National Taxpayer Advocate

Annual Report to Congress

2010 Annual Report to Congress

NATIONAL TAXPAYER ADVOCATE

2010 ANNUAL REPORT TO CONGRESS

Volume One

TAXPAYER ADVOCATE SERVICE

YOUR VOICE AT THE IRS

December 31, 2010

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Dedication

This report is dedicated

to

the hardy souls

who have worked actively over the years

for tax reform and tax simplification,

and to the busy majority of U.S. taxpayers

who are cheering for them to succeed.

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Preface

Honorable Members of Congress:

I respectfully submit for your consideration the National Taxpayer Advocate's 2010 Annual Report to Congress. Section 7803(c)(2)(B)(ii) of the Internal Revenue Code requires the National Taxpayer Advocate to submit this report each year and in it, among other things, to identify at least 20 of the most serious problems encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems.

This is my tenth Annual Report to Congress, so it seems a natural time for reflection. What has the report accomplished these last ten years? Perhaps the report's greatest contribution is to make transparent the operations of federal tax administration in the United States. We have tried to fulfill what Congress intended – an uncensored, nonpartisan perspective on the current challenges in tax administration, whether these challenges result from administrative policies and procedures or from legislation. Most notably, the Most Serious Problems section of the Annual Report to Congress discusses in considerable detail not only which problems taxpayers are encountering, but why those problems exist. We also include the IRS's response, so Members of Congress, taxpayers, and practitioners can analyze key challenges from all angles.

Even as we have spotlighted problems in tax administration and challenged the IRS and the Office of Chief Counsel to make more information and guidance available to the public, we in TAS have strived to live up to these high transparency standards ourselves. Each year we list the congressional activity that has taken place with respect to our legislative recommendations, and looking back over the years, the list is quite long.[1] Recently, we began to post on our website the IRS's formal responses to our annual recommendations on Most Serious Problems, and we attempt to track what has been accomplished.[2] We are developing procedures to post information about our year-round advocacy projects as well, so taxpayers and policymakers can see what is underway and what has been accomplished, including improvement projects undertaken jointly by the IRS and the Taxpayer Advocate Service.

The point of all this transparency is not for policymakers and commentators inside and outside the IRS to agree with us (although of course we love it when they do). Rather, we are often raising emerging issues or advocating for approaches that the IRS has not explored. Thus, the point is to begin a dialogue about what is the right answer in a given situation, and to ensure that everyone taking part in that dialogue has sufficient information with which to make up his or her own mind about the desired outcome or approach. There have certainly been times in my tenure as the National Taxpayer Advocate when the IRS has not been permitted to publicly agree with us – even though there may be private agreement – because our position conflicts with one or another Administration's position. Other times, the IRS just won't agree to something because it is content in its established ways and it is just too difficult or unsettling to think outside the box. (I see this most often in collection, as I discuss below.) I can understand the IRS reaction – the pressure to produce immediate revenue collection results may seem to weigh more heavily than the longer term

1 For this year's listing of legislative activity, see the introduction to the section on Legislative Recommendations, *infra*.

2 http://www.irs.gov/advocate/article/0,,id=171153,00.html.

benefits to be derived from carefully designed research studies and the like, but that sort of thinking means the important work required to improve long-term compliance often doesn't get done.

Having said that, when the IRS does decide to do something, and especially when it decides to work with TAS, good things can happen for taxpayers. For example, when we first proposed regulation of return preparers in 2002, the IRS vigorously opposed the concept.[3] It was not until Commissioner Shulman selected this issue to be one of his major initiatives that the IRS was able to work on an issue that for years it had internally recognized was vitally necessary. Once able to address it, the IRS moved swiftly to establish a regulatory approach. And because TAS was involved on a day-to-day basis in the planning and design of the initiative, we were able to ensure that our concerns were addressed and the interests of taxpayers were given priority.

So, what are the challenges that I see for the IRS over the next ten years? First, the overwhelming complexity of the Internal Revenue Code and the tax administration system that complexity has spawned. Second, the successful integration of social program and incentive delivery into the IRS's traditional revenue collection structure. Third, the movement toward greater automation at the expense of human and personal interaction with taxpayers, including the elimination of common sense, good judgment, and discretion in decision-making. Nowhere is this latter challenge seen more clearly than in the IRS's reactive, regimented approach to enforced tax collection that values numbers and checklists over truly assisting taxpayers with their devastating tax debts and helping them become voluntarily compliant taxpayers in the long term. I will briefly discuss these three challenges in reverse order.

Automation should facilitate IRS interaction with taxpayers, not diminish it – particularly in its Examination and Collection practices.

As the leader of over 2,000 employees who daily deal with multiple cases, issues, and tasks, multiple systems, multiple operating divisions and offices, and multiple Internal Revenue Manual (IRM) provisions and other guidance, I am the first to acknowledge that automation in today's IRS can be a sanity-saver and an absolute necessity. But for all the benefits of automation, if we do not carefully monitor how it is used, it can become a barrier instead of an aid to communicating with taxpayers and providing them assistance. For example, as we discuss in our Most Serious Problems, *IRS Policy Implementation Through Systems Programming Lacks Transparency and Precludes Adequate Review* and *The IRS's Over-Reliance on its "Reasonable Cause Assistant" Leads to Inaccurate Penalty Determinations*, automation can substitute for judgment and discretion, to the taxpayer's detriment. Moreover, because policies programmed into decision-tree tools are not subjected to the same rigorous internal clearance process as are policies established in the IRM, these programs can result in decisions and determinations that harm taxpayers and that IRS employees, following the law and their good judgment, would not arrive at. Finally, because the IRS does not have an adequate cadre of employees who are trained and knowledgeable in artificial intelligence and other decision sciences, the IRS's automated decision tools all too often are static and not updated often enough or accurately enough to prevent repeated mistakes.

3 *See* National Taxpayer Advocate 2002 Annual Report to Congress 216 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*).

Automated case processing also undermines human contact in the IRS correspondence examination program[4] and in IRS collection activities such as lien determinations.[5] As we have reported for years, over 75 percent of individual audits are conducted as correspondence examinations[6] – which means that unless a taxpayer mails documentation timely in response to the IRS's cryptic audit letters, the audit will just plow along on autopilot without any human being looking at the case or attempting to place an outbound phone call to the taxpayer, until the Statutory Notice of Deficiency is issued (automatically) proposing an assessment of tax. All too often the taxpayer has sent in information that the IRS has not associated with the taxpayer's case in time to stop the issuance of the (automated) Notice of Deficiency.

Ironically, as we cover in detail in our Most Serious Problems discussing undelivered mail[7] and the IRS's untimely handling of incoming taxpayer mail,[8] if the IRS were to apply some of the automated search, updating, and tracking tools available to it through the United States Postal Service and other entities, it would do a much better job in delivering important notices to taxpayers where they actually live, thereby increasing the chances that the taxpayer will respond timely. These tools could also free up resources currently dedicated to rework and thus enable the IRS to reach out and call the taxpayer. A little human contact and conversation can work wonders in understanding the taxpayer's financial circumstances.

With respect to collection – we have covered this area of tax administration so much over the last ten years that the footnote containing our writings fills up nearly half a page.[9] Why have we focused so much on collection? Well, because collection is when taxes cease to be abstract and become personal and real for millions of taxpayers. And collection is where, if not handled appropriately, real and lasting harm can be visited upon taxpayers – destroying people's lives and businesses. It is also where the IRS's dedication to taxpayer rights is the most tested.[10]

Collection requires a delicate balancing of the government's interest in collecting revenue and ensuring that all taxpayers pay their fair share of tax, on the one hand, and the legitimate interests of taxpayers with financial difficulties, on the other. Congress articulated this balance in a section of the tax code that directs the IRS, albeit in the context of Collection Due Process hearings, to consider whether any proposed collection action "balances the need for the efficient collection of taxes with

4 *See, e.g.*, Most Serious Problem: *The IRS's Failure to Track and Analyze the Outcomes of Audit Reconsiderations and Inconsistent Guidance Increase Taxpayer Burden and Inflate IRS Audit Results and Cost Effectiveness Measures, infra*.

5 *See* Status Update: *The IRS Has Been Slow to Address the Adverse Impact of its Lien-Filing Policies on Taxpayers and Future Tax Compliance, infra*; Most Serious Problem: *IRS Collection Policies Channel Taxpayers into Installment Agreements They Cannot Afford, infra*; and *Estimating the Impact of Liens on Taxpayer Compliance Behavior: An Ongoing Research Initiative*, vol. 2, *infra*.

6 IRS Databook FY 2009, Table 9a.

7 *See* Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers, infra*.

8 *See* Most Serious Problem: *The IRS Does Not Process Vital Taxpayer Responses Timely, infra.*

9 *See* vol. 2, *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*, note 22, *infra*.

