IRS is to inquire whether the offer will:

1. Result in a financial gain for the taxpayer; and
2. Be “generally perceived within the community as a fair and equitable solution.”³

The National Taxpayer Advocate believes the first part of the inquiry is unnecessary because, by definition, a victim of preparer fraud will never be financially advantaged by the fraud. In the second part of this inquiry, the National Taxpayer Advocate, as the “voice of the taxpayer” inside the IRS, is the appropriate official to assess whether an offer would be perceived as fair and equitable.⁴

EXAMPLE

In January 2013, small business MomPop LLC enlists the help of Fasten Tax Group, a PSP, to assist in filing its federal and state payroll taxes. Each pay period, MomPop transfers funds to Fasten to meet its payroll tax obligations. In July 2014, the IRS notifies MomPop that no payroll taxes have been filed since December 2013. For the past six months, Fasten Tax Group has received funds from MomPop and nearly 500 other businesses, but has not made any payments to the IRS on behalf of its clients. MomPop has not been able to reach anyone at Fasten Tax Group. Meanwhile, MomPop has cash reserves of \$20,000 and other assets that exceed its tax liability of approximately \$80,000 to the IRS in payroll taxes, interest, and penalties.

- 1 For an in-depth discussion of the challenges faced by victims of PSPs, see Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply with the Law Regarding Victims of Payroll Service Provider Failure*, *supra*.
- 2 See Treas. Reg. 301.7122-1(b)(1). Treasury Regulations provide three grounds for an offer to be accepted: doubt as to liability; doubt as to collectability; and effective tax administration (ETA). For an in-depth discussion of the IRS’s offer in compromise (OIC) authority, see Most Serious Problem: *OFFERS IN COMPROMISE: Despite Congressional Actions, the IRS Has Failed to Realize the Potential of Offers in Compromise*, *supra*.
- 3 Memorandum from Rocco A. Steco, Acting Director, Collection Policy, to Directors, Campus Compliance Operations, and Directors, Field Collection Operations Area, *Interim Guidance on Offers in Compromise from Taxpayers When Payroll Service Provider Issues Are Present* (Sept. 16, 2014). This guidance supplements the procedures found in Internal Revenue Manual (IRM) 5.8.11.2.2.1, *Public Policy or Equity Compelling Factors*, IRM 5.8.11.4.2, *Financial Statement Analysis*, and IRM 5.8.11.5, *Documentation and Verification*, and will be incorporated into the next revision of these IRM sections.
- 4 In 1997, The National Commission on Restructuring the Internal Revenue Service called the Taxpayer Advocate the “voice of the taxpayer.” See National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 48 (1997).

The majority shareholder of MomPop has been in contact with her congressional office about the harm her company has suffered because of Fasten Tax Group's fraudulent actions. A congressional staffer assures her that Congress has given the IRS the ability to work with victims of PSPs in a fair and equitable manner. At the urging of the staffer, MomPop submits an offer in compromise of \$10,000. Despite the congressional directive to give special consideration to offers from victims of PSP fraud, the IRS rejects MomPop's offer, stating that its acceptance would not be perceived within the community as a fair and equitable solution.

RECOMMENDATION

To address the inherent conflict with the IRS determining whether acceptance of an offer in compromise by a victim who was defrauded by a payroll service provider is fair and equitable, Congress should specify that such determination be made by National Taxpayer Advocate.

PRESENT LAW

An OIC is an agreement between a taxpayer and the government that settles a tax liability for payment of less than the full amount owed.⁵ That is, the IRS has the discretionary authority to accept offers for less than the full amount if certain conditions are met.

In 1998, Congress introduced the concept of accepting OICs based on effective tax administration and provided specific guidance to the IRS on accepting such offers.⁶ OICs based on ETA provide the IRS the flexibility to consider all of the circumstances that led to a delinquency. The IRS may accept ETA offers even if it could achieve full collection when such collection would create an economic hardship for the taxpayer or the taxpayer identifies "compelling public policy or equity considerations."

Unsatisfied with the IRS's lack of interest in using its ETA OIC authority for victims of PSPs, Congress specifically mandated in section 106 of the Consolidated Appropriations Act of 2014 that the IRS "shall give special consideration to an offer-in-compromise from a taxpayer who has been the victim of fraud by a third party payroll tax preparer."⁷ In 2014, the IRS developed an interim guidance memorandum that supplements its Internal Revenue Manual (IRM) section on OICs.⁸ This guidance "allows the offer specialist to investigate and process offers submitted by taxpayers impacted by the fraudulent acts of a PSP in the most expeditious manner possible."⁹

Among the considerations outlined in the guidance is whether payment of less than the remaining tax balance would:

- Result in financial gain for the taxpayer?
- Be generally perceived within the community as a fair and equitable solution?

5 Internal Revenue Code (IRC) § 7122.

6 The IRS Restructuring and Reform Act of 1998, Pub. L. 105-106, 112 Stat. 685 (1998); H.R. REP. No. 105-599, at 289 (1998) (Conf. Rep.).

7 Consolidated Appropriations Act, 2014, Division E, Title I, § 106 (Pub. L. No. 113-76).

8 Memorandum from Rocco A. Steco, Acting Director, Collection Policy, to Directors, Campus Compliance Operations, and Directors, Field Collection Operations Area, *Interim Guidance on Offers in Compromise from Taxpayers When Payroll Service Provider Issues Are Present* (Sept. 16, 2014).

9 *Id.*

In two other provisions of the Internal Revenue Code, Congress has explicitly designated the National Taxpayer Advocate as the one to determine whether an action is in the best interest of the taxpayer. First, in the context of lien withdrawals, it is the IRS that determines whether withdrawing the lien is in the best interest of the United States.¹⁰ However, it is the National Taxpayer Advocate who decides whether it is in the *taxpayer's* best interest to withdraw the lien.¹¹ This is because, as the voice of the taxpayer, the National Taxpayer Advocate is charged with advocating on behalf of specific groups of taxpayers and all taxpayers.¹² She is thus the appropriate IRS official to make the determination as to what is in the taxpayer's best interest.

A similar provision exists for releasing a levy. In certain circumstances, the National Taxpayer Advocate makes the determination of whether the return of property is in the taxpayer's best interest.¹³ Notwithstanding these provisions, under current IRS guidance, the IRS designates itself to decide whether an OIC submitted under ETA authority would be “generally perceived within the community as a fair and equitable solution.”

REASONS FOR CHANGE

Congress has provided the IRS with the tools to promote the use of OICs as a viable collection alternative for victims of failed PSPs, including compromising the amount of tax in appropriate instances. In practice, the IRS has not embraced its ETA OIC authority; instead, it has consistently underutilized this tool to provide relief to victims. For example, in fiscal years 2013 and 2014, the IRS accepted only 54 non-economic hardship ETA offers submitted by victims of PSPs.¹⁴ The IRS does not track the number of these victims. However, even if considering only the approximately 500 to 600 employers impacted by the AccuPay bankruptcy, accepting 54 non-economic hardship ETA offers over the past two years is hardly the “flexible” use that Congress intended.

As discussed above, the IRS's interim guidance on evaluating OICs submitted by victims of PSP fraud provides that the IRS shall inquire whether the offer would be generally perceived within the community as a fair and equitable solution.¹⁵ Just as Congress vested the National Taxpayer Advocate with the authority to make the determination of the taxpayer's best interest with respect to liens and levies, the IRS Commissioner has recognized the National Taxpayer Advocate as the voice of the taxpayer by delegating to her, and to her alone, the authority to issue a Taxpayer Advocate Directive where IRS procedures harm a group of taxpayers or even all taxpayers.¹⁶ Thus, the National Taxpayer Advocate, as the voice of the taxpayer inside the IRS, should be the one to make the determination of whether an offer based on ETA is fair and equitable.

10 See IRC § 6323(j)(1)(D).

11 See *id.*

12 See National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 48-9 (1997). See also IRM 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001); IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

13 See IRC § 6343(d)(2)(D).

14 See IRS follow-up response to fact check (Dec. 8, 2014). While the IRS does not systemically track the number of OICs submitted by victims of PSPs, it stated that it knew of 33 such offers received in fiscal year (FY) 2013 and 57 in FY 2014. See IRS response to fact check (Nov. 26, 2014).

15 Memorandum from Rocco A. Steco, Acting Director, Collection Policy, to Directors, Campus Compliance Operations, and Directors, Field Collection Operations Area, *Interim Guidance on Offers in Compromise from Taxpayers When Payroll Service Provider Issues Are Present* (Sept. 16, 2014).

16 See IRM 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001). See also IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

EXPLANATION OF RECOMMENDATION

We concur with the current IRS guidance that requires an inquiry as to whether other taxpayers would perceive the proposed offer to be fair and equitable. However, rather than leaving this determination up to the IRS, we recommend that Congress amend section 106 to provide that when evaluating these offers consideration should be given as to whether other taxpayers would perceive the proposed offer to be fair and equitable and to designate the National Taxpayer Advocate to make such an assessment. The National Taxpayer Advocate, as the voice of the taxpayer within the IRS, is uniquely qualified to make this assessment.

In addition, the recommendation proposes that section 106 of the Consolidated Appropriations Act of 2014 also be amended to provide that in evaluating the offer the IRS should not consider whether the taxpayer received financial gain as a result of compromise of tax liabilities attributable to PSP fraud. This inquiry is irrelevant for two reasons:

1. Every compromise of tax in every instance will result in some financial benefit to the taxpayer proposing the compromise; and
2. Victims of PSP fraud have already paid out the tax liability once (albeit to the PSP), and already are economically in the same situation as a taxpayer who paid the payroll taxes directly to the IRS. The victim will, by definition, be economically disadvantaged vis-à-vis other taxpayers by being required to pay one cent more.¹⁷

Therefore, the inquiry into financial gain or benefit is meaningless. The relevant inquiry is whether the taxpayer timely paid the payroll taxes and withholding to the PSP, and whether the taxpayer received any sort of reimbursement (*e.g.*, from insurance) that mitigated its loss. This is a simple factual analysis that requires no value-laden subjective judgment.

¹⁷ This assumes the taxpayer has not recovered some or all of the tax payments via insurance, court ordered restitution, payment on a civil judgment, or distributions from a PSP's bankruptcy.

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MANAGERIAL APPROVAL FOR LIENS: Require Managerial Approval Prior to Filing a Notice of Federal Tax Lien in Certain Situations

PROBLEM

One of the IRS's most significant powers is its authority to file a Notice of Federal Tax Lien (NFTL) in the public records when a taxpayer owes past due taxes. The NFTL protects the government's interests in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders.¹ Unlike most other creditors, the IRS does not need a judgment from a court to file an NFTL.² When properly applied, the IRS's lien authority can be an effective tool in tax collection. However, when the IRS uses its authority improperly, NFTLs can needlessly harm taxpayers and undermine long-term tax collection.³

Concerned about the serious impact liens can have on a taxpayer's life and the hardship they can cause,⁴ Congress enacted § 3421 of the IRS Restructuring and Reform Act of 1998 (RRA 98) to preclude the IRS from "abusively us[ing] its liens-and-seizure authority."⁵ The law requires the IRS to adopt procedures in which an employee's determination to file an NFTL would, "where appropriate," be approved by a supervisor and to set out disciplinary actions when such approval is not obtained.⁶

The IRS has deemed that it is rarely "appropriate" to require such approval, because it has made virtually no adjustments to its procedures along the lines of what Congress directed in enacting § 3421 of RRA 98. Instead, the IRS has adopted a collection strategy that often relies on the *broad* use of its lien authority.⁷ Notably, the IRS has eased previous restrictions on NFTL filings by allowing lower-graded employees to file NFTLs without managerial approval.⁸ The IRS also flipped Congress' intent on its head by requiring employees to obtain managerial approval if they determine *not* to file an NFTL or defer filing in many circumstances.⁹ Further, the IRS never established appropriate disciplinary actions for employees who fail to secure managerial approval to file an NFTL when such approval is required (*i.e.*, Revenue Officers below GS-9).¹⁰

1 Internal Revenue Code (IRC) §§ 6321, 6322, and 6323(a).

2 *Id.* IRS collection actions are either taken by the Automated Collection System (ACS) or Revenue Officers (ROs). ROs work in field offices and can send letters, issue liens and levies, and answer calls. ACS is a computerized inventory system that sends taxpayers notices demanding payment, issues liens and levies, and answers telephone calls in an effort to resolve balance due accounts and delinquencies.