10 We discuss the IRS's inadequate implementation of significant taxpayer rights protections in the following Most Serious Problems: *IRS Collection Policies and Procedures Fail to Adequately Protect Taxpayers Suffering an Economic Hardship, The Failure of the Office of Appeals to Adequately Document Prohibited Ex Parte Communications May Violate Taxpayer Rights and Damage the Public's Perception of its Independence*, and *The IRS's Failure to Provide Timely and Adequate Collection Due Process Hearings May Deprive Taxpayers of an Opportunity to Have Their Cases Fully Considered, infra.*

the legitimate concern of the person that any collection be no more intrusive than necessary."[11] At present, many IRS collection practices do not require much balancing. For example, IRS lien filing policies focus almost exclusively on tax collection without regard for the legitimate concern of affected persons that collection actions be no more intrusive than necessary.

Since 1999, the IRS has increased annual lien filings from 168,000 to 1,096,000, a rise of 550 percent. Lien filings can badly damage or destroy a taxpayer's creditworthiness because they are picked up by the credit rating agencies and retained on the taxpayers' credit reports for seven years from the date the tax liability is resolved, or longer if it is not resolved.

If lien filings were clearly correlated with substantial increases in revenue collection, one could at least understand the IRS's position. But over the same period that the IRS has increased lien filings by 550 percent, revenue collected by the IRS's Collection function has remained flat. Moreover, in last year's report and in a status update this year, we have described in detail that the IRS has failed to code many payments from taxpayers against whom liens have been filed, making it impossible for the IRS to determine how much revenue its liens bring in.[12] In fact, the IRS must pay filing fees to local county clerks' offices and incurs its own costs, making it questionable whether liens generate much, if any, direct revenue. By damaging taxpayers' creditworthiness, the IRS may even be reducing long-term revenue collection.

Despite the IRS's periodic announcements of plans to assist financially struggling taxpayers with collection problems, the IRS has refused our repeated requests to moderate its lien filing policies and to conduct in-depth research to determine their effectiveness and their impact on long-term taxpayer compliance. Although the IRS has taken a few steps in that direction during the past year, it has reached no conclusions and has continued the trend toward more lien filings despite the worst economy in at least a generation. The IRS still has no idea whether or to what extent liens contribute to the efficient collection of taxes, and it therefore still does not know whether it is balancing the need for the efficient collection of taxes with the legitimate concern of taxpayers that any collection action be no more intrusive than necessary.

Lien filing is not the only area in collection about which we are concerned. Between FY 2006 and FY 2010, the IRS's inventory of unpaid assessments has grown almost 33 percent;[13] the dollars reported as "currently not collectible" (CNC) increased by 78 percent;[14] the number of taxpayer accounts reported as CNC increased by 73 percent;[15] and the dollar value of Taxpayer Delinquent

11 IRC § 6330(c)(3)(C) (cross referenced by IRC § 6320(c)).

12 *See* Status Update: *The IRS Has Been Slow to Address the Adverse Impact of its Lien-Filing Policies on Taxpayers and Future Tax Compliance, infra*. *See also* National Taxpayer Advocate 2009 Annual Report to Congress 17 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*); and National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2., *The IRS's Use of Notices of Federal Tax Lien (NFTL).*

13 Unpaid assessments were about $270 billion in FY 2006 and $359 billion FY 2010. IRS, *Collection Process Study, Executive Summary* 2 (Sept. 30, 2010). The data for the unpaid assessments at the conclusion of FY 2010 was provided by SB/SE in an e-mail message dated Dec. 14, 2010.

14 CNC dollars were $16.2 billion in FY 2006 and $28.9 billion in FY 2010. IRS, Collection Activity Reports, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Oct. 2010).

15 *Id.*

Accounts (TDAs) assigned to the Collection Queue increased by 70 percent.[16] In FY 2010, the dollars reported as CNC by the collection Field function (CFf) were approximately 320 percent of the combined total of dollars collected on open CFf TDAs and installment agreements generated by the CFf.[17] Yet the IRS's enforcement budget has grown by 20 percent since FY 2006.[18]

Something is clearly wrong with this picture. Sadly, IRS collection practices have not evolved or entered the 21st century. As any near-retirement collection employee will tell you, and as we demonstrate throughout this report, the IRS is still approaching collection with the same one-size-fits-all approach that it used 30 or 40 years ago. Meanwhile, the taxpayer population has changed considerably over those years. Forty years ago, the Earned Income Tax Credit (EITC) did not exist. Today, over 65 million low income taxpayers are part of the tax system, many of them required to file in order to claim the EITC.[19] There are more self-employed taxpayers than ever, many of them in marginal businesses – with the attendant difficulties of paying estimated income and self-employment taxes.[20] For each of these populations, the IRS faces different challenges to bring these taxpayers into ongoing voluntary compliance, ensuring they do not dig themselves into more debt and address the tax arrears. To be a world-class 21st century tax administrator, the IRS must be flexible in its approach to tax debt, and its overriding objective must be to increase long-term voluntary compliance. In our volume 2 discussion, *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*, we set forth a comprehensive analysis of how the IRS could reform its practices in order to achieve this goal.

The IRS should revise its approach to social programs and incentives administered through the Code.

Over the last decade, the Internal Revenue Code has become filled with special incentives and programs that benefit groups of individual and business taxpayers.[21] These provisions are known as "tax expenditures."[22] They can take many forms, including deductions, credits, or preferential

16 The dollar value of TDAs assigned to CFf was about $46.2 billion at the end of FY 2010. IRS, Collection Activity Reports NO-5000-2, *Taxpayer Delinquent Account Reports* (Oct. 2010). The Collection Queue is an inventory of TDA accounts that are active, but unassigned to the ACS or CFf functions. *See* IRM 5.1.20.2 (May 27, 2008).

17 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Oct. 2010); IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Cumulative Report* (Oct. 2010).

18 U.S. Department of the Treasury, *Budget in Brief, Internal Revenue Service, available at* www.treasury.gov/about/budget-performance/budget-in-brief/Documents/IRS. The IRS's appropriations for "Enforcement – Exam and Collections" for FY 2006 and FY 2010 were approximately $3.9 billion and $4.7 billion respectively.

19 IRS Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2009). For this purpose, we consider "low income" to mean adjusted gross incomes that do not exceed 250 percent of the Federal Poverty Level. See IRC § 7526(b)(1)(B)(i). Family sizes were computed using the total number of exemptions reported on taxpayer returns.

20 The number of small businesses with one to four employees has increased by 16 percent since 1993, from 2.3 million to 2.7 million. *See* U.S. Department of Labor, Bureau of Labor Statistics, Business Employment Dynamics data, Table G, *available at* http://www.bls.gov/bdm/table_g.txt.

21 The Congressional Budget Office (CBO) has estimated that refundable credits will increase by approximately $500 billion over the next ten years. Doug Elmendorf, CBO, *Federal Budget Challenges* (Apr. 20, 2009), *available at* http://www.cbo.gov/ftpdocs/100xx/doc10093/04-20-Harvard.pdf (last visited Aug. 23, 2010). From 1974 to 2004, tax expenditures more than doubled in number from 67 to 146 and tripled in size from $243 to $728 billion. Government Accountability Office, GAO-05-690, *Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Examined* 21-31 (Sept. 2005). Currently, there are over 170 tax expenditures worth approximately $1.1 trillion. *See* Ofc. of Mgmt. & Budget, *Budget of the United States Government* FY 2011, Analytical Perspectives, Ch. 16 (Tax Expenditures), Table 16-1 at 209-13. Approximately one quarter of government spending consists of tax expenditures. *See* Thomas L. Hungerford, *Tax Expenditures and the Federal Budget*, at 17, Cong. Res. Serv., RL34622 (Aug. 19, 2008).

22 For a detailed discussion of tax expenditures, see *Evaluate the Administration of Tax Expenditures*, vol. 2, *infra*.

tax rates. While some are easy for the IRS to administer – they are simply a matter of using information reported on the tax return and checking it against third party information reporting – others require information to which the IRS does not have access, thereby requiring it to do extensive and intrusive auditing in order to ensure compliance. Some of these provisions are designed to assist low income populations, which present socio-economic, education, mobility, and functional and language literacy challenges. When the tax administrator is tasked with delivering benefits to this population – and charged with ensuring compliance with the eligibility rules and guarding against fraud – the IRS's traditional revenue collection approach just doesn't work. Something different is needed – an approach that recognizes that the IRS no longer is just a revenue collection agency but is also a benefits administrator.

As we discuss in our Most Serious Problem on the IRS mission statement, this dual mission is not an abstract concept.[23] Recognition that the IRS delivers significant social benefits to diverse populations (including small businesses and low income taxpayers) means that the IRS must hire employees that have program area expertise and the skillset to deal with benefits delivery rather than tax enforcement. Making the IRS's dual mission explicit in its mission statement would also make clearer that the IRS must be properly funded to accomplish both of these tasks well; it cannot do them both by simply robbing tax enforcement to pay for new incentive programs. The urgency for this recognition is nowhere more apparent than in the challenge the IRS faces in successfully fulfilling its role in health care reform, which we describe in Volume 2, *The Patient Protection and Affordable Care Act: A Preliminary Analysis of the Challenges Facing the IRS in Implementing Health Care Reform.* The IRS can do this, but it will need a different type of employee to deliver this program – one with a social service background, not just more revenue agents or revenue officers – and it will require sufficient resources.

The time for tax reform and tax simplification is now.

What is left to be said about tax reform and simplification? We all know we need it. I will not outline here the stunning statistics about the hours and costs required of each taxpayer to deal with his or her taxes, nor will I discuss the major industry of return preparation that has grown up around this complex tax code. Our number one most serious problem and number one legislative recommendation go into the data in detail and provide a good sense of what tax complexity does to each and every one of our lives.[24] It is not good.

But if we all agree that tax reform is necessary, why hasn't it happened? Well, our answer to this question is that we are all unwilling to acknowledge the strong vested interests each of us has in the current structure. Tax complexity doesn't occur just because of "big money" special interests. It occurs because of the tax provisions that benefit each one of us. *We* are the special interests. And until we acknowledge that, tax reform discussions will deteriorate into shouting matches and finger pointing about cutting "their" special tax breaks and not "ours."

23 *See* Most Serious Problem: *The IRS Mission Statement Does Not Reflect the Agency's Increasing Responsibilities for Administering Social Benefits Programs, infra.*

24 *See* Most Serious Problem: *The Time for Tax Reform is Now, infra;* and Legislative Recommendation: *Enact Tax Reform Now, infra*.

The road to true tax reform requires each and every one to be willing to stop protecting our own tax breaks long enough to begin a dialogue about what we want our system to look like, so we remain a vibrant nation with a tax system that is transparent to its taxpayers – one that is simpler to understand and to comply with. If we want to run business incentives or social programs through that system, then we need to have a way to evaluate those programs so we can describe to the taxpayers what is being done and how effective those programs are. In short, as we discuss in our number one Most Serious Problem and the Volume 2 piece on tax expenditures, tax reform requires great discipline and transparency about this type of spending through the code, or else we risk losing faith with our taxpayers.

As part of this dialogue about tax reform, we must remember why we have taxes in the first place: The federal government raises funds to provide protection and services to its citizens and residents primarily through taxes. We can all have different visions about the types and scope of government protection and services we want. But the fact is, without taxes, the government can do nothing for its citizens.

So let us start this dialogue with the recognition that some level of taxation is necessary. As we continue that dialogue by discussing the structure of the tax system, let us also discuss the current tax system. By identifying aspects of the current system that cause complexity or excessive frustration, we can better design the new one.

To help this dialogue along, we are doing something unique, as near as we can tell, in tax administration. The Taxpayer Advocate Service is establishing a vehicle to receive taxpayers' suggestions about tax reform. Taxpayers will be able to access this site at http://www.taxpayeradvocate.irs.gov through our newly designed Internet site dedicated to taxpayer rights and education. We ask that taxpayers approach this with the frame of mind that everything – even the tax breaks that benefit them or their businesses personally – should be on the table. What would they be willing to give up if they knew that others are giving up their breaks and the end result would be a much simpler system – one in which the average taxpayer might be able to prepare his or her own tax return? What particular provisions of the existing tax system are especially burdensome or seem particularly unfair? So, let us know. We promise to track these suggestions and post them, periodically, thereby helping to further the cause of tax reform and tax simplification.

Respectfully submitted,

Nina E. Olson
National Taxpayer Advocate
31 December 2010

National Taxpayer Advocate 2010 Annual Report to Congress

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Volume Two: TAS Research and Related Studies

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Introduction: The Most Serious Problems Encountered by Taxpayers

Internal Revenue Code (IRC) § 7803(c)(2)(b)(ii)(III) requires the National Taxpayer Advocate to prepare an Annual Report to Congress which contains a summary of at least 20 of the most serious problems encountered by taxpayers each year. For 2010, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS in resolving 21 such problems. This year's report also includes status updates on four issues addressed in previous Annual Reports, including the adverse impact of IRS lien filing policies, which was covered in depth in the 2009 report.[1]

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

To simply report on the top 20 problems would pose many difficulties. First, in doing so, it would require us to repeat much of the same data and propose many of the same solutions year to year. Thus, the statute allows the National Taxpayer Advocate to be flexible in selecting both the subject matter and the number of topics to be discussed, and to use the report to put forth actionable and specific solutions instead of mere criticism and complaints.

Methodology of the Most Serious Problem List

The National Taxpayer Advocate considers a number of factors in identifying, evaluating, and ranking the most serious problems encountered by taxpayers. The 21 issues and the four status updates in this section of the Annual Report were ranked according to the following criteria:

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

1 National Taxpayer Advocate 2009 Annual Report to Congress 17 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*); *see also* National Taxpayer Advocate 2009 Annual Report to Congress 357 (Legislative Recommendation: *Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens*); and National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1, *The IRS's Use of Notices of Federal Tax Lien*.

After reviewing this ranking, the National Taxpayer Advocate identifies five issues which are, in her judgment, after taking into consideration all of the above factors, the ones most in need of attention and thus requiring the most prominent placement in the ranking. Finally, the National Taxpayer Advocate and the Office of Systemic Advocacy examine the results of the ranking on the remaining issues and adjust it where editorial or numeric considerations warrant a particular placement or grouping. This year, ten problems that affect taxpayer rights are grouped together, while six others discuss tax administration issues.

Taxpayer Advocate Management Information System List

The identification of the most serious problems reflects not only the mandates of Congress and the IRC, but Taxpayer Advocate Service's (TAS) integrated approach to advocacy – using individual cases as a means for detecting trends and identifying systemic problems in IRS policy and procedures or the Code. TAS tracks individual taxpayer cases on TAMIS. The top 25 case issues, which are listed in Appendix 1, reflect TAMIS receipts based on taxpayer contacts in fiscal year 2010, a period spanning October 1, 2009, through September 30, 2010.

IRS Responses

TAS provides the IRS's respective operating divisions and functional units with the opportunity to comment on and respond to the problems described in each year's report. For each most serious problem, these responses appear unedited (with the exception of correcting typographical or clerical errors), under the heading "IRS Comments," followed by the National Taxpayer Advocate's own comments and recommendations.

Use of Examples

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

MSP #1

The Time for Tax Reform is Now

DEFINITION OF PROBLEM

The most serious problem facing taxpayers – and the IRS – is the complexity of the Internal Revenue Code.

ANALYSIS OF PROBLEM

The National Taxpayer Advocate on numerous occasions has identified the complexity of the tax code as the most serious problem facing taxpayers and urged Congress to simplify it. In this section, we discuss the sources and impact of code complexity and the practical obstacles to simplification. In an accompanying legislative recommendation later in this report, we outline principles and proposals that we encourage Congress to consider as it explores tax reform options.

A. Why is Tax Reform Needed?

1. The Current Tax Code Imposes Huge Compliance Burdens on Individual Taxpayers and Businesses.

Consider the following:

- According to a TAS analysis of IRS data, U.S. taxpayers and businesses spend about 6.1 billion hours a year complying with the filing requirements of the Internal Revenue Code.[1] And that figure does not include the millions of additional hours that taxpayers must spend when they are required to respond to IRS notices or audits. (For a breakdown of hours by tax form and information reporting document, see Table 1.1.1 at the end of this discussion.)
- If tax compliance were an industry, it would be one of the largest in the United States. To consume 6.1 billion hours, the "tax industry" requires the equivalent of more than three million full-time workers.[2]
- Compliance costs are huge both in absolute terms and relative to the amount of tax revenue collected. Based on Bureau of Labor Statistics data on the hourly cost of an

1 The TAS Research function arrived at this estimate by multiplying the number of copies of each form filed for tax year 2008 by the average amount of time the IRS estimated it took to complete the form. While the IRS estimates are the most authoritative available, the amount of time the average taxpayer spends completing a form is difficult to measure with precision. This TAS estimate may be low because it does not take into account all forms and, as noted in the text, it does not include the amount of time taxpayers spend responding to post-filing notices, examinations, or collection actions. Conversely, the TAS estimate may be high because IRS time estimates have not necessarily kept pace fully with technology improvements that allow a wider range of processing activities to be completed via automation. We note that the aggregate burden of 6.1 billion hours is lower than the 7.6 billion hour estimate included in our 2008 report. Analysts in the IRS Office of Research, Analysis and Statistics (RAS) have advised us that the lower burden estimates likely reflect efficiency gains attributable to wider use of tax software, particularly by higher income business taxpayers. However, these efficiency gains have not necessarily reduced the burden on middle income and lower income taxpayers. Indeed, measured by dollars, RAS estimates that the mean burden has declined but the median burden has increased. TAS cannot independently determine the margin of error of existing estimates, and RAS acknowledges that the reduction in the time burden estimates may be at least partially attributable to measurement error.