3 See Most Serious Problem: *MANAGERIAL APPROVAL FOR LIENS: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98*, *supra*.

4 IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance, 105th Cong., 2d Sess. (1998) (see, e.g., statements of Nina E. Olson, Executive Director of the Community Tax Law Project in Richmond, Virginia).

5 RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 685, 758 (1998). See also S. Rep. No. 105-174, at 78 (1998); Unanimous Consent Request - H.R. 2676, 143 Cong. Rec. S12230-02, at S12231 (statement of Senator Roth).

6 RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 685, 758 (1998).

7 Internal Revenue Manual (IRM) 5.12.2.6, *NFTL Filing Criteria* (Oct. 14, 2013).

8 IRM 1.2.44.5 *Delegation Order 5-4* (Rev. 3), (May. 9, 2013); IRM 5.19.4.5.3.4 *When Filing an NFTL Requires Approval* (Jan. 1, 2015).

9 IRM 5.12.2.5.3, *NFTL "Do-Not-File" and Filing Deferral Determination Approvals* (Jan. 1, 2015); IRM 5.19.4.5.2.1, *Do Not File Approvals* (Aug. 4, 2014).

10 See IRS response to TAS research request (Jul. 31, 2014); IRM 5.12.2.5.2, *NFTL Filing Determination Approvals* (Oct. 14, 2013).

The IRS's decision to ignore Congress's directive and rely on a broad NFTL filing policy has had significant consequences for both the IRS and taxpayers and compromises a taxpayer's rights to *privacy* and *to a fair and just tax system*.¹¹ As illustrated by the findings in several significant Taxpayer Advocate Service (TAS) research studies, these expanded NFTL filing policies have not only been ineffective in collecting revenue, but impair current and future payment compliance and the taxpayer's earnings. These policies have particularly damaging effects on taxpayers whose accounts the IRS has classified as "currently not collectible" (CNC) because of economic hardship.¹²

EXAMPLE

A taxpayer was assessed a tax liability of \$15,000 and placed in CNC (hardship) status because he has no assets and collection action would render him unable to pay his basic living expenses. However, since the liability is over \$10,000, the IRS Automated Collection System (ACS) automatically files an NFTL, which is never reviewed by an ACS supervisor.¹³ This NFTL filing damages the taxpayer's credit report, making it difficult for him to find an apartment to rent (many landlords check a potential tenant's credit and have policies against renting to an individual with a poor credit rating or unpaid debt).

RECOMMENDATIONS

To ensure that NFTLs are given due consideration before being filed, the National Taxpayer Advocate recommends that Congress:

- Codify § 3421 of RRA 98 to require IRS employees to obtain managerial approval prior to filing an NFTL where it is likely that the NFTL will cause a hardship, will do little to protect the government's interest in the taxpayer's property or rights to property, or will impair the taxpayer's ability to pay the tax, including the following three categories:
 1. The taxpayer's income falls below 250 percent of the federal poverty level;
 2. The taxpayer's account has been placed in currently not collectible status due to economic hardship; or
 3. The taxpayer has entered into an installment agreement (IA) with the IRS.
- Require the IRS supervisor, as part of the managerial approval process, to consider the following:
 1. Whether the NFTL would attach to property;
 2. Whether the benefit of filing an NFTL for the government would outweigh the harm to the taxpayer; and
 3. Whether the NFTL filing will jeopardize the taxpayer's ability to comply with the tax laws in the future.

11 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> and Publication 1, Your Rights as a Taxpayer (June 2014).

12 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 105-29 (*Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111 (*Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (*The IRS's Use of Notices of Federal Tax Lien*). See also IRM 1.2.14.1.14 Policy Statement 5-71 (Nov. 19, 1980). Taxpayer accounts are reported as currently not collectible when the taxpayer has no assets or income, which by law, are subject to a levy.

13 IRM 5.19.4.5.3.2 (3), *Currently Not Collectible* (Jan. 1, 2015). In general, an NFTL is filed when BOTH of the following conditions exist: The aggregate assessed balance is at or above \$10,000 and the account is being closed using unable to locate, unable to contact, or hardship provisions.

- Require the IRS take disciplinary action against employees who fail to secure managerial approval prior to filing an NFTL in the situations required by law.

PRESENT LAW

During the RRA 98 legislative process, it became evident that Congress and leaders in the tax community were concerned about how the IRS was using its lien authority and its impact on taxpayers. Specifically, the Joint Committee on Taxation observed “the imposition of liens, levies, and seizures may impose significant hardships on taxpayers” and “that extra protection in the form of an administrative approval process is appropriate.”¹⁴ Leaders in the tax community, such as the National Association of Enrolled Agents, recommended that Congress restrict IRS employees’ ability to file NFTLs without proper managerial reviews, thereby ensuring these actions were appropriate and suitable.¹⁵

To address these concerns, Congress enacted § 3421 in RRA 98.¹⁶ Under this provision, where deemed appropriate, a determination by an employee to file a lien would be approved by an IRS supervisor who would:

- Review the taxpayer’s information;
- Verify that a balance is due; and
- Affirm that the action proposed is appropriate in light of the taxpayer’s circumstances, considering the amount due and the value of the property or right to property.¹⁷

Failure to follow these procedures should result in appropriate disciplinary action against the responsible supervisor or employee.¹⁸ This section became effective upon passage of the Act with one exception; it did not apply to actions taken under the IRS ACS until January 1, 2001.¹⁹

REASONS FOR CHANGE

As mentioned above, the NFTL filing negatively impacts a taxpayer’s credit history,²⁰ having the potential of reducing a taxpayer’s credit score by 100 points,²¹ and has a long-lasting effect on the taxpayer’s financial viability. For example, the existence of the NFTL filing, and the information contained in the

14 Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 1998*, JCS-6-98 (Nov. 24, 1998). See also RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 695, 758 (1998). See also S. REP. No. 105-174, at 78 (1998); Unanimous Consent Request - H.R. 2676, 143 CONG. REC. S12230-02, at S12231.

15 *Exploring the Development of Taxpayer Bill of Rights Legislation, Hearing Before the House Comm. On Ways and Means*, 104th Cong. (1995) (statement of Joseph F. Lane, Enrolled Agent). See also IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance, 105th Cong., 2d Sess. 375 (1998) (statement of Bruce Strauss, Enrolled Agent) (suggesting among other things that tax liens filings “must all be reviewed by an independent IRS quality review function prior to implementation of the decision.”).

16 RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 685, 758 (1998).

17 RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 685, 758 (1998).

18 RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 685, 758 (1998).

19 RRA 98, Title III, § 3421(c), Pub. L. No. 105-206, 112 Stat. 685, 758 (1998).

20 It is difficult to speculate as to the degree to which an NFTL will affect a taxpayer’s credit score, because every individual’s situation is different, and there are many different credit-scoring systems. Therefore, the impact on one system could be very different from another because the numeric scales are different. See Experian, *A World of Insight*, available at <http://www.experian.com/ask-experian/20080903-tax-liens-and-credit-scores.html> (last visited Dec. 12, 2014). However, a recent IRS study conducted by Experian found that NFTLs have a minimal impact on a consumer’s credit score in certain situations. See IRS and Experian Decision Analytics, *Federal Tax Lien Impact Study* (Mar. 31, 2014).

21 Written response from Vantage Score® (Sept. 17, 2009). The impact of the NFTL filing is greatest upon the initial filing and diminishes over time.

notice, are included in the consumer (credit) reports²² and therefore can impair a taxpayer's ability to obtain financing,²³ find or keep a job,²⁴ and secure affordable housing or insurance.²⁵ It can also hamper the taxpayer's ability to stay compliant and obtain credit needed to pay preexisting tax debts.²⁶

The taxpayer may experience effects of the NFTL filing in the long term, because an NFTL filing will remain on a taxpayer's credit report for years, or even indefinitely. Specifically, "paid tax liens" appear on credit reports for seven years from the date of payment,²⁷ and unpaid liens may remain on the report indefinitely, even when the underlying lien becomes legally unenforceable (*e.g.*, because the statutory limitations period for collection has expired and the lien self-released or the lien is legally satisfied as a result of an accepted offer in compromise (OIC) or the IRS accepts a bond).²⁸ When a taxpayer has little or no ability to pay and no assets from which to collect, an NFTL filing may further damage his or her financial viability and generate significant downstream costs for the government.²⁹

Aware of the serious impact and hardship NFTLs can cause in a taxpayer's life,³⁰ Congress enacted § 3421 of RRA 98 to preclude the IRS from "abusively us[ing] its liens-and-seizure authority."³¹ However, relying

22 The term "consumer report" is defined in the Fair Credit Reporting Act (FCRA), § 603(d), 15 USC § 1681a(d). Hereinafter, we will use the more commonly used term "credit report."

23 Some lenders decline to extend credit to a taxpayer if the IRS has filed an NFTL against the taxpayer's property. Others will charge substantially higher rates, even if the lien is subordinated. See, *e.g.*, GMAC Factoring Agreement, available at <http://contracts.onecle.com/arbinet/gmac.factor.2003.02.01.shtml> (last visited Dec. 13, 2014).

24 Some licensing boards require members to maintain a clean credit history and some employers require employees to do so as a condition of employment. See, *e.g.*, Form U4, *Uniform Application for Broker-Dealer Registration*, Q14M (May 2009), available at <http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015112.pdf> (last visited Dec. 13, 2014).

25 See also IRS Publication 594, *What You Should Know About the IRS Collection Process* 4 (Apr. 2012) (recognizing the taxpayer may not be able to obtain a loan to buy a house or a car, get a new credit card, or sign a lease as result of the NFTL filing).

26 See, *e.g.*, IRC § 6323(d) (providing that security protection only extended to the lender for disbursements made within 45 days after the filing of the NFTL, or until the lender is provided actual notice of the NFTL); IRC § 3505(b) (holding a lender providing funds for the ongoing operation of a business potentially liable for unpaid withholding taxes if certain criteria are met).

27 FCRA, § 605(a)(3), 15 USC § 1681c(a)(3). See also Federal Trade Commission, Statement of General Policy or Interpretation; Commentary on the FCRA, 55 Fed. Reg. 18804, 18818 (May 4, 1990). The filing of a release will be noted on the credit report but does not necessarily impact the credit score in a significant way.

28 As a matter of policy, Experian keeps unpaid tax liens on a credit report for 15 years while Equifax and Transunion credit reports reflect them indefinitely. See <http://www.transunion.com/personal-credit/credit-issues-bad-credit/what-affects-your-credit-score.page>; <http://www.experian.com/blogs/ask-experian/2007/05/16/how-long-public-records-stay-on-your-credit-report/>; <http://blog.equifax.com/credit/faq-how-long-does-information-stay-on-my-credit-report/> (last visited on Dec. 13, 2014). For example, most NFTLs are self-releasing, *i.e.*, the notice indicates that unless the IRS re-files it by the listed date, the notice operates as a certificate of release under IRC § 6325(a). IRC § 6325(a) also provides for a release of liens because the underlying liability became legally unenforceable or the IRS accepted a bond.

29 See T. Keith Fogg, *Systemic Problems with Low-Dollar Lien Filing*, 2011 TNT 194-9 (Oct. 6, 2011); National Taxpayer Advocate 2011 Annual Report to Congress 109-28. A further consequence of a lien's damage to a taxpayer's financial viability may be a need for unemployment benefits, food stamps and the like, thus increasing societal cost.

30 *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance*, 105th Cong., 2d Sess. (1998) (see, *e.g.*, statement of Nina E. Olson, Executive Director of the Community Tax Law Project in Richmond, Virginia).