2 This calculation assumes each employee works 2,000 hours per year (*i.e.*, 50 weeks, with two weeks off for vacation, at 40 hours per week).

employee, TAS estimates that the costs of complying with the individual and corporate income tax requirements for 2008 amounted to $163 billion – or a staggering 11 percent of aggregate income tax receipts.[3]

- According to a tally compiled by a leading publisher of tax information, there have been approximately 4,428 changes to the tax code over the past 10 years, an average of more than one a day, including an estimated 579 changes in 2010 alone.[4]
- The tax code has grown so long that it has become challenging even to figure out how long it is. A search of the code conducted for this report turned up 3.8 million words.[5] A 2001 study published by the Joint Committee on Taxation put the number of words in the Code at that time at 1,395,000.[6] A 2005 report by a tax research organization put the number of words at 2.1 million, and notably, found that the number had *almost tripled* since 1975.[7]
- The income tax regulations issued by the Treasury Department to provide guidance on the meaning of the Internal Revenue Code now stand about a foot tall.[8] The CCH Standard Federal Tax Reporter, a leading publication for tax professionals that summarizes administrative guidance and judicial decisions issued under each section

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3 The IRS and several outside analysts have attempted to quantify the costs of compliance. For an overview of previous studies, see Government Accountability Office, GAO-05-878, *Tax Policy: Summary of Estimates of the Costs of the Federal Tax System* (Aug. 2005). There is no clearly correct methodology, and the results of these studies vary. All monetize the amount of time that taxpayers and their preparers spend complying with the Code. The TAS estimate of the cost of complying with personal and business income tax requirements (and thus excluding the time spent complying with employment, estate and gift, excise, exempt organization tax requirements) was made by multiplying the total number of such hours (5.6 billion) by the average hourly cost of a civilian employee ($29.18), as reported by the Bureau of Labor Statistics. *See* Bureau of Labor Statistics, U.S. Department of Labor, *Employer Costs for Employee Compensation – December 2008*, USDL: 09-0247 (Mar. 12, 2009) (including wages and benefits), *at* http://www.bls.gov/news.release/archives/ecec_03122009.pdf. The TAS estimate of compliance costs as a percentage of total income tax receipts for 2008 was made by dividing the income tax compliance cost as computed above ($163 billion) by total 2008 income tax receipts ($1.45 trillion). *See* Office of Management and Budget, Budget of the United States Government - Fiscal Year 2011, Historical Tables, Table 2-1, *at* http://www.whitehouse.gov/sites/default/files/omb/budget/fy2011/assets/hist.pdf. TAS's estimate that compliance costs amount to about 11 percent of aggregate income tax receipts falls on the lower side of some previous estimates. For example, Professor Joel Slemrod computed that compliance costs constitute about 13 percent of income tax receipts, while the Tax Foundation computed that compliance costs constitute about 22 percent of income tax receipts. *See* Public Meeting of the President's Advisory Panel on Federal Tax Reform (Mar. 3, 2005) (statement of Joel Slemrod, Paul W. McCracken Collegiate Professor of Business Economics and Public Policy, University of Michigan Stephen M. Ross School of Business), *at* http://www.taxreformpanel.gov/meetings/meeting-03032005.shtml; J. Scott Moody, Wendy P. Warcholik & Scott A. Hodge, *Special Report: The Rising Cost of Complying with the Federal Income Tax* (Tax Foundation, Dec. 2005), *at* http://www.taxfoundation.org/research/show/1281.html.

4 Unpublished CCH data provided to TAS (Dec. 22, 2010).

5 To determine the number of words in the Internal Revenue Code, TAS downloaded a zipped file of Title 26 of the U.S. Code (*i.e.*, the Internal Revenue Code) from the website of the U.S. House of Representatives at http://uscode.house.gov/download/title_26.shtml. We unzipped the file, copied it into Microsoft Word, and used the "word count" feature to compute the number of words. The version of Title 26 we used was dated Feb. 1, 2010, so the count does not reflect legislation enacted during the second session of the 111th Congress. In Word, the document ran 11,045 single-spaced pages. The printed code contains certain information that does not have the effect of law, such as a description of amendments that have been adopted, effective dates, cross references, and captions. Therefore, our count somewhat overstates the number of words that are officially considered a part of the tax code, although as a practical matter, a person seeking to determine the law will likely have to read and consider many of these additional words, including effective dates, cross references, and captions. It is possible that other attempts to determine the length of the Code have attempted to exclude some or all of these components, but there is no clearly correct methodology to use, and there is no easy way to selectively delete information from a document of this length.

6 *See* Staff of the Joint Committee on Taxation, 107th Cong., Study of the Overall State of the Federal Tax System and Recommendations for Simplification, Pursuant to Section 8022(3)(B) of the Internal Revenue Code of 1986 (vol. I), at 4 (Comm. Print 2001).

7 J. Scott Moody, Wendy P. Warcholik & Scott A. Hodge, *Special Report: The Rising Cost of Complying with the Federal Income Tax* (Tax Foundation, Dec. 2005), *at* http://www.taxfoundation.org/research/show/1281.html.

8 *See* CCH Income Tax Regulations (published as six volumes) or RIA Federal Tax Regulations (published as five volumes). Estate, gift, employment, and excise tax regulations are published in additional volumes.

of the Code, now comprises 25 volumes and takes up nine feet of shelf space.[9] Two companies publish newsletters *daily* that report on new developments in the field of taxation; the print editions often run 50-100 pages and the electronic databases contain substantially more detailed information.[10]

- The complexity of the Code leads to perverse results. On the one hand, taxpayers who honestly seek to comply with the law often make inadvertent errors, causing them to either overpay their tax or become subject to IRS enforcement action for mistaken underpayments. On the other hand, sophisticated taxpayers often find loopholes that enable them to reduce or eliminate their tax liabilities.
- Individual taxpayers find return preparation so overwhelming that about 60 percent now pay preparers to do it for them.[11] Among unincorporated business taxpayers, the figure rises to about 71 percent.[12] An additional 29 percent of individual taxpayers use tax software to help them prepare their returns,[13] with leading software packages costing $50 or more. IRS researchers estimate the monetary compliance burden of the median individual taxpayer (as measured by income) rose from $220 in 2000 to $258 in 2007, an increase of 17 percent.[14]

2. The Tax Code Is Rife with Complexity and Special Tax Breaks, Helping Taxpayers Who Can Afford Expensive Tax Advice and Discriminating Against Those Who Cannot.

Transparency is a critical feature of a successful tax system. It is essential if the system is to build taxpayer confidence and maintain high rates of tax compliance. No one wants to feel like a "tax chump" – paying more while suspecting that others are taking advantage of loopholes to pay less. Taxpayers who believe they are unfairly paying more than others inevitably will feel more justified in "fudging" to right the perceived wrong. And the complexity of the current system does, indeed, inflict a "wrong," providing a distinct advantage to taxpayers who can afford expensive tax-planning advice while, at least in relative terms, discriminating against taxpayers who do not have access to such advice.

The outcome of this situation is predictable – taxpayers develop a sense of cynicism about the tax system and the government that has foisted it on them, and tax compliance takes a hit.

9 CCH Standard Federal Tax Reporter (2010).

10 These publications are *Highlights & Documents* (published by Tax Analysts) and the *Daily Tax Report* (published by BNA). According to the Federal Editor in Chief of Tax Analysts, *Tax Notes Today* (the electronic publication that serves as the main source for stories in *Highlights & Documents*) contains an average of 50-70 items a day.

11 IRS Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2008); George Contos, John Guyton, Patrick Langetieg & Melissa Vigil, *Individual Taxpayer Compliance Burden: The Role of Assisted Methods in Taxpayer Response to Increasing Complexity* 7 (presented at IRS Research Conference, June 2010).

12 IRS Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2008).

13 George Contos, John Guyton, Patrick Langetieg & Melissa Vigil, *Individual Taxpayer Compliance Burden: The Role of Assisted Methods in Taxpayer Response to Increasing Complexity* 7 (presented at IRS Research Conference, June 2010).

14 *Id.* at 26.

Dozens of tax breaks benefit narrow groups of taxpayers or industries. Here is a small sampling of narrow benefits, either intended or incidental, for which the average taxpayer does not qualify:

- **Black Liquor Credit.** This provision is generally intended as an incentive for "green" biofuel, but it allows paper mills to claim credit for a pulp by-product.[15]
- **Easement for Harmonious Shapes and Textures.** This provision allows donors of certain easements for conservation purposes to claim a charitable deduction, but it is almost impossible for the IRS to administer.[16] For example, it requires valuation of real property rights that preserve historic facades of houses or preclude development of open space, which under the tax regulations take into account such variables as the "harmonious variety of shapes and textures" on a landscape.[17]
- **Electric Vehicle/Golf Cart Credit.** This provision provides a credit for the purchase of qualified plug-in electric vehicles, which at one point included golf carts. While that loophole has been closed, the credit still covers the $100,000-plus Tesla sports car.[18]
- **Film and TV Deduction.** This provision allows taxpayers to expense costs associated with the production of films and television programs in lieu of the less generous depreciation deduction generally available to businesses.[19]
- **Forestry Conservation Bonds.** This provision authorizes a credit for investors in bonds issued by a government or nonprofit entity for the purpose of acquiring at least 40,000 acres adjacent to a national park, subject to a native fish habitat conservation plan of the U.S. Fish and Wildlife Service.[20]
- **Railroad Track Maintenance Credit.** This provision provides a special credit for taxpayers who happen to own a railroad.[21]

We acknowledge that tax incentives are enacted for legitimate reasons, including to encourage certain types of behavior or to provide benefits in certain circumstances. Nevertheless, when every interest group gets its own tax break, taxpayers worry that others are getting a better deal. Additionally, some taxpayers who could benefit from tax breaks fail to claim them because they do not know they exist.