31 RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 685, 758 (1998). See also S. Rep. No. 105-174, at 78 (1998); Unanimous Consent Request - H.R. 2676, 143 Cong. Rec. S12230-02, at S12231 (statement of Senator Roth).

on the word “appropriate” in § 3421, the IRS has made virtually no adjustments to its procedures along the lines of what Congress directed. Specifically, since Congress enacted § 3421, the IRS has:

1. Restated its policy that only ROs below the GS-9³² level must receive managerial approval prior to filing an NFTL.³³ The IRS said the costs and administrative burden of expanding the § 3421 protection to other situations outweighed the taxpayer’s interest.³⁴ This approval requirement for ROs below the GS-9 level applies to only less than one percent of ROs.³⁵
2. Eased managerial approval requirements for lien filings. Specifically, despite the fact that Congress gave the IRS more than two years to determine how to implement § 3421 of RRA 98 for ACS,³⁶ the only change the IRS made was to grant ACS employees in grades as low as GS-6 the authority to file NFTLs without managerial review.³⁷ This change was contrary to Congress’s directive and more lax than prior ACS guidance, which required GS-7 employees and below to obtain approval from either a senior RO or a manager to file an NFTL.³⁸ Presently, ACS files about one third of NFTLs and very few require managerial approval³⁹ (*i.e.*, less than 6.2 percent of ACS employees are below GS-6).⁴⁰
3. Required all ACS employees and ROs, regardless of grade level, to obtain managerial approval if they determine not to file a lien in cases that meet specified criteria.⁴¹
4. Never established disciplinary action for employees who fail to secure managerial approval where required.⁴²

Essentially, the IRS ignored a congressional directive and elected to adopt an even broader NFTL filing policy, rather than one that emphasizes review of taxpayers’ particular facts and circumstances to ensure the NFTL will attach to assets and not cause hardship. The IRS files many NFTLs systemically, pursuant to “business rules” that require automatic NFTL filing or lack substantive human review.⁴³ This systemic filing has contributed to a significant increase in the number of NFTLs over the last 15 years. For

32 The General Schedule (GS) classification and pay system covers the majority of civilian white-collar federal employees (about 1.5 million worldwide) in professional, technical, administrative, and clerical positions. U.S. Office of Personnel Management, <http://www.opm.gov/policy-data-oversight/pay-leave/pay-systems/general-schedule/> (last visited on Dec. 4, 2014). Within the Collection function, a “GS-9” employee is relatively junior.

33 IRM 5.12.2.5.2, *NFTL Filing Determination Approvals* (Oct. 14, 2013).

34 Memorandum from Assistant Commissioner (Collection) (July 30, 1998) (concluding section 3421 does not require supervisory review of all collection actions but allows the IRS discretion to determine where such review would be appropriate); Memorandum to Counsel to the National Taxpayer Advocate from Chief, Branch 1, General Litigation Division, Ref. No. GL-122444-98 (Dec. 23, 1998) (same).

35 IRS Human Resources Reporting Center on Revenue Officers (Aug. 13, 2013). As of July 26, 2014, less than one percent of ROs were below the GS-9 level. GS-8 and lower revenue officers totaled two out of 3,742 ROs. Also, the NFTLs issued by ROs below the GS-9 level may still not be reviewed by a manager. The IRM permits a manager to assign the lien review responsibility to another RO at an “appropriate” grade level. (emphasis added). See IRM 5.12.2.7, *Approval of Lien Notice Filing* (Oct. 14, 2013).

36 RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 758 (1998).

37 IRM 1.2.44.5, *Delegation Order 5-4 (Rev. 3)* (May. 9, 2013); IRM 5.19.4.5.3.4, *When Filing an NFTL Requires Approval* (Jan. 1, 2015).

38 Email from former IRS Chief Compliance Officer to the National Taxpayer Advocate (Nov. 2, 2009) (on file with TAS).

39 IRS No 5000-25, Lien Report, FY 2013 and 2014. ACS filed 204,279 and 198,682 liens out of 602,005 and 535,580 total lien filings for FY2013 and FY2014, respectively.

40 IRS Human Resources Reporting Center, Position Report Query, ACS employees (no exec), All GSs and GS-5 and less, run date 11/14/2014. As of Nov. 1, 2014, 159 employees out of 2,571 ACS employees were below the GS-6 level.

41 IRM 5.19.4.5.2, *Do Not File Decisions* (Jan. 1, 2015).

42 IRS response to TAS information request (Jul. 31, 2014).

43 IRM 5.19.4.5.3.2, *Filing Criteria* (Jan 1, 2015).

example, NFTL filings rose by about 219 percent from fiscal year (FY) 1999 to 2014,⁴⁴ yet the Collection function is collecting slightly more in real 2014 dollars than in 1999.⁴⁵

The ACS function's systemic reliance on its collection action as a means to collect revenue has been particularly ineffective. In FY 2014, ACS collected only about 5.9 percent of the dollars placed in its inventory, took in about 5.5 percent of those inventory dollars through refund offsets,⁴⁶ and ultimately transfers much of its inventory to the Queue.⁴⁷

As TAS research studies have shown, the IRS's reliance on its NFTL filing authority was unproductive and negatively impacts future compliance.⁴⁸ More importantly, the automatic filing of an NFTL imposes further harm on taxpayers who are already experiencing hardship. When a taxpayer has little or no ability to pay and has no assets from which to collect, an NFTL may further impede his or her financial viability and ultimately can undermine tax revenue and future compliance. In addition, the government has a secondary interest at stake. If the NFTL badly damages the taxpayer and the taxpayer's family by driving up the taxpayer's costs or renders him or her unemployed or underemployed, the government may be forced to provide a social safety net in the form of unemployment benefits, food stamps, and the like, thus increasing societal cost and raising everyone's share of taxes.

However, these considerations have not deterred the IRS from filing NFTLs against taxpayers in CNC status. Taxpayer accounts placed in CNC status because the IRS was either unable to contact or locate the taxpayer, or determined the taxpayer was in economic hardship, will be subject to NFTLs as long as certain requirements are met (*i.e.*, the tax liability is \$10,000 or greater).⁴⁹ Such NFTL filing on CNC taxpayers is especially concerning in light of a TAS research study that showed NFTLs were responsible for only \$2 of every \$10 in payments collected from taxpayers in CNC status. Nearly \$6 of every \$10 collected from these taxpayers came from refund offsets, which do not require an NFTL filing.⁵⁰ Nonetheless, the same study showed the IRS filed NFTLs against more than 72 percent of CNC taxpayers suffering economic hardship.⁵¹ The study also found CNC hardship taxpayers, on average, ended up owing about 50 percent more to the IRS in 2010 than at the time of lien (or proxy lien) filing.⁵²

Thus, Congress should codify § 3421 of RRA 98 in the Internal Revenue Code, because the IRS has largely ignored the directive it set out in RRA 98, and contrary to Congress' directive, has adopted a broad NFTL filing strategy that avoids any managerial oversight in most instances. This strategy has achieved

44 IRS Data Book, Table 16 (Nov. 19, 2014). NFTL filings were 168,000 and 535,580 for FYs 1999 and 2014, respectively.

45 *Id.* When adjusted for inflation (converted to 2014 dollars) the IRS collected about \$32.1 billion in FY 1999 and about \$34.2 billion in FY 2014.

46 In FY 2014, ACS collected \$3,107,887,286, and another \$2,850,701,610 were refund offsets, out of \$52,254,945,879 placed in ACS in FY2014. IRS NO 5000-2, Part 1 - TDAs, ACS/CS TDAs.

47 The Queue is a holding inventory where collection cases sit, based on business rules and available resources, usually after being in ACS, and before being assigned to the Collection Field function or reassignment to ACS.

48 National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2, 93-112 (*Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*). For instance, for the full period analyzed by TAS research (2002–2010), NFTL taxpayers were less likely to file required returns, with the increased likelihood of non-filing ranging between about one and three percent.

49 IRM 5.19.4.5.3.2(3), *Currently Not Collectible* (Jan. 1, 2015). Generally an NFTL is filed when BOTH of the following conditions exist: Aggregate assessed balance is at or above \$10,000 and account is being closed using unable to locate (cc03), unable to contact (cc12) or hardship (cc24 through 32) provisions.

50 National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18.

51 *Id.*

52 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 108-30 (*Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

poor collection results, harms taxpayers experiencing economic hardship, and negatively impacts future compliance.

EXPLANATION OF RECOMMENDATIONS

The IRS was already instructed by Congress in § 3421 of RRA 98 to identify where it would be appropriate to require managerial approval prior to filing an NFTL. The IRS could fulfill Congress' directive administratively, and earlier in this report, the National Taxpayer Advocate provided such administrative recommendations.⁵³ However, because the IRS has neglected to address Congress' directive over the past 15 years, the National Taxpayer Advocate recommends that Congress codify § 3421 in the IRC and further clarify when managerial approval is required before filing an NFTL.

Congressional clarification requiring managerial approval in specific circumstances will better ensure that a legitimate basis for the NFTL exists, for example, that the NFTL will attach to property or rights to property and will ultimately facilitate collection. Additionally, it also would protect taxpayers' *right to a fair and just tax system* and *right to privacy*, by creating an NFTL policy that considers each taxpayer's individual facts and circumstances, and that IRS actions will be no more intrusive than necessary.⁵⁴

The National Taxpayer Advocate understands requiring managerial approval prior to filing all liens is not feasible, but believes requiring the IRS to mandate managerial approval prior to filing a lien in specific situations would prevent unnecessary and harmful NFTLs. As TAS has illustrated in its research studies on NFTL filings discussed above, NFTLs are particularly damaging to low income taxpayers, and are often less effective than IAs. In light of these findings, it would make sense for managerial approval to be required before filing an NFTL in the following situations:

- **Taxpayer's income falls at or below 250 percent of the federal poverty level:** Prior to filing an NFTL, an employee could review information and determine whether the taxpayer's income falls at or below 250 percent of the federal poverty level.⁵⁵ By identifying these taxpayers, the IRS can presume economic hardship (*i.e.*, inability to pay basic living expenses) and consider whether the NFTL will only cause further hardship.⁵⁶ The IRS already makes this presumption when identifying low income taxpayers to filter out of the Federal Payment Levy Program (FPLP).⁵⁷

53 See Most Serious Problem: *MANAGERIAL APPROVAL FOR LIENS: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98*, *supra*.

54 IRM 5.11.1.3.1, *Pre-Levy Considerations* (Aug. 1, 2014). The IRS has emphasized the need for such judgment in the context of making a levy determination by instructing ROs to exercise good judgment when making the determination to levy, which means they are to consider the taxpayer's financial condition.

55 To determine a taxpayer's income, employees could review the taxpayer's most recent tax return, or available third-party information, whichever is more recent. See Department of Health and Human Services (DHHS), *The 2014 HHS Poverty Guidelines*, available at <http://aspe.hhs.gov/poverty/14poverty.cfm>. For calendar year 2014, an individual who makes \$11,670 or less is in poverty. This number is then multiplied by 250 percent to determine the 250 percent federal poverty threshold.

56 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.

57 The FPLP is an automated system the IRS uses to match its records against those of the government's Bureau of the Fiscal Service (BFS) to identify taxpayers with unpaid tax liabilities who receive certain payments from the federal government. In 2011, the IRS finalized and implemented a low income filter. This filter's design was largely based on a TAS study, which tested a filter model that identified and removed from FPLP low income taxpayers the model showed would experience economic hardship. Largely accepting the findings from the TAS study, the IRS designed a filter that excluded taxpayers from the FPLP whose incomes fall below 250 percent of the federal poverty level. National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 46-72 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).

- **Taxpayers in CNC-hardship status:** As shown above, taxpayers in CNC-hardship status are often crippled by tax debt, and filing NFTLs against them does little to protect the government's interest, and often makes the taxpayer's situation even worse.⁵⁸ The manager can consider whether the NFTL will actually assist in collecting the tax (*i.e.*, there are assets to which the lien will attach) or it will only further harm the taxpayer.
- **Taxpayers in a non-streamlined installment agreement:**⁵⁹ Taxpayers in an IA make significant strides toward paying off their tax debts.⁶⁰ Filing a lien against these taxpayers may jeopardize their ability to pay, because the NFTL can hinder their earning potential by damaging their credit rating and ability to secure financing or maintain professional licenses.

By making these recommendations, the National Taxpayer Advocate is not prohibiting the IRS from filing a lien against these taxpayers. Instead, having IRS managers involved will ensure an NFTL does not impose an undue hardship on taxpayers, *i.e.*, that liens will be filed in the appropriate instances. Managers would be responsible for considering whether an NFTL will attach to property, whether the benefit to the government outweighs the harm to the taxpayer, and whether the filing will jeopardize the taxpayer's ability to comply with the tax laws in the future. Managerial involvement will further protect the government's interest in the taxpayer's property or rights to property and can prevent impediments to the taxpayer's ability to pay the tax in the long run.