15 *See* IRC § 6426; *see also* Office of Management & Budget, *Budget of the United States Government FY 2011*, Analytical Perspectives, Ch. 14 (Federal Receipts) 177 (explaining that "byproducts derived from the processing of paper or pulp (known as black liquor when derived from the kraft process) . . . would qualify as cellulosic biofuel and, to the extent so qualifying, could result in substantial revenue losses and a windfall to the paper industry"). Recent successive amendments have substantially addressed this issue. *See* Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. 111-312, § 704 (amending IRC § 6426); Small Business Jobs Act of 2010, Pub. L. 111-240, § 2121 (requiring a certain acid quality for cellulosic biofuel); Health Care and Education Reconciliation Act of 2010, Pub. L. 111-152, § 1408 (requiring a certain water, sediment, and ash content for cellulosic biofuel).

16 *See* IRC § 170(h).

17 Treas. Reg. § 1.170A-14(d)(4)(ii)(A)(5).

18 *See* IRC § 30D.

19 *See* IRC § 181.

20 *See* IRC § 54B.

21 *See* IRC § 45G.

In 2006, for example, taxpayers were permitted to claim a one-time tax credit for telephone excise taxes that the government had improperly collected.[22] The credit ranged from $30 to $60, depending on the number of personal exemptions the taxpayer was entitled to claim on the return.[23] No substantiation was required unless a taxpayer claimed a larger amount, so this credit was essentially free money. Yet IRS data show that 28 percent of eligible taxpayers (37 million out of 133 million) did not claim the credit.[24] Why would 37 million taxpayers fail to claim an authorized credit? The only plausible explanation is that they never learned about it because they were already so overwhelmed by the complexity of their tax returns.[25]

3. Complexity Obscures Understanding and Creates a Sense of Distance Between Taxpayers and the Government, Resulting in Lower Rates of Voluntary Tax Compliance.

Few Americans would steal from a local charity. Yet IRS data show that when taxpayers have a choice about reporting their income, tax compliance rates are astonishingly low. Workers who are classified as employees have little opportunity to underreport their income because it is subject to tax withholding. Employees thus report about 99 percent of their earned income. But among workers whose income is not subject to tax withholding, compliance rates plummet. IRS studies show that non-farm sole proprietors report only 43 percent of their business income and unincorporated farming businesses report only 28 percent.[26]

Tax noncompliance cheats honest taxpayers, who must pay more to make up the difference. According to the IRS's most recent comprehensive estimate, the net tax gap stood at $290 billion in 2001,[27] when 132 million tax returns were filed.[28] This means that each taxpayer was effectively paying a "surtax" of some $2,200 to subsidize noncompliance by others.

As the Administration and Congress assess our existing tax system, it is important to consider why tax compliance rates are so low among taxpayers whose income is not subject to withholding or reporting. Put simply, why would an individual who would never consider stealing from a local charity have little compunction about cheating on his taxes?

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22 *See* IRS Notice 2006-50, 2006-1 C.B. 1141. Unlike the other examples cited in this section, the telephone excise tax refunds were authorized by the Department of the Treasury after several circuits of the U.S. Court of Appeals ruled that the long-distance telephone services at issue were not subject to taxation.

23 IRS News Release, *IRS Announces Standard Amounts for Telephone Tax Refunds*, IR-2006-137 (Aug. 31, 2006).

24 IRS Office of Research, Analysis, and Statistics, Response to TAS Information Request (Dec. 17, 2008).

25 One might assume that tax preparers would know about the credit. Yet IRS data show that 16 percent of practitioner-prepared returns failed to claim the credit. IRS Office of Research, Analysis, and Statistics, Response to TAS Information Request (Dec. 17, 2008).

26 *See* IRS News Release, *IRS Updates Tax Gap Estimates*, IR-2006-28 (Feb. 14, 2006) (accompanying charts *at* http://www.irs.gov/newsroom/article/0,,id=154496,00.html). As low as these rates are, they would be even lower if not for the fact that some of this income is reported to the IRS by third parties.

27 *See* IRS News Release, *IRS Updates Tax Gap Estimates*, IR-2006-28 (Feb. 14, 2006).

28 IRS Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2001).

The National Taxpayer Advocate believes the answer is partly attributable to the sense of affinity and unity that individuals feel with local organizations and the relative disconnect that they feel with the government. Stealing from a local charity feels like stealing from family and friends, yet cheating on one's taxes feels to many like a victimless offense.

We suggest there are two reasons for this disconnect and that tax reform can and should address them. First, members of a community generally understand the services that local organizations provide and the benefits that they personally derive. By contrast, many Americans do not understand how their tax dollars are spent or how they benefit.

Second, the complexity of the tax code obscures understanding, with the result that taxpayers often have little idea how much they are paying or why. They also worry that they are missing tax breaks while others are benefiting from too many breaks. This is hardly surprising when Congress annually is making hundreds of changes to the tax code, while at the same time, the press is filled with stories about corporate tax shelters and foreign bank accounts used by "other" taxpayers to shield income from the IRS.

In our view, the existing tax system perpetuates the sense of distance that many taxpayers feel from their government, and tax compliance rates suffer. This may seem abstract, but voluntary compliance is central to our tax system, so this "distance" must be addressed. We believe that simplifying the tax code would be a big step in the right direction. We also believe that providing taxpayers with a "taxpayer receipt" showing how their tax dollars are being spent could help bridge the disconnect by allowing taxpayers to see concretely what benefits they are receiving in exchange for their tax dollars.[29]

4. The Tax Code Is So Complex That the IRS Has Difficulty Administering It.

The IRS employs about 100,000 workers[30] and generally performs very well, but it faces daunting challenges in running the tax system. Despite the fact that about 90 percent of taxpayers rely on preparers or tax software packages, the IRS received 110 million calls in each of the last two fiscal years.[31] That is a staggering number, and not surprisingly, the IRS was unable to answer more than 25 percent of them.[32] In fiscal year (FY) 2008, the IRS received approximately 167 million calls overall,[33] largely inquiries generated by the Economic Stimulus Act, and was only able to answer 53 percent.[34]

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29 The IRS publishes a pie chart that provides a breakdown of the major categories of federal spending. *See* IRS Form 1040 Instructions (2009), at 100. However, most taxpayers never see this chart. Fewer than ten percent of taxpayers prepare their returns by hand, and even among that group, few likely take the time to read through the 175-page instructions booklet in which the pie chart is contained. We therefore recommend that a "taxpayer receipt" be provided to all taxpayers and that it present a somewhat more detailed breakdown of federal spending than the chart.

30 IRS Data Book, 2009, Table 31 *at* http://www.irs.gov/pub/irs-soi/09db31ps.xls.

31 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (weeks ending Sept. 30, 2009 and Sept. 30, 2010).

32 The Customer Account Services Level of Service was 70 percent in FY 2009 and 74 percent in FY 2010. *See* IRS, Joint Operations Center, *Snapshot Reports: Customer Account Services – CAS* (weeks ending Sept. 30, 2009 and Sept. 30, 2010). These percentages reflect the number of calls that reached telephone assisters among all calls seeking to do so.

33 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2008).

34 IRS, Joint Operations Center, *Snapshot Reports: Customer Account Services – CAS* (week ending Sept. 30, 2008).

Other challenges facing the IRS are described throughout this report. To cite one example, the IRS cannot process on a timely basis a considerable portion of the more than 11 million pieces of taxpayer correspondence it receives each year. This situation leads to erroneous tax assessments, improper collection actions, additional penalties and interest for taxpayers, and additional refund interest costs to the government.[35] To cite another example, the IRS relies heavily on automated processes to achieve efficiencies, but in doing so, it sometimes fails to address the unique circumstances of individual taxpayers. The dramatic increase in automated lien filings over the past decade and the IRS's unwillingness to require its employees to make individualized lien determinations are also described in this report.[36]

Simply put, additional tax code complexity will further strain the IRS's ability to serve taxpayers, while a simpler code will make the job of the tax administrator much easier – something that would benefit both taxpayers and the government.

B. Since There Is General Sentiment That the System Is Broken, Why Isn't It Being Fixed?

There is a widespread belief that the influence of "special interests" is the biggest road-block to comprehensive tax reform. There is no doubt that many provisions in the tax code benefit narrow groups of taxpayers, including several described above. But the dirty little secret is that the largest special interests are us – the vast majority of U.S. taxpayers. Virtually all of us benefit from certain exclusions from income, deductions from income, or tax credits (collectively known as "tax expenditures").[37]

In December 2010, the Joint Committee on Taxation published its annual analysis of tax expenditures for the five-year period FY 2010 through FY 2014, and the largest tax expenditures were the following:[38]

- The exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance ($659.4 billion).
- The exclusion for retirement plan contributions and earnings ($596.5 billion).[39]
- The mortgage interest deduction for owner-occupied housing ($484.1 billion).