By requiring the IRS to take disciplinary action against employees who fail to secure appropriate managerial approval prior to filing an NFTL, the IRS will be prompted to provide better employee training on the law and will communicate to employees the gravity of the NFTL filing process. It will also confirm the IRS's commitment to protecting taxpayers' rights.⁶¹

58 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 108-30 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

59 See IRM 5.14.5.1, *Installment Agreements Overview* (May 23, 2014). 1) Guaranteed agreements: under IRC § 6159(c) taxpayers who meet certain conditions and who have a delinquency \$10,000 or less are entitled to an installment agreement. 2) Streamlined agreement: streamlined agreement criteria may be secured where the aggregate unpaid balance of assessments does not exceed \$25,000 and may be paid off within a 72-month period. Taxpayers who meet this criterion do not need to provide a financial information statement to the IRS. 3) Non-streamlined agreement: agreements that fall outside the parameters of the guaranteed and streamlined IAs.

60 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 108-30 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

61 For a detailed discussion of appropriate disciplinary actions see Most Serious Problem: *MANAGERIAL APPROVAL FOR LIENS: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98*, *supra*.

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MANAGERIAL APPROVAL: Amend IRC § 6751(b) to Require IRS Employees to Seek Managerial Approval Before Assessing the Accuracy-Related Penalty Attributable to Negligence under IRC § 6662(b)(1)

PROBLEM

The IRS can assess penalties against a taxpayer either after an independent review by an IRS employee or automatically with the use of a computer program. An employee who makes an independent determination regarding a penalty assessment must receive written managerial approval before the penalty can be assessed, subject to several exceptions.¹ Penalties that are “automatically calculated through electronic means” do not require managerial approval.² This exception makes sense in the context of the failure to pay and failure to file penalties, which require a relatively straightforward mathematical calculation and involve no exercise of judgment and discretion.³

However, the exception poses a problem, particularly for accuracy-related penalties imposed on the portion of underpayment attributable to negligence or disregard of rules or regulations pursuant to IRC § 6662(b)(1) (hereinafter “negligence penalty”).⁴ “Negligence” includes “any failure to make a reasonable attempt to comply with the provisions of this title, and the term “disregard” includes any careless, reckless, or intentional disregard.”⁵ The IRS can consider various factors in deciding if the taxpayer’s actions were negligent, including actions taken by the taxpayer to ensure the tax was correct.⁶ However, the negligence penalty does not apply to any portion of an underpayment if it is shown that there was reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.⁷ A reasonable

1 See IRC § 6751(b)(1). IRC § 6751(b)(2)(A) provides that managerial approval is not required for additions to tax pursuant to IRC §§ 6651, 6654, and 6655.

2 See IRC § 6751(b)(2)(B).

3 IRC § 6651(a)(1) imposes a penalty for failure to file a required return by the date prescribed (including extensions). The penalty is generally five percent of the amount of tax if the failure to file is not more than one month. There is an additional five percent penalty for each additional month or fraction of a month. The penalty generally cannot exceed 25 percent in the aggregate. The penalty increases to 15 percent per month or fraction of a month for a maximum of 75 percent if the failure to file the return is fraudulent. IRC § 6651(f). See also IRM 20.1.2.2.7, *Failure to File a Tax Return – IRC 6651*, (Apr. 19, 2011). IRC § 6651(a)(2) imposes a penalty for failure to pay the tax shown on the return referenced in IRC § 6651(a)(1) on or before the due date. The penalty is 0.5 percent of the amount of tax if the failure to pay is not more than one month. There is an additional penalty of 0.5 percent for each additional month or fraction of a month. The penalty cannot exceed 25 percent in the aggregate. See also IRM 20.1.2.2.8.4, *Failure to Pay Tax Shown on Return – IRC 6651(a)(2)*, (Apr. 19, 2011). When both penalties are assessed on the same return, the failure to file penalty is reduced by the amount of the failure to pay penalty. See IRC § 6651(c)(1).

4 “Underpayment” is defined as “the amount by which any tax imposed by this title exceeds the excess of (1) the sum of (A) the amount shown as the tax by the taxpayer on his return, plus (B) amounts not so shown previously assessed (or collected without assessment), over (2) the amount of rebates made. IRC § 6664(a).

5 IRC § 6662(c). See also IRM 4.19.3.16.6, *Accuracy-Related Penalty Due to Negligence or Disregard of Rules or Regulations (Negligence Disregard Penalty)*, (Sept. 30, 2014) (IMF AUR); IRM 20.1.5.7.1(5)(a), *Negligence*, (Jan. 24, 2012) (indicating that exam may assert negligence based on a mismatch of interest income in a single year if the taxpayer does not appear for an examination).

6 IRM 4.10.6.2.1, *Negligence*, (May 14, 1999). Other factors include the taxpayer’s history of noncompliance; the taxpayer’s failure to maintain adequate books and records; and whether the taxpayer had a reasonable explanation for unreported or understated income.

7 IRC § 6664(c)(1).

cause determination takes into account all of the pertinent facts and circumstances, and requires the IRS employee to exercise judgment and discretion.⁸

Assessing penalties electronically involves an automated process that does not consider the facts and circumstances of a case until the taxpayer contacts the IRS in response to the proposed penalty, thus burdening the taxpayer to prove the penalty does not apply. For the negligence penalty in particular, automatic assessments do not allow for a consideration of the taxpayer's specific facts and circumstances. Under the automatic assessment regime, a taxpayer who did make a reasonable attempt to comply and acted in good faith must take extra, burdensome steps to rid him or herself of an arbitrary penalty assessment. Not only does this approach undermine voluntary compliance, but it affects a taxpayer's *right to quality service, right to pay no more than the correct amount of tax, and the right to a fair and just tax system.*⁹

EXAMPLE

The IRS audited Taxpayer A's return because of an inaccuracy in the income reported. This is the second year that the discrepancy has occurred. The IRS proposed an assessment based on the difference in wages between what she and her employer reported. The notice mentioned that penalties could apply, but no penalty is calculated on the notice.¹⁰ The taxpayer agrees to this assessment and does not respond. As a result, the IRS also automatically imposes a negligence penalty based on IRC § 6662(b)(1) and issues a statutory notice of deficiency (SNOD). The taxpayer does not closely review the SNOD because the taxpayer agrees with the assessment and is unaware that the IRS automatically assesses the penalty when there is no response from the taxpayer.

RECOMMENDATION

To address the lack of managerial review of IRC § 6662(b)(1) penalties automatically calculated through electronic means, the National Taxpayer Advocate recommends that Congress:

- Amend IRC § 6751(b)(2)(B) to require written managerial approval prior to assessment of the accuracy-related penalty imposed on the portion of underpayment attributable to negligence or disregard of rules or regulations under IRC § 6662(b)(1), and specify which penalties and facts or circumstances result in penalties “automatically calculated through electronic means.”

⁸ Treas. Reg. § 1.6664-4(b)(1).

⁹ See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. For information on how accuracy-related penalties may impact future compliance among Schedule C taxpayers (i.e., sole proprietors), see National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 1-12 (Research Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*).

¹⁰ Notice CP 2501 is sent to the taxpayer to obtain additional information prior to issuing a CP 2000. The CP 2000 is sent to the taxpayer to propose a change to his or her tax liability because of income not identified or not fully reported on the taxpayer's tax return. Accordingly, the CP 2501 will not contain a penalty computation. It will state that “An accuracy-related penalty is charged if there is any underpayment of tax on your return due to negligence. This penalty is 20 percent of the net tax increase on the portion due to negligence.” IRM Exhibit 4.19.3-7(86) (Sept. 30, 2014). While the CP 2000 may include a penalty notice, the IRS is not required to include a penalty calculation. See IRM 4.19.3.20.1.4, *Accuracy Related Penalties*, (Sept. 1, 2012) (“The AUR system electronically calculates the Accuracy Related penalties; therefore, a penalty notice may be issued in the initial letter to the taxpayer proposing a deficiency...”). In fact, the CP 2000 template includes this information about penalties: “If this penalty applies, we will bill you for this amount at a later date. The bill may reflect the amount as unpaid interest.” This is in contrast to the statutory notice of deficiency, which includes either Form 4549-A, *Income Tax Examination Changes (Unagreed and Excepted Agreed)* or Form 5278, *Statement – Income Tax Changes*, both of which include a section for the calculation of penalties. See IRS, Letter 531 (Aug. 2012).

PRESENT LAW

Presently, a taxpayer who submits a return that is not accurate (*i.e.*, reflects an “underpayment”) may be subject to an accuracy-related penalty under IRC § 6662.

The IRS Restructuring and Reform Act of 1998 (RRA 98) introduced the specific statutory requirement that the immediate supervisor of the individual making the initial determination of a penalty assessment must personally approve the initial determination, in writing, prior to assessment.¹¹ In explaining this legislative reform, the Chair of the Senate Finance Committee commented, “In order to prevent IRS employees from arbitrarily using penalties as leverage against taxpayers, this bill requires non-computer determined penalties to be approved by management.”¹²

Congress carved out the exception for penalties “automatically calculated through electronic means” but there is no legislative history to explain why these penalties should be excluded from managerial approval. However, by enacting IRC § 6751(b), the legislators intended to provide protections to taxpayers against the arbitrary use of penalties by the IRS.¹³ IRC § 6751(b)(2) also allows an exception to managerial approval for assessments related to:

- Failure to file a tax return or pay tax under IRC § 6651;
- Failure to pay estimated income tax under IRC § 6654; and
- Failure by a corporation to pay estimated tax under IRC § 6655.¹⁴

The exceptions under IRC § 6751(b)(2)(A) are based on relatively simple mathematical calculations involving “true/false” fact scenarios and do not require an inquiry into the taxpayer’s facts and circumstances. For example, the question of whether a taxpayer failed to file a required tax return can be answered with a simple “yes” or “no.”

The IRS has defined “automatically calculated through electronic means” to include more than “merely an electronic device to perform arithmetic functions to determine the amount of a penalty.”¹⁵ The exception includes situations where the penalty is assessed “**free** of any independent determination by an IRS employee as to whether the penalty should be imposed against a taxpayer.”¹⁶

The IRS Office of Chief Counsel has opined that the requirement for managerial approval does not apply to negligence penalties assessed under IRC § 6662(b)(1) pursuant to the Automated Underreporter

11 See Pub. L. No. 105-206, § 3306(a), 112 Stat. 685, 744 (1998) (codified in IRC § 6751(b)). The statutory language reads in relevant part: “(1) IN GENERAL — No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate. (2) EXCEPTIONS — Paragraph (1) shall not apply to — (A) any addition to tax under section 6651, 6654, or 6655; or (B) any other penalty automatically calculated through electronic means.”

12 See 144 CONG. REC. S7623-89 (statement of Senator Roth) (1998).

13 *Id.*

14 IRC § 6751(b)(2)(A).

15 IRM 20.1.1.2.3(5), *Managerial Approval for Penalty Assessments*, (Aug. 5, 2014). While there is no legislative history, this position is supported by the IRS Office of Chief Counsel. See SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b)* (Jan. 30, 2002).

16 IRM 20.1.1.2.3(5), *Managerial Approval for Penalty Assessments*, (Aug. 5, 2014).

program.¹⁷ This is not a distinction that Congress addressed in the statutory provision. Unlike “true/false” penalties, the determination to assess a negligence penalty requires knowledge of what actions the taxpayer took to comply with the tax laws, as well as his or her motivations for those actions. As a result, the National Taxpayer Advocate is focusing her recommendation on automatically calculated negligence penalties under IRC § 6662(b)(1).

For the purpose of this penalty, “negligence” is defined to include “any failure to make a reasonable attempt to comply with the provisions of this title” and the term “disregard” includes any “careless, reckless, or intentional disregard.”¹⁸ The accuracy-related penalty does not apply to any portion of an underpayment where the taxpayer acted with reasonable cause and in good faith.¹⁹ A reasonable cause determination takes into account all of the pertinent facts and circumstances.²⁰ Generally, the most important factor is the extent to which the taxpayer made an effort to determine the proper tax liability.²¹

REASONS FOR CHANGE

The purpose of penalties is to encourage voluntary compliance and deter noncompliance.²² A recent TAS research study shows that the arbitrary application of penalties may undermine taxpayer compliance. In 2013, TAS conducted a study to estimate the effect of accuracy-related penalties on Schedule C filers whose examinations were closed in 2007.²³ The results identified matched pairs of taxpayers with similar situations that were different in only one respect: one was assessed a 20 percent accuracy-related penalty and the other was not. Among taxpayers who were subject to a default assessment or who appealed examination’s determination, those subject to penalties were no more compliant (than similarly situated taxpayers who were not penalized) immediately following the assessment.²⁴ In addition, five years later they were less compliant than those who were not penalized.²⁵

The automatic application of negligence penalties is a significant component of the IRS’s Automated Underreporter (AUR) program. AUR is an automated program that identifies discrepancies between the amounts that taxpayers reported on their returns and what payors reported via Form W-2, Form 1099, and other information returns.²⁶ In general, penalties assessed under the AUR program are automatically computed pursuant to a computer program when a discrepancy is detected in the document matching

17 See SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b) 3* (Jan. 30, 2002) (“The circumstances in which the Automated Underreporter program calls for assessment of a negligence penalty, however, does not require an independent determination by a Service employee.”). For general information about the AUR program, see IRM 4.19.3, *Overview of IMF Automated Underreporter*, (Sept. 30, 2014).

18 IRC § 6662(c).

19 IRC § 6664(c)(1).

20 Treas. Reg. § 1.6664-4(b)(1).

21 *Id.*

22 See Policy Statement 20-1, IRM 1.2.20.1.1 (June 29, 2004).

23 See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 1-12 (Research Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*). TAS used Discriminant Function (or “DIF”) scores—an IRS estimate of the likelihood that an audit of the taxpayer’s return would produce an adjustment—as a proxy for a taxpayer’s subsequent compliance. See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 3.

24 National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 11.

25 *Id.* The difference is statistically significant at 95 percent level of confidence.

26 See IRM 4.19.3.1, *Overview of IMF Automated Underreporter* (Sept. 30, 2014). The AUR program relies on two sources: the Individual Master File (IMF), which contains information reported to the IRS by taxpayers (such as when taxpayers file Form 1040, U.S. Individual Income Tax Return), and the Information Returns Master File (IRMF), which includes information submitted by payors, such as on Form W-2, *Wage and Tax Statement*. Underreporter cases result when computer analysis detects a discrepancy between the two data sources. IRM 1.4.19.1, *Overview*, (Nov. 1, 2012).

program.²⁷ If the negligence penalty is assessed in AUR, without an employee independently determining its appropriateness, there is no requirement for managerial approval.²⁸

Specifically, when the AUR program detects a discrepancy on a tax return, the IRS sends the taxpayer a letter asking for an explanation and a notice proposing an assessment.²⁹ If the taxpayer does not respond to those inquiries, AUR will issue a notice of deficiency, which proposes a liability assessment and includes calculation of applicable penalties.³⁰ If the taxpayer responds to the initial inquiry or the notice of deficiency, the IRS employee must consider the response, and any resulting IRC § 6662(b)(1) penalty assessment must receive prior managerial approval.³¹

The AUR program can also assess the negligence penalty under IRC § 6662(b)(1) automatically.³² The IRS system has “uniform factual criteria” programming that automatically proposes the negligence penalty when a taxpayer fails to report income reported on third-party information returns for a second year.³³ The programmed determination, in this instance, is that the taxpayer fits into a category of taxpayers who the IRS believes are “negligent” because failing to include third-party information returns for two consecutive years does not constitute the use of ordinary and reasonable care in the preparation of a tax return.³⁴

The IRS clearly uses different levels of effort to communicate with taxpayers and ascertain the reason for an apparent discrepancy before proposing a penalty, depending on the type of examination or matching program. Taxpayers receiving notices from the AUR program appear to receive the least communication prior to penalty assessment.³⁵ This procedure differs from those in field and office audits, where

27 SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b) 2* (Jan. 30, 2002).

28 IRM 20.1.1.2.3.2, *Automated Underreporter Program*, (Aug. 5, 2014). See also IRM 20.1.5.1.6, *Managerial Approval of Penalties*, (Jan. 24, 2012).

29 SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b) 2* (Jan. 30, 2002). As mentioned above, the initial notices may not include a penalty calculation. See footnote 10, *supra*.

30 SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b) 2* (Jan. 30, 2002). For information on the notice of deficiency, see IRC § 6212 and IRM 4.8.9.8.3, *Criteria for Issuance*, (July 9, 2013).

31 *Id.* at 4. The IRS has implemented Counsel’s advice. When a taxpayer responds to either the initial contact letter or the notice of deficiency, the IRS must consider the response. See IRM 20.1.1.2.3.2(2), *Automated Underreporter Program*, (Aug. 5, 2014). This consideration requires an independent determination and therefore is not automatically calculated through electronic means and requires managerial approval. See IRM 20.1.1.2.3.2(3), *Automated Underreporter Program*, (Aug. 5, 2014). Managerial approval is not required when an employee uses command code FTDPN when working a case involving the failure to deposit penalty under IRC § 6656. IRM 20.1.1.2.3.3, *IDRS Command Code FTDPN*, (Dec. 11, 2009). Employees use command codes while working in the Integrated Data Retrieval System (IDRS), a database of taxpayer information. For more information on IDRS, see IRM 2.9.1.1, *Overview of Integrated Data Retrieval System*, (Jan. 1, 2000).

32 “Negligence” includes any failure to make a reasonable attempt to comply with the provisions of the tax law. IRC § 6662(c). The negligence penalty includes instances where the taxpayer shows a disregard for the tax rules. IRC § 6662(b)(1). “Disregard for the tax rules” includes any careless, reckless, or intentional disregard.” IRC § 6662(c). However, a position that has a reasonable basis is not attributable to negligence. Treas. Reg. § 1.6662-3(b)(1).

33 SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b) 3* (Jan. 30, 2002).

34 SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b) 3* (Jan. 30, 2002). Counsel believes that this is a correct interpretation of IRC § 6751(b)(2)(B). *Id.*

35 See National Taxpayer Advocate 2013 Annual Report to Congress 185. For a discussion on the shortcomings of customer service and data systems within the AUR program, see National Taxpayer Advocate 2007 Annual Report to Congress 259-74 (Most Serious Problem: *Automated Underreporter*).

the IRS employee is encouraged to solicit explanations regarding adjustments from the taxpayer prior to assessment.³⁶

Automatically calculated penalties are a significant problem for taxpayers. In FY 2013, the IRS conducted over 75 percent of all individual audits by Correspondence Examination and issued over 4.12 million Notices CP 2000 (AUR notices) in FY 2013.³⁷ Moreover, in FY 2014, more than 71,000 of these letters proposed over \$71 million in accuracy-related penalties *before* the IRS ever inquired about the discrepancy or called the taxpayer.³⁸ This leaves the burden on the taxpayer to prove that the penalty does not apply.

As discussed above, if a taxpayer responds to the automatically-proposed penalty, the employee assigned to the case must review the submission. The assessment is no longer “automatically calculated through electronic means” and will be reviewed by a manager. The taxpayer who does not respond will not get the same review.

There are many reasons why a taxpayer may not respond to a notice. First, the taxpayer may not respond to the first notice because he or she agrees with the adjustment proposed and thus does not review the second separate notice that contains the penalty assessment. Second, low income taxpayers often face particular challenges when dealing with the IRS.³⁹

Moreover, in an environment of continuing budget cuts, the inability to contact the IRS is a challenge faced not only by low income taxpayers, but by *all* taxpayers. In fiscal year (FY) 2014, only 64.4 percent of taxpayers calling to speak to an IRS customer service representative could get through and the average time on hold was 19.55 minutes.⁴⁰ The National Taxpayer Advocate has highlighted the need to improve customer service to preserve taxpayer rights.⁴¹ The consequences of this problem are exacerbated with automatically-assessed penalties, which are reviewed only when a taxpayer responds. Most importantly, automatic IRC § 6662(b)(1) penalty assessments, while “efficient” from the IRS’s point of view, may actually decrease taxpayer compliance and therefore the collection of revenue.⁴²

Several taxpayer rights are impacted when negligence penalties are assessed automatically without managerial approval. For instance, taxpayers who must defend themselves from automatically assessed penalties that go to their intent, have not had *their right to quality service* honored. Likewise, *the right to pay no more than the correct amount of tax*, which includes interest and penalties, is violated when the IRS can assess penalties without first reviewing the appropriateness of the assessment. Finally, *the right to a fair and just tax system*, which ensures that the IRS will “consider facts and circumstances that might affect

36 See IRM 4.10.6.3.5, *Soliciting the Taxpayer’s Explanations*, (May 14, 1999). See also National Taxpayer Advocate 2013 Annual Report to Congress 186.

37 IRS Data Book, Table 14, Information Reporting Program (FY 2013).

38 IRS Compliance Data Warehouse, Individual Master File (Dec. 22, 2014). This figure omits the accuracy-related penalties assessed in FY 2014 as a result of AUR cases opened in earlier periods. It also omits taxpayers who received a CP 2000 only after receiving a letter (CP 2501) inquiring about the reason for the discrepancy.

39 Low income taxpayers are more likely to face limited English proficiency, low literacy rates, physical or mental disabilities, lower education levels, limited access to the internet, and limited access to qualified tax professionals. See National Taxpayer Advocate 2009 Annual Report to Congress 112-113.

40 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2014).

41 See National Taxpayer Advocate 2013 Annual Report to Congress 20-39 (Most Serious Problem: *IRS BUDGET: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance*); National Taxpayer Advocate 2012 Annual Report to Congress 34-41 (Most Serious Problem: *The IRS Is Significantly Underfunded to Serve Taxpayers and Collect Tax*); National Taxpayer Advocate 2011 Annual Report to Congress 3-14 (Most Serious Problem: *The IRS is Not Adequately Funded to Serve Taxpayers and Collect Taxes*).

42 See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 1-12 (Research Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*).

[the taxpayer's] underlying liabilities,” is violated when the IRS automatically imposes negligence penalties, without any managerial approval. It also brings into question the fairness of the system when the IRS reviews penalties against taxpayers who respond to a notice, but automatically assesses penalties against taxpayers who do not reply.

EXPLANATION OF RECOMMENDATION

This legislative recommendation requires managerial approval prior to assessment of the accuracy-related penalty imposed on the portion of underpayment attributable to negligence or disregard of rules or regulations under IRC § 6662(b)(1). The managerial review of this penalty, which includes the failure to make a “reasonable attempt” to comply with rules or “any careless, reckless, or intentional disregard” of the rules, should involve a thorough review of the taxpayer’s facts and circumstances, which is not possible with an automatic assessment.⁴³

There may be other instances where the IRS automatically imposes penalties where an analysis of facts and circumstances is required. For instance, the IRS applies IRC § 6751 to the analysis of its two-year EITC ban cases under IRC § 32(k).⁴⁴ Under IRS procedures, managerial approval is required in all cases that involve the two-year ban under IRC § 32(k).⁴⁵ However, in 2013, TAS reviewed cases involving the two-year ban and found that in 69 percent of the cases, the ban was imposed without the required managerial approval.⁴⁶

In response to this review, the IRS agreed to reinforce among its employees “that all two-year bans must have managerial approval on all manual cases and on systemically imposed two-year ban cases *if correspondence is received*.”⁴⁷ (emphasis added). This leaves taxpayers facing a two-year ban under IRC § 32(k) in a similar situation to taxpayer receiving automatic penalty assessments under IRC § 6662(b)(1). Therefore, the National Taxpayer Advocate recommends that Congress specify which penalties and facts and circumstances result in penalties “automatically calculated through electronic means.”

43 IRC § 6662(c).

44 See National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress, vol. 2 44. IRC § 32(k)(1)(B)(ii) disallows Earned Income Tax Credit (EITC) claims for two taxable years if there has been a final determination that the taxpayer’s claim of credit was due to “reckless or intentional disregard of rules and regulations.”

45 See IRM 4.19.14.6.1(4), *EITC 2/10 Year Ban - Correspondence Guidelines for Examination Technicians (CET)*, (Jan. 1, 2013).

46 See National Taxpayer Advocate 2013 Annual Report to Congress 104. Based on this review, the National Taxpayer Advocate made a legislative recommendation in 2013 to amend IRC § 32(k) to provide that the IRS has the burden of proof as to whether it is appropriate to impose the two-year ban on claiming EITC. See National Taxpayer Advocate 2013 Annual Report to Congress at 311-15 (Most Serious Problem: *Allocate to the IRS the Burden of Proving it Properly Imposed the Two-Year Ban on Claiming the Earned Income Tax Credit*).