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35 *See* Most Serious Problem: *The IRS Does Not Process Vital Taxpayer Responses Timely, infra.*

36 *See* Status Update: *The IRS Has Been Slow to Address the Adverse Impact Its Lien Filing Policies Have on Taxpayers and Future Tax Compliance, infra.*

37 When Congress wishes to spend money, it may do so in either of two ways. It can make expenditures directly via cash outlays, or it can make expenditures by providing tax breaks through the tax code. This latter category of spending is referred to as "tax expenditures." A tax expenditure is essentially any reduction in income tax liability that results from an exclusion, exemption, or deduction from gross income or a credit, preferential tax rate, or deferral of tax. As a practical matter, a tax expenditure has the same impact as a government spending program. Assume that an individual facing a 25 percent tax rate pays $10,000 in mortgage interest and that the government wants to provide a subsidy for home ownership. It could accomplish this objective in two ways: (1) it could allow the taxpayer to deduct the $10,000 of mortgage interest from his gross income, which would produce a tax reduction of $2,500, or (2) it could make a direct payment of $2,500 to the taxpayer in lieu of the tax deduction. The taxpayer ends up in the same economic position either way. For a detailed discussion of tax expenditures, see *Evaluate the Administration of Tax Expenditures*, vol. 2, *infra*.

38 *See* Staff of the Joint Committee on Taxation, 111th Cong., *Estimates of Federal Tax Expenditures for Fiscal Years 2010-2014*, Table 1 (Joint Comm. Print 2010).

39 This total represents the sum of defined benefit plans ($303.2 billion), defined contribution plans ($212.2 billion), and plans covering partners and sole proprietors (sometimes known as "Keogh" plans) ($81.1 billion).

- The reduced rates of tax on dividends and long-term capital gains ($402.9 billion).
- The exclusion for various Medicare benefits ($337.1 billion).[40]
- The earned income tax credit ($268.8 billion).[41]
- The deduction for nonbusiness state and local taxes ($237.3 billion).
- The exclusion of capital gains at death ($194.0 billion).
- The deduction for charitable contributions ($187.5 billion).

As this list illustrates, the big-ticket items do not benefit narrow special interests. They benefit large segments of the taxpaying public. Moreover, many of these tax breaks are designed to promote objectives that most taxpayers would consider desirable. The mortgage interest deduction is designed to promote home ownership. The employer exclusion for health care-related benefits is designed to encourage employers to provide health insurance coverage for their workers. The exclusion of retirement plan contributions is designed to encourage Americans to save for retirement. The EITC provides a credit for low income individuals who hold jobs, seeking to encourage work and raise them out of poverty. Finally, the deduction for charitable contributions is designed to encourage taxpayers to support charities and other nonprofit organizations that seek to advance the public good.[42]

As the magnitude of the numbers suggests, however, tax expenditures have a huge impact on the public's attitude toward tax reform. In theory, most of us agree that the tax code is too complex and that broadening the tax base by eliminating existing tax breaks in exchange for lower rates would improve the system.[43] In practice, the prospect of lower rates may seem speculative and distant, while the threatened loss of existing tax breaks raises immediate concerns. Thus, taxpayers require some reassurance that the loss of their tax breaks will indeed be accompanied by a corresponding reduction in rates.

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40 This total represents the sum of hospital insurance - Part A ($175.8 billion), supplementary medical insurance - Part B ($124.5 billion), prescription drug insurance - Part D ($35.1 billion), and exclusion of certain subsidies to employers who maintain prescription drug plans for Medicare enrollees ($1.7 billion).

41 This account reflects the full value of the EITC, including the refundable portion associated with significant outlay effects. *See* Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2010-2014*, Table 1, at 52 n.5.

42 Despite the best of intentions, the evidence is mixed concerning the extent to which these tax incentives encourage more of the behavior they seek to induce. For a more complete discussion, see Volume 2, *Evaluate the Administration of Tax Expenditures*, of this report.

43 The bipartisan fiscal commission appointed by the President recently made recommendations along these lines. *See* National Commission on Fiscal Responsibility and Reform, *A Moment of Truth*, at 15, 28-34 (Dec. 2010) *at* http://www.fiscalcommission.gov/news/moment-truth-report-national-commission-fiscal-responsibility-and-reform.

C. Tax Reform Is Personal: We Must All "Give at the Office."

Overall, the Joint Committee on Taxation estimates that tax expenditures total about $1.1 trillion a year.[44] As compared with about 138 million tax returns filed in 2010,[45] that amounts to an average reduction in tax per return of about $8,000.[46]

Because tax is computed as a percentage of income, a taxpayer who pays tax at a rate of 25 percent would be receiving the benefit of deductions or exclusions from income worth $32,000 (*e.g.,* if an individual's deductions for mortgage interest and charitable contributions and exclusions from income for employer-provided health insurance, retirement plan contributions and transportation subsidies total $32,000, the tax savings would come to $8,000 at a 25 percent rate).[47]

Example

> A single parent with two minor children has an adjusted gross income of $100,000 in 2010. He receives the benefit of "tax expenditures" totaling $32,000 (consisting of exclusions for employer-provided health insurance and retirement plan contributions and deductions for mortgage interest, state and local taxes, and charitable contributions). In addition, he receives the benefit of three personal exemptions – one for himself and one for each child, totaling $10,950.[48] Therefore, the taxpayer reduces his $100,000 adjusted gross income by $42,950 (the sum of total tax expenditures for which he qualifies and three personal exemptions) to arrive at a taxable income of $57,050. Under the 2010 rate tables, the taxpayer owes federal income tax of $9,110. Thus, this taxpayer is actually paying a marginal tax rate of 25 percent, but he ends up paying an average rate of tax of about nine percent.[49]

We are not advocating for a flat tax or recommending that all tax expenditures be terminated. For purposes of illustrating the magnitude of existing tax expenditures and the complexity of the computations, we provide this example simply to note that the government could raise the same level of revenue by taxing this individual at a tax rate of about nine percent.

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44 *See* Staff of the Joint Committee on Taxation, 111th Cong., *Estimates of Federal Tax Expenditures for Fiscal Years 2010-2014* (Joint Comm. Print 2010). The Joint Committee provides a separate estimate for each tax expenditure, but it does not add them up to provide an aggregate total. Tax expenditures have interactive effects for which the Joint Committee has not attempted to account. If those effects were incorporated, the aggregate total of foregone revenue would be somewhat lower. Nevertheless, the aggregate total provides a reasonable approximation of the level of tax expenditures, and we use it in this report for that purpose.

45 *See* IRS 2010 Filing Season Statistics *at* http://www.irs.gov/newsroom/article/0,,id=220953,00.html.

46 As discussed in a prior footnote, tax expenditures have interactive effects, so if all tax expenditures were simultaneously eliminated, the change in revenue would likely be somewhat less than $1.1 trillion. Accordingly, the average tax reduction per taxpayer could be somewhat less than $8,000. Nevertheless, this total represents a reasonable approximation and is used for illustrative purposes in this report. *See* Leonard Burman, Eric Toder & Christopher Geissler, *How Big Are Total Individual Income Tax Expenditures, and Who Benefits from Them?* Discussion Paper 31, Amer. Soc. Sci. Assoc'n (New Orleans, La., Jan. 5, 2008) 3, shorter version published in 98 *Amer. Econ. Rev.* 79 (2008) (stating that despite interaction effects, "commentators have added up tax expenditures to make general statements about their magnitude").

47 Some tax expenditures disproportionately benefit higher income taxpayers. Therefore, the dollar value of tax expenditures is likely to be somewhat lower than $8,000 for a typical taxpayer.

48 The Joint Committee on Taxation does not consider either personal exemptions or the standard deduction to be tax expenditures because they "defin[e] the zero-rate bracket that is a part of normal tax law." *See* Staff of the Joint Committee on Taxation, 111th Cong., *Estimates of Federal Tax Expenditures for Fiscal Years 2010-2014*, at 4-5 (Joint Comm. Print 2010). Therefore, they reduce taxable income further.

49 Because tax rates rise with income, this taxpayer pays tax at 10 percent on his first $11,950 of taxable income, at 15 percent on taxable income between $11,950 and $45,550, and at 25 percent on his additional income. We are assuming that this taxpayer chooses to file using the head-of-household filing status.

The concept of tax expenditures is not widely understood. We suspect many taxpayers would instinctively recoil at the thought of surrendering $32,000 in tax breaks because they would assume their overall tax burden would skyrocket. If, however, a typical taxpayer were asked if she would be willing to give up $32,000 in tax breaks in exchange for substantially lower rates that would leave her overall tax burden unchanged, we think her reaction would be overwhelmingly positive.

Consider another example: The Alternative Minimum Tax (AMT) is perhaps the most reviled provision of the tax code.[50] But it is important to recognize that the AMT does not exist in a vacuum. Rather, the AMT is a monument and an intended antidote to tax expenditures run amok. Congress first enacted a minimum tax in 1969 because of concerns that wealthy taxpayers were taking advantage of tax expenditures to the point that some were paying little or no tax. The Senate Finance Committee report that accompanied the provision stated:

> Under present law, many individuals and corporations do not pay tax on a substantial part of their economic income as a result of the receipt of various kinds of tax-exempt income or special deductions. . . . [T]he committee believes that an overall minimum tax on tax preferences is . . . needed to reduce the advantages derived from these preferences and to make sure that those receiving such preferences also pay a share of the tax burden.[51]

The AMT continues to serve this same function today, if imperfectly. In a world without tax expenditures, the AMT would have no place.

If tax reform is to gain traction, the key challenge will be to persuade taxpayers that they personally, and the system as a whole, will be better off if many targeted benefits are eliminated in favor of lowering tax rates for substantially all U.S. taxpayers.

As the statutory voice of the taxpayer, the National Taxpayer Advocate believes that tax reform is essential and urgent, but it must not be rushed. Tax reform should not be imposed on taxpayers. Rather, it should be shaped with taxpayer engagement and support. Ultimately, taxpayer involvement will lead to a better result, and equally important, it will make taxpayers feel more connected with the end product, which could lead to compliance gains as well.

The key is that in conducting this dialogue, we must be honest. We cannot pretend that broadening the tax base means eliminating someone else's tax break while preserving our

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50 The National Taxpayer Advocate has repeatedly identified the AMT as a serious problem for taxpayers and has recommended its repeal in prior reports and congressional testimony. *See* National Taxpayer Advocate 2008 Annual Report to Congress 356-362 (Legislative Recommendation: *Repeal the Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2006 Annual Report to Congress 3-5 (Most Serious Problem: *Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2004 Annual Report to Congress 383-385 (Legislative Recommendation: *Alternative Minimum Tax*); National Taxpayer Advocate 2003 Annual Report to Congress 5-19 (Most Serious Problem: *Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2001 Annual Report to Congress 166-177 (Legislative Recommendation: *Alternative Minimum Tax for Individuals*); *see also Alternative Minimum Tax: Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways & Means* (Mar. 7, 2007) (statement of Nina E. Olson, National Taxpayer Advocate); *Blowing the Cover on the Stealth Tax: Exposing the Individual AMT: Hearing Before the Subcomm. on Taxation and IRS Oversight of the Senate Comm. on Finance* (May 23, 2005) (statement of Nina E. Olson, National Taxpayer Advocate).

51 S. Rep. No. 91-552, at 111-112 (1969).

own. Everything must be put on the table, and we must make clear that, in exchange for lower rates, some tax breaks will be eliminated immediately and others will be phased out.

But it is equally important to make clear that, assuming revenue neutrality, the average taxpayer will not pay more tax and the tax code will be much easier to understand and comply with. Taxpayers would have a better understanding of how their tax liabilities are computed, would have more confidence that the system is treating them fairly relative to others, and would save time and money preparing their returns because they could do the job quickly themselves.

Based on all the comments we receive in the Taxpayer Advocate Service and our experience in handling some 300,000 taxpayer cases a year, lowering rates in exchange for broadening the tax base seems like an excellent bargain. We are confident that in the end, public support for a simpler code will be strong and deep.

D. It May Be Prudent to Keep Consideration of Structural Tax Reform Separate From the Debate Over Revenue Levels.

Although our office does not take a position on fiscal policy issues or tax rates, we are mindful that leaders of both parties have expressed deep concerns about the long-term structural imbalance between government revenues and government spending, and that in addition to spending cuts, tax revenues at some point may have to be increased. We are also mindful that the question of whether and to what extent to raise revenue is extremely contentious.

If structural tax reform and revenue levels are considered together as part of a package, we are concerned that the debate over revenue levels could overshadow and derail meaningful tax reform. Therefore, we suggest that Congress consider addressing these issues separately. First, Congress could enact structural tax reform on a revenue-neutral basis. Second, Congress could decide on appropriate revenue levels and adjust the tax rates as it deems appropriate.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress substantially reform and simplify the Internal Revenue Code. Some specific simplification suggestions are discussed in the Legislative Recommendations section of this report.

To enhance taxpayer awareness of the connection between taxes paid and benefits received, the National Taxpayer Advocate further recommends that Congress direct the IRS to provide all taxpayers with a "taxpayer receipt" showing how their tax dollars are being spent. This "taxpayer receipt" could be a more detailed version of the pie chart currently published by the IRS and would be provided directly to each taxpayer.[52] For the reasons discussed above, we believe better public awareness of the connection between taxes and government spending may improve civic morale, improve tax compliance, and make more productive the national dialogue over looming fiscal policy choices.

52 *See* IRS Form 1040 Instructions (2009), at 100.

TABLE 1.1.1, Hours Required to Prepare Tax Returns and Information Reporting Documents

Type of Return	Number (in millions)	Average Total Hours/Minutes	Total Hours (in millions)
Tax Returns			
Individual Income Tax (1040)	140.9	17.3	2,437.57
Estate and Trust Income Tax (1041)	3.1	82.70	256.37
Estate and Trust Est'd Tax (1041-ES)	0.7	3.28	2.30
Partnerships 1065 and 1065B)	3.4	108.08	367.47
S Corporations (1120S)	4.5	165.35	744.08
Corporations (1120)	2.2	159.80	351.56
1066	0.03	54.25	1.63
1120-A (obsolete in TY 2009)	0	0	0
1120-C	0.009	107.60	0.97
1120-F	0.03	151.18	4.54
1120-FSC	0.000	152.90	0.06
1120-H	0.2	32.62	6.52
1120-POL	0.006	26.62	0.16
1120-L/ND/PC/REIT/SF	0.01	131.75	1.32
1120-RIC	0.01	114.90	1.15
Estate Tax (706)	0.04	7.75	0.31
Gift Tax (709)	0.3	5.77	1.73
Employment Tax (940 series)	6.1	12.30	75.03
Employment Tax (941 series)	23.8	15.70	373.66
Tax-Exempt Organizations (990)	0.4	158.52	63.41
Excise Tax (720)	0.1	37.20	3.72
Form 1040X	5.1	3.50	17.85
Tax Returns Subtotal			**4,711.39**

Information Reporting	Number (in millions)	Average Total Hours/Minutes	Total Hours (in millions)
Form W-2	240.9	0.50	120.45
K-1 (1041)	3.3	7.75	25.58
K-1 (1065)	21.2	27.57	584.48
K-1 (1120S)	7	25.73	180.11
1096	5.5	0.22	1.19
1098	96.9	0.12	11.63
1098-C	0.2	0.30	0.06
1098-E	20.8	0.12	2.43
1098-T	25.7	0.22	5.57
1099-A	1.2	0.15	0.18
1099-B	816.7	0.33	272.23
1099-C	2.7	0.17	0.45
1099-CAP	0.007	0.18	0.00
1099-DIV	100.9	0.30	30.27
1099-G	78.3	0.18	14.36
1099-H	0.02	0.30	0.01
1099-INT	248.6	0.22	53.86
1099-LTC	0.2	0.22	0.04
1099-MISC	85.5	0.27	22.80
1099-OID	2.9	0.20	0.58
1099-PATR	1.8	0.25	0.45
1099-Q	1.5	0.18	0.28
1099-R	81.5	0.30	24.45
1099-S	2.5	0.13	0.33
1099-SA	2.4	0.13	0.32
5498	114.9	0.40	45.96
5498-ESA	0.7	0.12	0.08
5498-SA	3.1	0.17	0.52
W2-G	10.7	0.30	3.21
Information Returns Subtotal			**1,401.87**
Grand Total			**6,113.26**

Sources: IRS Form Instructions and Publications for Tax Year 2009; Document 6149 - 2009 Update (rev. 11-2009); and Document 6961 - 2010 Update (rev. 07-2010).

Document 6149 at: http://www.irs.gov/pub/irs-soi/d6149.pdf

Document 6961 at: http://www.irs.gov/pub/irs-soi/d6961.pdf

Most Serious Problem

MSP #2 The IRS Mission Statement Does Not Reflect the Agency's Increasing Responsibilities for Administering Social Benefits Programs

RESPONSIBLE OFFICIAL

Douglas H. Shulman, Commissioner

DEFINITION OF PROBLEM

Historically, the IRS's mission has been to collect taxes imposed by Congress to fund federal spending. A notable exception was the enactment of the Earned Income Tax Credit (EITC) in 1975, which allows low income, working taxpayers to receive, through the tax code, government payments that exceed their income tax liabilities (*i.e.*, the EITC is a refundable credit).[1] The EITC has posed numerous challenges for the IRS over the years, as the IRS has sought to increase awareness of the EITC so that taxpayers who qualify know to claim it, while the IRS simultaneously has deployed sophisticated anti-fraud programs to prevent inadvertent and fraudulent overclaims.

Although it took several decades, the IRS in our view is now doing a relatively good job of administering the EITC. In recent years, however, Congress has directed the IRS to administer a host of new benefit programs:

- In 2007, Congress directed the IRS to make Economic Stimulus Payments (ESPs) to most U.S. taxpayers and some non-taxpayers.[2] Among the consequences, the IRS was overwhelmed with phone calls, receiving more than double the typical number.[3] This increase caused the percentage of calls getting through to a customer service representative to drop sharply, from 82 percent in fiscal year (FY) 2007 to 53 percent in FY 2008.[4]
- In 2008, Congress directed the IRS to administer the first of several versions of the First-Time Homebuyer Credit (FTHBC).[5] Among the consequences of the various versions of the FTHBC provisions were: taxpayers claiming the credit could not electronically file their returns to comply with strict documentation requirements; significant IRS processing and enforcement resources were diverted from the IRS's core work to

1 Internal Revenue Code (IRC) § 32.

2 Economic Stimulus Act, Pub. L. No. 110-185 (2008).

3 On an enterprise-wide basis, the IRS received 166.6 million calls in FY 2008, more than twice the 82.8 million calls it received in FY 2007. IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot: Enterprise Total* (weeks ending Sept. 30, 2007 and Sept. 30, 2008).