47 See National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress, vol. 2 44.

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#18**

CONTACT INFORMATION ON STATUTORY NOTICES OF DEFICIENCY: Revise IRC § 6212 to Require the IRS to Place Taxpayer Advocate Service Contact Information on the Face of the Statutory Notice of Deficiency and Include Low Income Taxpayer Clinic Information with Notices Impacting that Population

PROBLEM

Section 1102(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) provides that statutory notices of deficiency (SNODs) “shall 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.”¹ The Conference Report provided further clarification by stating the IRS should publish information on the right to contact Taxpayer Service (TAS) “on” the SNOD, as opposed to “with” the notice.²

A TAS review of the current IRS inventory of SNODs found that the majority do not include the contact information for the local TAS office on the face of the notices and, in several instances, the wrong TAS office is listed. Congress enacted this provision of RRA 98 to ensure that taxpayers are aware of their right to contact the local office of the Taxpayer Advocate Service at a crucial point in their tax controversy. Taxpayers need to know they can talk to someone in their own state who has knowledge of the underlying local economic conditions that might affect the case. When the taxpayer receives a SNOD, the IRS has not actually assessed the additional tax, and the taxpayer still has a limited opportunity to address the issue directly with the IRS or petition the Tax Court. It is also an ideal time for the IRS to inform certain taxpayers about the services provided by low income taxpayer clinics (LITCs), as well as their contact information. While TAS employees can explain to the taxpayer the right to file a petition in the Tax Court, LITC practitioners can assist an eligible taxpayer throughout the tax controversy and represent the taxpayer in court.

EXAMPLE

A taxpayer receives a statutory notice of deficiency (SNOD) proposing a \$3,000 adjustment due to the disallowance of the Earned Income Tax Credit (EITC). The SNOD was mailed with a Notice 1214, *Helpful Contacts for Your Notice of Deficiency*, containing TAS contact information, but it became separated from the SNOD after receipt by the taxpayer. The taxpayer does not agree with the adjustment and has tried to call the IRS to ask what he needs to do to resolve the issue, but his calls never go through to a live assistor. The notice includes language informing the taxpayer of his right to contact TAS, but the taxpayer does not understand that he can seek assistance from the local office of TAS and a low income taxpayer clinic in his county.

- 1 Pub. L. 105-206, 112 Stat. 703 (1998). The RRA 98 provision amends IRC § 6212(a) to require the additional language on statutory notices of deficiency.
- 2 H.R. REP. NO. 105-599, at 215 (1998) (Conf. Rep.). Because both RRA 98 and IRC § 6212 address both the right to contact TAS and the contact information together, we believe that the conference report language stating that the information should be on the notice should apply to both.

RECOMMENDATIONS

To bring the IRS inventory of statutory notices of deficiencies (SNODs) into compliance with § 1102(b) of RRA 98 and to inform taxpayers of their right to seek the assistance at the local office of the Taxpayer Advocate Service (TAS) and Low Income Taxpayer Clinics (LITCs), the National Taxpayer Advocate recommends that Congress revise Internal Revenue Code (IRC) § 6212 to require the IRS to do the following:

1. Include language on the face of the SNOD informing the taxpayer of the right to contact a local office of TAS. Such language should also provide the address and phone number of the TAS office aligned with the taxpayer's last known residence.
2. For SNODs determined by the IRS, in consultation with the National Taxpayer Advocate, to have a significant probability of impacting low income taxpayers, include language on the face of the notice describing LITCs and provide a website link that lists contact information for all the LITCs.
3. For SNODs that are certain to impact low income taxpayers (e.g., those proposing to assess the Earned Income Tax Credit), also include in the envelope used to mail the SNOD Publication 4134, Low Income Taxpayer Clinic List, which provides information on the services provided by LITCs and contact information for each clinic.

PRESENT LAW

Section 1102(b) of RRA 98

Section 1102(b) of RRA 98 amended IRC § 6212(a) to provide that SNODs “shall 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.”³ Furthermore, the Conference Report states “The IRS would be required to publish the taxpayer’s right to contact the local Taxpayer Advocate on the statutory notice of deficiency.”⁴

Chief Counsel Opinion

In response to a request for legal opinion by TAS, the IRS Office of Chief Counsel has opined that the IRS complies with § 1102(b) of RRA 98 when it provides Notice 1214 as an insert in the SNOD. Counsel further explained that Notice 1214 was developed by the IRS for the purpose of complying with RRA 98. In fact, the description of the notice on the IRS Forms Repository site includes the following language: “This notice is issued to conform with the IRS restructuring and reform act of 1998 section 1102(b). It was included as an insert with all statutory notices of deficiency (90-Day Letters).” Counsel supported its opinion by stating that the SNOD includes language regarding TAS and Notice 1214 is listed as an enclosure on the SNOD.⁵

Validity of the SNOD

In *John C. Hom & Associates, Inc. v. Commissioner*, the Tax Court addressed the validity of the SNOD when it does not include all the information required by RRA 98. Specifically, the taxpayer argued that the SNOD was invalid for failing to include the address and telephone number of the local office of

3 Pub. L. 105-206, § 1102(b) 112 Stat. 685, 703 (1998). The RRA 98 provision amends IRC § 6212(a) to require the additional language on statutory notices of deficiency.

4 H.R. REP. No. 105-599, at 215 (1998) (Conf. Rep.).

5 Email from the Office of the Special Counsel to the National Taxpayer Advocate to a TAS Senior Attorney-Advisor (Nov. 20, 2014).

the National Taxpayer Advocate and that inclusion of a web page link is inadequate compliance with IRC § 6212. The court held that the SNOD was valid and complied with IRC § 6212 despite including only the web link.⁶ Note that this opinion only addressed the validity of the SNOD for jurisdictional purposes. The opinion did not address whether the IRS actually complied with RRA 98 by only including the Web page link on the face of the notice.⁷

IRC § 7526

IRC § 7526 created the LITC program and authorizes the IRS to award matching grants of up to \$100,000 per year to qualifying clinics. Such clinics cannot charge more than a nominal fee for services (except for reimbursement of actual costs incurred). They must represent low income taxpayers involved in controversies with the IRS and provide education and outreach on the rights and responsibilities of U.S. taxpayers who speak English as a second language. LITCs are generally legal aid or legal services organizations: clinics at accredited law, business, or accounting schools, and other not-for-profit organizations that provide services to the poor.

REASONS FOR CHANGE

Inclusion of TAS Information on the Face of the SNOD

The taxpayer's receipt of a SNOD is a critical point in the audit or appeals process. The taxpayer needs information about what he or she must do to protect the right to an independent review of the proposed deficiency prior to assessment. The SNOD is a pre-assessment document, which means the taxpayer may still have the opportunity resolve the issue before going to the Tax Court.

TAS reviewed the inventory of SNOD templates and notices and found 11 of 17 current ones failed to comply with the requirements in RRA 98. Of the 11 SNODs that failed, eight included, as an insert or stuffer in the envelope with the SNOD, Notice 1214, *Helpful Contacts for Your Notice of Deficiency*, which has the addresses and phone numbers of the local TAS offices.⁸ In addition, two included the information on the face of the notice but only auto-populated one particular TAS office rather than one near the taxpayer.⁹ Finally, one notice included as a stuffer Publication 3953, which includes information about TAS.¹⁰ While the Tax Court has held the SNOD is still valid with the language required by IRC § 6212(a), it is our position that the failure of the IRS to strictly comply with the RRA 98 requirements harms taxpayers.¹¹

6 140 T.C. 210 (2013), *appeal docketed*, No. 13-72684 (9th Cir. July 31, 2013).

7 See also *Comm'r v. Forest Glen Creamery Co.*, 98 F.2d 968, 971 (7th Cir. 1938) (holding that documents with the notice must be considered when determining if the taxpayer was misled by errors for notice validity purposes).

8 The following SNODs include Notice 1214 as a stuffer: CP 3219N, Letter 531A, Letter 531B, Letter 531C, Letter 531J, Letter 902 (DO), Letter 902-T, and Letter 1384 (SC).

9 CP 3219A, *Notice of Deficiency – AUR IMF*, auto-populates the notice with the TAS Austin, Texas office information. Letter 3219C auto-populates the Atlanta, Georgia office information on every notice issued.

10 Letter 3523, *Notice of Determination of Worker Classification* (NDWC), is not technically a statutory notice of deficiency, but we added this letter to the list because it is similar to a SNOD in that it provides the taxpayer the right to petition Tax Court to contest a proposed assessment of tax. It is the statutory notice for employment tax when there is a controversy involving worker classification or § 530. TAS contact information is included in Publication 3953, *Q&A's About Tax Court Proceedings for Determination of Employment Status Under IRC Section 7436*, which is sent along with Letter 3523. See IRS response to TAS information request (July 31, 2014). For more detail on the SNODs reviewed by TAS, see Most Serious Problem: *Statutory Notices of Deficiency Do Not Include Local Taxpayer Advocate Office Contact Information on the Face of the Notice*, *supra*.

11 *John C. Hom & Associates, Inc. v. Comm'r*, 140 T.C. 2010 (2013), *appeal docketed*, No. 13-72684 (9th Cir. July 31, 2014).

Congress was very clear that it did not want the IRS to merely give out a national contact number for the Taxpayer Advocate Service. Instead, by requiring the National Taxpayer Advocate to ensure that the phone numbers of the local offices are published, Congress specifically wanted taxpayers to know how to seek assistance from the nearest Local Taxpayer Advocate (LTA) office.¹² The Conference Report gave further clarification by stating that the IRS should publish the right to contact the local office of TAS “on” as opposed to “with” the SNOD.¹³

The IRS Office of Chief Counsel has informally opined that by inserting Notice 1214 into the SNOD envelope, the IRS has complied with the requirements of RRA 98 regarding local contact information. We vigorously disagree with Counsel’s legal reasoning in its opinion. Because of the fundamental disagreement as to what is necessary to satisfy the requirements of RRA 98, Congress should make clear what the IRS is required to do to adequately inform certain taxpayers of their right to seek assistance from the local office of TAS or an LITC.¹⁴

This recommendation does not address the validity of the SNOD for Tax Court jurisdictional purposes. As the Tax Court noted in *Hom*, inclusion of a mere link to a website providing TAS information is enough to give the SNOD validity for purposes of the current language of IRC § 6212. However, we are proposing that Congress revise the language of the statute to make it consistent with the intent of § 1102(b) of RRA 98. Just because a SNOD is valid for Tax Court jurisdictional purposes does not mean that the IRS is in compliance with RRA 98 when it issues a SNOD without adequate language to inform the taxpayer of the right to seek assistance from a local office of TAS.

Finally, the provision of local TAS contact information in this proposed manner furthers the taxpayers’ *right to a fair and just tax system*. The Taxpayer Bill of Rights specifically defines this right by providing that taxpayers have the right to seek assistance from TAS if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels. Therefore, by not clearly providing local address and telephone contact information for TAS on the SNOD as required by RRA 98, the IRS is infringing on the taxpayers’ rights.

Inclusion of LITC Information on the Face of and as an Insert to the SNOD

Certain taxpayers could benefit from seeking assistance from an LITC at the point in the tax controversy when they receive the SNOD. LITCs represent low income individuals and their services are free or low cost for eligible taxpayers. LITCS assist taxpayers in disputes with the IRS, including audits, appeals, collection matters, and federal tax litigation. They can also help taxpayers respond to IRS notices and correct account problems. LITCs also provide education for low income taxpayers and taxpayers who speak English as a second language (ESL) about their taxpayer rights and responsibilities.¹⁵ There are currently 131 LITCs.¹⁶ In 2013, LITCs represented almost 21,000 taxpayers in over 18,000 cases and provided

12 Pub. L. 105-206, § 1102(a), 112 Stat. 701 (1998) (adding IRC § 7803(c)(2)(C)(iii), which requires the National Taxpayer Advocate to ensure that the local telephone number for each local TAS office is published and available to taxpayers in that local area).

13 H.R. REP. No. 105-599, at 215 (1998) (Conf. Rep.).

14 Email from Office of the Special Counsel to the National Taxpayer Advocate to a TAS Senior Attorney Advisor (Nov. 20, 2014).

15 IRC § 7526. LITCs, their employees, and their volunteers are independent from the IRS but receive some of their funding from the IRS through the LITC grant program. Each clinic determines whether prospective clients meet income guidelines and other criteria before agreeing to represent them. See <http://www.taxpayeradvocate.irs.gov/Tax-Professionals/Low-Income-Taxpayer-Clinics>.

16 See IRS Publication 4134, *Low Income Taxpayer Clinic List* (Jan. 2014) (listing 133 clinics, but two subsequently withdrew from the program).

consultation and advice to over 25,000 additional taxpayers.¹⁷ A clinic practitioner could ensure that the taxpayer is aware of the available options at the time the IRS issues the SNOD. Most importantly, the taxpayer can receive assistance in filing a timely petition with the Tax Court, if necessary.¹⁸

The provision of a description of LITCs and a website link to a list of all LITCs on the face of those SNODs likely to impact low income taxpayers will ensure that these taxpayers have sufficient information if they choose to seek the assistance of an LITC.¹⁹ For those SNODs that by definition impact this taxpayer population—for example, those proposing to assess the EITC, it is important to also include the contact information as an insert. The provision of the LITC information in the proposed manner also furthers the taxpayers’ *right to retain representation*. The Taxpayer Bill of Rights specifically defines this right by including the following language: “Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford representation.”²⁰

EXPLANATION OF RECOMMENDATION

To ensure that the IRS adequately informs taxpayers of their right to contact the local office of the Taxpayer Advocate Service, the National Taxpayer Advocate recommends that Congress include language in IRC § 6212 explicitly directing the IRS to place the address and phone number of the TAS office closest to the taxpayer’s address in a prominent manner on the face of the SNOD. The revision of the provision would first provide that the IRS must place on the face of the SNOD language informing the taxpayer about the right to contact the local office of TAS. The revision would also direct the IRS to place on the face of the SNOD the address and phone number for the TAS office aligned with the zip code of the taxpayer’s last known address.

In addition, Congress should revise IRC § 6212 to require the IRS to include on the face of those SNODs determined to have a chance of impacting low income taxpayers language describing LITCs and provide a website link for the contact information.²¹ The IRS would select the SNODs most likely to impact low income taxpayers in consultation with the National Taxpayer Advocate. For example, SNODs for tax deficiencies related to the EITC, Premium Tax Credit (PTC), Automated Underreporter (AUR), and Automated Substitute for Return (ASFR) are likely to impact low income taxpayers.

For those SNODs that include deficiencies that, by definition, will impact low income taxpayers, the IRS should also include in the SNOD envelope an insert with information describing the services provided by LITCs as well as the addresses and phone numbers of such clinics. The IRS shall determine those SNODs certain to impact low income taxpayers in consultation with the National Taxpayer Advocate. For example, SNODs with deficiencies for EITC and PTC should include such inserts because the income and subject matter of these deficiencies indicate that the taxpayers may be eligible for LITC assistance.

17 In 2013, the LITCs represented 20,972 taxpayers in 18,144 cases and provided consultation and advice to 25,179 additional taxpayers. TAS LITC Program Office (Dec. 5, 2014); for more data which illustrates how LITCs help low income taxpayers, see IRS Publication 5066, *Low Income Taxpayer Clinics Program Report 3*, 9, 12 (Dec. 2014).

18 IRC § 7526.

19 We are not suggesting that the IRS include a specific LITC located in the taxpayer’s geographic area on the face of the SNOD because the IRS is precluded from doing so. See National Taxpayer Advocate 2007 Annual Report to Congress 551-53 (Additional Legislative Recommendation: *Referral to Low Income Taxpayer Clinics*).

20 For more information on the Taxpayer Bill of Rights, see <http://www.taxpayeradvocate.irs.gov/about-tas/taxpayer-rights#rights>.

21 For example, the IRS could provide a link to the LITC page on <http://www.irs.gov/advocate> or a link to IRS Publication 4134, *Low Income Taxpayer Clinic List*.

IRS Pub. 4134, *Low Income Taxpayer Clinic List*, is a four-page document providing:

- A brief description of the services provided by LITCs and taxpayer eligibility to receive such services;
- Clinic locations by geographic area;
- Phone numbers;
- The type of clinic; and
- The languages served at each clinic.

The list of clinics is updated annually. IRS could use the periodically updated version of Publication 4134 as an insert to the SNOD. Because Publication 4134 is a specific purpose publication, it is less likely to be thrown out than a general use document, especially if targeted to the appropriate population.²² Note that Publication 4134 is not included in the envelope with all SNODs. We are mindful of the IRS interest in minimizing postage costs.²³ However, informing the targeted population of their rights is money appropriately spent.

22 Treasury's Go Direct campaign, which began in 2005, found that inserts can be effective if they include a clear message and strong visual graphic tailored specifically to each target audience. Information Provided by Weber Shandwick to TAS (Oct. 10, 2014).

23 The IRS Printing and Postage Budget Reduction Implementation Team proposed the elimination of all non-mandatory inserts in all correspondences. IRS Media & Publications, *PPBR Proposals Approved for Implementation* (Sept. 2010).

LR
#19**LATE-FILED RETURNS: Clarify the Bankruptcy Law Relating to Obtaining a Discharge****PROBLEM**

Taxpayers who face financial hardship and seek a bankruptcy discharge of their tax liabilities face uncertainty as to whether they will be able to obtain a discharge of these liabilities if they do not file their tax returns timely. This lack of clarity is due to conflicting judicial interpretations of a provision of § 523(a) of the Bankruptcy Code, which sets forth exceptions to the bankruptcy discharge in certain cases.¹ Section 523(a)(1)(B)(i) creates an exception for a tax debt for which the debtor had not filed returns, and § 523(a)(1)(B)(ii) creates an exception for a tax debt for which the debtor had filed the return after the due date and within two years of the bankruptcy case. At least before 2005, a tax would be dischargeable when the debtor filed the return late more than two years before the bankruptcy case was filed. As part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA),² Congress amended § 523(a) and added a paragraph at the end of this section, sometimes referred to as the “Hanging Paragraph.” This addition provides “the term ‘return’ means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements).”³

Some courts, including two circuit courts of appeals, have taken the approach that the language defining a return as one that satisfies “applicable filing requirements” means that unless a return is filed by the appropriate due date, the tax liability is not eligible for discharge.⁴ This means an individual taxpayer who files a tax return late—even one day late—could never discharge the tax in bankruptcy. This rule can apply even where the IRS has determined the late filing was due to reasonable cause or a natural disaster, or because the taxpayer was in combat status. Other courts do not interpret the “applicable filing requirements” language as requiring a timely filed return.

Although the IRS currently takes the position that an untimely filed return does not bar a bankruptcy discharge, this stance can change at any time.⁵ Also, despite the IRS’s current position, given the split in legal interpretation, it is possible that some courts could ignore the IRS position. In addition, the uncertainty in the bankruptcy law may have an adverse impact on taxpayers with state tax liabilities. As a result, otherwise compliant taxpayers who file late returns may not be able to obtain the fresh start intended by the Bankruptcy Code, or achieve finality in resolving their tax liabilities at the time of the discharge. This may undermine the taxpayers’ *right to a fair and just tax system* and *right to finality*.

1 The Bankruptcy Code is contained in Title 11 of the United States Code. 11 U.S.C. § 523(a)(1)(B) and (C) sets forth exceptions to a bankruptcy discharge for certain tax debts when the debtor is an individual. See 11 U.S.C. §§ 727(b), 1141(d)(2), and 1328(a)(2). Unless otherwise noted, all code references are to provisions in the Bankruptcy Code contained in Title 11 of the United States Code.

2 Pub. L. No. 109-8, § 714, 119 Stat. 23, 128 (2005).

3 The Hanging Paragraph also provides that the term return includes a return prepared pursuant to Internal Revenue Code (IRC) § 6020(a) or similar state or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to IRC § 6020(b) or a similar state or local law. These two IRC provisions will be discussed below.

4 See, e.g., *In re McCoy*, 666 F.3d 924 (5th Cir. 2012), cert. denied, 133 S. Ct. 192 (2012); *In re Mallo*, 2014 WL 7360130 (10th Cir. Dec. 29, 2014), aff’g 498 B.R. 268 (D. Colo. 2013); *In re Creekmore*, 401 B.R. 748 (Bankr. N.D. Miss. 2008). See also *In re Payne*, 431 F.3d 1055, 1060 (7th Cir. 2005) (Judge Easterbrook dissenting) (after the BAPCPA, tax liability on a late-filed return is nondischargeable).

5 Chief Counsel Notice 2010-16, 2010 WL 3617597 and Chief Counsel Advisory 201044008 (Nov. 5, 2010), 2010 WL 4384171.

EXAMPLE

Due to a severe medical condition, a taxpayer with an excellent compliance history files her federal and state tax returns one day after their deadlines. Because of her financial circumstances, she cannot meet her tax obligations timely. Over the next several years, her condition worsens and due to financial hardship, she files a bankruptcy petition seeking a discharge of her tax and other liabilities. Because she filed returns one day late, the taxpayer cannot be certain if her tax liabilities will be discharged, thereby undermining her fresh start.

RECOMMENDATION

To address conflicting judicial interpretations as to whether the “applicable filing requirements” language in § 523(a) of the Bankruptcy Code imposes a timely filing requirement, the National Taxpayer Advocate recommends that Congress clarify this language to provide that a late-filed tax return may be considered a return for purposes of obtaining a bankruptcy discharge.⁶

PRESENT LAW

Section 523(a) of the Bankruptcy Code contains many exceptions to the discharge of an individual’s liabilities in bankruptcy.⁷ Section 523(a)(1) lists three exceptions to the discharge of tax liabilities:

- An exception to discharge based on the type of tax, date of tax assessment, and the age of the tax debt;⁸
- An exception to discharge in cases where a taxpayer did not file a return⁹ or filed a late return within two years of filing a bankruptcy petition;¹⁰ and
- An exception to discharge in the case where a bankruptcy debtor made a fraudulent or willful attempt to evade or defeat taxes for which a discharge is being sought.¹¹

In 2005, Congress enacted the BAPCPA, adding an unnumbered “Hanging Paragraph”¹² to the end of § 523. It reads:

For purposes of this subsection, the term ‘return’ means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law.

The Hanging Paragraph, which defines what constitutes a return for purposes of a bankruptcy discharge, has caused confusion for the courts. Several courts of appeal dealt with the issue before Congress

6 The American Bar Association Section of Taxation proposed to Congress a substantially similar amendment to § 523(a) in a submission dated July 29, 2014.

7 Section 523(a) references the discharge provisions contained in 11 U.S.C. §§ 727, 1141, 1228(a), 1228(b), and 1328(b). 11 U.S.C. § 1328(a)(2) also references section 523(a)(1)(B).

8 See 11 U.S.C. § 523(a)(1)(A) (referencing 11 U.S.C. §§ 507(a)(3) and 507(a)(8)).

9 See 11 U.S.C. § 523(a)(1)(B)(i).

10 See 11 U.S.C. § 523(a)(1)(B)(ii).

11 See 11 U.S.C. § 523(a)(1)(C).

12 The term comes from the fact this paragraph is unnumbered and stands alone at the end of § 523(a). See *In re McCoy*, 666 F.3d 924, 926 n.3 (5th Cir. 2012), *cert. denied*, 133 S. Ct. 192 (2012).

added the paragraph.¹³ However, with the change in law in 2005, courts had to interpret the Hanging Paragraph’s definition of the term “return” for bankruptcy law purposes—namely that, to be considered a return, the tax filing must satisfy the requirements of applicable nonbankruptcy law—including applicable filing requirements. If a taxpayer files a document that does not qualify as a return under the Hanging Paragraph, it will be considered a non-filed return under § 523(a)(1)(B)(i), and any tax reported will be excepted from discharge.

Some courts have interpreted the phrase “applicable filing requirements” in the Hanging Paragraph to impose a rule requiring the taxpayer to have met the filing due date. This would apply even where the IRS had found reasonable cause for the failure to file a return and thus did not impose a late filing penalty on the taxpayer.¹⁴ Therefore, under a strict reading of this provision, a taxpayer who files even one day late will be denied a discharge for taxes due on the return. This rule can be referred to as the “One-Day-Late Rule.”

For example, in *In re Creekmore*,¹⁵ a bankruptcy court held that any late-filed return can never qualify as a return for the purpose of obtaining a bankruptcy discharge,¹⁶ unless it was prepared pursuant to IRC § 6020(a). Under IRC § 6020(a), if a taxpayer fails to file a return, the IRS may prepare a return with information disclosed by the taxpayer and signed by the taxpayer. This is a cooperative process between the taxpayer and the IRS.¹⁷ The *Creekmore* court noted that this reading of the Hanging Paragraph led to a harsh outcome for the taxpayer, but stated that taxpayers could avoid this problem by taking advantage of the “safe-harbor” found in IRC § 6020(a).

The only court of appeals opinion that deals with the Hanging Paragraph after the 2005 change in law is the Fifth Circuit Court of Appeals in *In re McCoy*.¹⁸ *McCoy* dealt with the issue of dischargeability of state tax liabilities. The *McCoy* court held that the first sentence of the Hanging Paragraph provided a “clear definition of ‘return’ for both state and federal taxes.”¹⁹ Therefore, in the view of the Fifth Circuit, the “applicable filing requirements” language in the Hanging Paragraph requires a return be timely filed and a tax liability on a late-filed return, even one day late, cannot be discharged in bankruptcy. Similar to the court in *Creekmore*, the *McCoy* court concluded the only way a taxpayer could avoid this harsh result

13 The most significant (non-bankruptcy) case dealing with what constitutes a return is *Beard v. Comm’r*, 82 T.C. 766 (1984), *aff’d per curiam*, 793 F.2d 139 (6th Cir. 1986). This case set forth a four-part test to determine whether an income tax filing document qualifies as a return. A document is a return under the test if: 1) it contains sufficient data to calculate the tax liability; 2) it purports to be a return; 3) it represents an honest and reasonable attempt to satisfy the requirements of the tax law; and 4) it is executed under penalties of perjury. Five circuit courts of appeal applied the *Beard* test in the bankruptcy context to determine whether the debtor filed a return for discharge purposes. Four of these cases were decided in favor of the IRS. See *In re Hindenlang*, 164 F.3d 1029 (6th Cir. 1999), *cert. denied*, 528 U.S. 810 (1999); *In re Hatton*, 220 F.3d 1057 (9th Cir. 2000); *In re Moroney*, 352 F.3d 902 (4th Cir. 2003); *In re Payne*, 431 F.3d 1055 (7th Cir. 2005). A fifth case, *In re Colsen*, 446 F.3d 836 (8th Cir. 2006), resulted in a victory for the taxpayer.

14 See Treas. Reg. § 301.6651-1(c); IRM 20.1.1.3.2 (Nov. 25, 2011).

15 401 B.R. 748 (Bankr. N.D. Miss. 2008).

16 The *Creekmore* court agreed with Judge Easterbrook’s dissent in *In re Payne*, 431 F.3d 1055 (7th Cir. 2005). In *Payne*, a case prior to the change in law, Judge Easterbrook noted that after the change in law, a tax due on a late-filed return is not dischargeable.

17 This is in contrast to IRC § 6020(b), which allows the IRS to prepare a return for a taxpayer who does not file one. This is sometimes referred to as a substitute for return (SFR) and does not involve taxpayer cooperation with the IRS. Under the Hanging Paragraph, a return prepared by the IRS pursuant to IRC § 6020(a) is considered a return for purposes of obtaining a bankruptcy discharge while one prepared pursuant to § 6020(b) is not.

18 666 F.3d 924 (5th Cir. 2012), *cert. denied*, 133 S. Ct. 192 (2012). In a significant recent development, the Tenth Circuit Court of Appeals agreed with the Fifth Circuit’s *McCoy* decision and held that tax debts on late-filed federal returns are not dischargeable in bankruptcy. See *In re Mallo*, 2014 WL 7360130 (10th Cir. Dec. 29, 2014), *aff’g* 498 B.R. 268 (D. Colo. 2013).

19 *In re McCoy*, 666 F.3d at 930.

was to take advantage of a provision similar to that contained in IRC § 6020(a).²⁰ Thus, under both *Creekmore* and *McCoy*, the One-Day-Late Rule precludes a bankruptcy discharge for tax liabilities on late-filed returns.

Other courts have taken a different approach to interpreting the “applicable filing requirements” language. In determining the definition of a “return” for bankruptcy purposes, these courts look to the substance of what is filed rather than when it is filed.²¹ Therefore, a late-filed return could qualify as a return for purposes of obtaining a bankruptcy discharge.

A significant amount of case law emerged subsequent to the 2005 enactment of the new bankruptcy law that added the Hanging Paragraph. However, the legislative history accompanying the law does not explain or shed light on the congressional intent behind the “applicable filing requirements” language and whether it requires timely filing for a taxpayer to obtain a bankruptcy discharge of tax liabilities.

In 2010, the IRS Office of Chief Counsel issued a Notice regarding its litigating position on the bankruptcy dischargeability of tax liabilities reported on late-filed returns.²² The Notice first discusses the case law before and after the addition of the Hanging Paragraph, then covers the court’s rationale in the *Creekmore* holding²³ and takes issue with reading a timely filing requirement into the “applicable filing requirements” language in the first sentence of the paragraph. Such a reading would make redundant the second sentence, providing that an IRC § 6020(b) return is not considered a return because this type of return (often referred to by the IRS as a substitute for return) is always prepared after the due date.

In addition, the Notice is critical of the *Creekmore* holding that timely filing of a return is required for a bankruptcy discharge because such a reading would essentially narrow the application of § 523(a)(1)(B)(ii), which excepts from discharge late-filed returns filed within two years of the bankruptcy petition filing (*i.e.*, allowing returns filed outside a two-year timeframe to be dischargeable), to the small number of returns prepared by the IRS under IRC § 6020(a).²⁴ Finally, the Notice points out that the *Creekmore* court’s “safe harbor” option under IRC § 6020(a) is “illusory,” as taxpayers do not have a right to demand that the IRS prepare a return for them under this provision and the IRS only does so in a “minute number of cases.”²⁵ The Notice therefore concludes that “section 523(a) in its totality does not create the rule that every late filed return is not a return for dischargeability purposes.”

20 Because *McCoy* dealt with the dischargeability of state tax liabilities, there was no possibility of a safe harbor under IRC § 6020(a). In the court’s view, the taxpayer needed a state law safe harbor provision similar to IRC § 6020 to be able to take advantage of a safe harbor.

21 See, e.g., *In re Gonzalez*, 506 B.R. 317 (1st Cir. B.A.P. 2014); *In re Martin*, 500 B.R. 1 (D. Colo. 2013); *In re Rhodes*, 498 B.R. 357 (Bankr. N.D. Ga. 2013).

22 Chief Counsel Notice 2010-16.

23 The Notice was issued prior to the *McCoy* decision and therefore does not discuss it. However, the Notice is discussed in the *McCoy* opinion.

24 See *In re Martin*, 482 B.R. 635, 639 (Bankr. D. Colo. 2012), *rev’d*, 500 B.R. 1 (D. Colo. 2013).

25 State-law provisions similar to IRC § 6020(a) are probably rare as well. This would call into question the “safe harbor” option recommended by the *McCoy* court.

REASONS FOR CHANGE

Courts have reached conflicting conclusions as to whether the “applicable filing requirements” language in the Hanging Paragraph imposes a timely tax return filing requirement in order for individual taxpayers to obtain a bankruptcy discharge. Some courts interpret this language to impose a strict One-Day-Late Rule, preventing taxpayers who file a return even a day past the deadline, or who have reasonable cause for late filing, from obtaining a bankruptcy discharge for liabilities reported on the return.²⁶ Courts, such as *Creekmore* and *McCoy*, have insisted that the only way liabilities on a late-filed return can be discharged is if the return is prepared under IRC § 6020(a) or a similar provision under state or local law. However, as noted in the IRS Chief Counsel Notice, this “safe harbor” does not really exist as taxpayers have no right to demand that the IRS prepare a return for them under this provision and the IRS only rarely does so.²⁷ This narrow and strict interpretation of 11 U.S.C. § 523(a) may result in harsh outcomes that undermine the “fresh start” rationale behind bankruptcy discharge.²⁸ However, other courts (and the IRS Office of Chief Counsel) have taken the opposite approach—the “applicable filing requirements” language in the Hanging Paragraph does not require timely filing of a tax return to obtain a discharge.²⁹

Forever barring the discharge of tax debts merely because the debtor files a return one date late seems unfair when considering how taxpayers who file late are treated under federal tax law. As noted earlier, while late filers can be subject to penalties, the penalties can be abated. In jurisdictions where tax debts cannot be discharged merely because the return was filed late, the consequences can be more financially severe. In other words, late-filing taxpayers may be punished more severely under bankruptcy law than under tax law.

Similarly, the One-Day-Late rule can have serious repercussions for previously compliant taxpayers who experience financial distress. In the example above, a taxpayer who otherwise meets the bankruptcy law requirements for discharge may not discharge a tax debt because she filed a return one day late.³⁰ This will hinder her from emerging from her financial predicament and undermine her fresh start.³¹ In addition, under certain circumstances, individuals (such as those in disaster areas or military combat zones) may be

26 See, e.g., *In re McCoy*, 666 F.3d 924 (5th Cir. 2012), cert. denied, 133 S. Ct. 192 (2012); *In re Creekmore*, 401 B.R. 748 (Bankr. N.D. Miss. 2008). See also *In re Payne* 431 F.3d 1055, 1060 (7th Cir. 2005) (Judge Easterbrook dissenting) (after the BAPCPA, tax liability on a late-filed return is nondischargeable).

27 While there are regulations under IRC § 6020, they focus on IRC § 6020(b) (including several examples) and only make brief mention of IRC § 6020(a). See Treas. Reg. § 301.6020-1. Similarly, the IRM only makes passing mention of IRC § 6020(a). See, e.g., IRM 4.12.1.8.2 (Oct. 05, 2010). However, there are more frequent and detailed IRM references and descriptions as to the preparation of returns under IRC § 6020(b). See, e.g., IRM 5.1.11.6.7.2 (Apr. 23, 2014).

28 See *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (noting that the bankruptcy law “gives to the honest but unfortunate debtor...a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.”).

29 See, e.g., *In re Gonzalez*, 506 B.R. 317 (1st Cir. B.A.P. 2014) (noting that the definition of return in the Hanging Paragraph appears to be focus on what is filed rather than when it is filed); *In re Martin*, 482 B.R. 635 (Bankr. D. Colo. 2012), rev'd, 500 B.R. 1 (D. Colo. 2013) (both the bankruptcy court and the district court rejected the timeliness requirement; they disagreed as to whether the taxpayer had made an honest and reasonable attempt to comply with the tax law).

30 Because the IRS does not agree with the One-Day-Late Rule, this issue is limited at present to jurisdictions that follow the Fifth Circuit’s holding in *McCoy*. However, it is possible that the IRS will change its litigation position in the future. In a significant recent development, the Tenth Circuit Court of Appeals agreed with the Fifth Circuit’s *McCoy* decision and held that tax debts on late-filed federal returns are not dischargeable in bankruptcy. See *In re Mallo*, 2014 WL 7360130 (10th Cir. Dec. 29, 2014), aff’g 498 B.R. 268 (D. Colo. 2013).

31 As a result, the taxpayer may have to request a currently-not-collectible (CNC) status from the IRS and deal with IRS collection function for an extended period of time, resulting in taxpayer frustration and the use of limited IRS resources to provide relief to a financially distressed taxpayer. See IRM 5.16.1 (Aug. 25, 2014).

permitted to file their returns late with no penalty.³² However, these returns are still officially late and the taxpayers may not be able to obtain a bankruptcy discharge of tax liabilities in the future.

EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate recommends that Congress clarify the meaning of the Hanging Paragraph language in § 523(a) of the Bankruptcy Code to provide that a late-filed tax return may be considered a return for bankruptcy discharge purposes. This would clear up judicial confusion over the 2005 law and indicate whether the “applicable filing requirements” language in the first sentence of the Hanging Paragraph imposes a timely filing requirement. It would also eliminate disparate treatment of taxpayers under the Bankruptcy Code.

32 See IRC §§ 7508, 7508A; Rev. Rul. 2007-59, 2007-2 C.B. 582 (providing that special late filing rules for those in military combat zones or disaster areas do not change the filing due date and only waive penalties).