4 *See* IRS, Fiscal Year (FY) 2008 Enforcement Results 7, *available at* http://www.irs.gov/pub/irs-news/2008_enforcement.pdf.

5 IRC § 36 Housing and Economic Recovery Act of 2008 (HERA), Pub. L. No. 110-289, § 3011, 122 Stat. 2654; *see also* American Recovery and Reinvestment Act of 2009 (ARRA), Pub. L. No. 111-5, § 1006 in Division B, 123 Stat. 115; The Worker, Homeownership and Business Assistance Act of 2009 (WHBAA), Pub. L. No. 111-92, 123 Stat 2984 (2009); The Homebuyer Assistance and Improvement Act of 2010 (HAIA) 124 Stat. 1356, Pub. L. No. 111-198 (July 2, 2010).

administer the credit; and returns claiming the credit have been subject to a high audit rate and substantial delays in the delivery of legitimate refund claims.[6]

- In 2009, Congress directed the IRS to administer the Making Work Pay (MWP) Credit for working individuals and to coordinate MWP credits with Economic Recovery Payments to certain non-working individuals.[7] Among the consequences, IRS processing resources were again diverted from core work, and more than seven million returns were not processed timely.[8]
- In 2010, Congress passed major new health care legislation and has directed the IRS to administer large portions of it, including the Premium Assistance Credit, the Individual Penalty for Lack of Coverage, the Employer Penalty, and the Small Business Tax Credit.[9] The Congressional Budget Office (CBO) has estimated that the IRS will need between $5 billion and $10 billion over ten years to implement these provisions.[10]

The increasing use of the IRS to administer benefit programs is placing significant strains on the IRS's limited resources and requiring the IRS to perform tasks that go well beyond its current mission statement to "[p]rovide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all."[11]

From an organizational standpoint, there are significant differences between benefits agencies and enforcement agencies in terms of culture, mindset, and the skills sets and training of their employees. Benefits agencies like the Social Security Administration (SSA) and the Department of Veterans Affairs, despite some shortcomings, are primarily trying to get to "yes" – to help eligible persons qualify for benefits. Enforcement agencies are more in the business of saying "no." As it prepares to administer large portions of the health care legislation, including approving claims by low income persons for health care tax credits and imposing a penalty tax on persons who are required to purchase health care but fail to do so, the IRS will have to change. Rather than being an agency that has increasingly been using automation to send notices to taxpayers saying, in effect, "you owe us," the IRS will move toward becoming an agency that hires and trains caseworkers who will work one-on-one with taxpayers to resolve legitimate disagreements.

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6 *See Filing Season Update: Current IRS Issues: Hearing Before the S. Comm. on Finance*, 111th Cong. (2010) (statement of Nina E. Olson, National Taxpayer Advocate); *The National Taxpayer Advocate's 2009 Report on the Most Serious Problems Encountered by Taxpayers: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 111th Cong. (2010) (statement of Nina E. Olson, National Taxpayer Advocate).

7 Pub. L. No. 111-5, § 1001, 123 Stat. 115, 309 (2009); IRC § 26A.

8 IRS, Daily Reject Code Report, Data Source ELF1545 (Oct. 14, 2010) (Cum counts year to date for paper and electronic returns for EC1132 and EC1133); IRS Wage and Investment (W&I) Division, Management Error Report (MER) (Sept. 23, 2010) (Cum counts year to date for paper and electronic returns for EC331 and EC346); Phone Conversation Between W&I and TAS (Oct. 6, 2010) (to clarify reject code amounts and MER Report Data).

9 The Patient Protection and Affordable Care and the Health Care (Affordable Care Act), Pub. L. 111-148, 124 Stat. 119 (Mar. 23, 2010) (to be codified as amended at scattered sections of 42 U.S.C.); *see also* Education Reconciliation Act (HCERA), Pub. L. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

10 CBO, *Potential Effects of the Patient Protection and Affordable Care Act on Discretionary Spending* (Mar. 15, 2010), *available at* http://www.cbo.gov/ftpdocs/113xx/doc11307/Specified_Authorizations_HR3590.pdf.

11 Internal Revenue Manual (IRM) 1.2.10.1.1, *The Agency, its Mission and Statutory Authority, available at* http://www.irs.gov/irs/article/0,,id=98141,00.html (last visited July 9, 2010).

From a budgetary standpoint, the IRS will require additional resources if it is expected to administer benefits programs without undermining its critical tax collection role. In particular, administering health care will require the IRS to become more of a service agency, yet IRS funding trends have been moving in the opposite direction. From FY 2004 through the proposed FY 2011 budget, funding for the Enforcement account increased by 18 percent while funding for the Taxpayer Services account fell by seven percent in inflation-adjusted terms.[12] Moreover, the account name "Taxpayer Services" considerably overstates the amount of service spending, because a substantial portion of that account pays for the processing of tax returns, which is essentially an overhead function. In FY 2010, only five percent of the IRS budget was allocated for the Pre-filing Taxpayer Assistance and Education subaccount,[13] which is what most people think of as core taxpayer service.

To help address these challenges, the National Taxpayer Advocate believes the IRS should revise its mission statement to explicitly acknowledge its dual roles of tax collector and benefits administrator. While the wording of a mission statement may seem like "inside baseball," it has overriding importance for two reasons. First, it serves as the organizing principle around which an agency's strategic plan is built (which in this case would include increasing the IRS's service capabilities to work collaboratively with persons who believe the IRS erred in denying a health care credit or imposing a penalty tax). Second, a revised mission statement would make clear that the IRS will require sufficient funding to perform both roles well.

In addition, to carry out its new role as benefits administrator, we encourage the IRS to consider creating a program office dedicated solely to the administration of benefits programs. This new office would be headed by a new deputy commissioner whose position would include the primary responsibility for setting policies and controlling resources to administer existing programs and implement new ones.

ANALYSIS OF PROBLEM

Background

Throughout the years, Congress has increasingly created Code-based social benefit programs. While many of the benefits are designed as refundable credits, social programs can take a variety of forms when run through the tax system, such as income exclusions, deductions, and tax credits.[14] As noted above, the EITC is the main long-standing social benefit the IRS has administered, and more recent programs include the Making Work Pay

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12 For additional information on trends in IRS funding, see National Taxpayer Advocate FY 2011 Objectives Report to Congress 6-8, *available at* http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf.

13 *See* Department of the Treasury, *FY 2011 Budget in Brief* at 65. *See also* Most Serious Problem: *The Wage & Investment Division's Is Tasked with Supporting Multiple Agency-Wide Operations, Impeding its Ability to Serve Its Core Base of Individual Taxpayers Effectively, infra*. It is important to note that the Pre-Filing Taxpayer Assistance account does not reflect resources dedicated to phone (and web) assistance.

14 The CBO has estimated that refundable credits will increase by approximately $500 billion over the next ten years. Doug Elmendorf, CBO, *Federal Budget Challenges* (Apr. 20, 2009), *available at* http://www.cbo.gov/ftpdocs/100xx/doc10093/04-20-Harvard.pdf.

Credit,[15] the First-Time Homebuyer Credit,[16] and various elements of the newly enacted health care legislation.[17]

Benefits and Drawbacks of Code-Based Programs

Running social programs through the tax system is beneficial in several respects. These benefits include the potential ability to reduce the burden of the application process (via return filing), direct access by the administrator to eligibility data relating to income, and the relative efficiency of the IRS as a payment processor.[18] The benefits also come with a cost to both the IRS and taxpayers. As discussed in detail below, Code-based social programs can undermine the IRS's ability to perform its core function of collecting taxes. Further, the current enforcement culture of the IRS may not be optimal for the administration of social benefits.

The IRS Has Faced Challenges in Administering Social Programs.

The administration of social programs diverts IRS resources away from the agency's core revenue collection function and can diminish taxpayer service. Over the past several years, as it delivered billions of dollars in recently enacted social benefits such as FTHBC, MWP, and economic stimulus payments, the IRS's resources were stretched thin.[19] The following discussion illustrates some of the challenges faced in administering the FTHBC, MWP credit, and health care reform provisions.

IRS Filters and Documentation Requirements for First-Time Homebuyer Credit Drained IRS Resources.

Because the FTHBC is refundable and worth up to $8,000, the IRS implemented several safeguards to reduce fraudulent claims. First, the IRS developed filters to identify questionable claims before they were paid.[20] Second, the IRS imposed strict documentation requirements that required taxpayers to submit a copy of Form HUD-1, Settlement Statement, or another settlement statement bearing the signature of both the buyer and seller. The documentation requirement created two problems:

1. The HUD-1 could not be electronically filed, so taxpayers claiming the FTHBC had to file paper returns; and

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15 Pub. L. No. 111-5, § 1001, 123 Stat. 115, 309 (2009); IRC § 26A.

16 IRC § 36 Housing and Economic Recovery Act of 2008 (HERA), Pub. L. No. 110-289, § 3011, 122 Stat. 2654; American Recovery and Reinvestment Act of 2009 (ARRA), Pub. L. No. 111-5, § 1006 in Division B, 123 Stat. 115; The Worker, Homeownership and Business Assistance Act of 2009 (WHBAA), Pub. L. No. 111-92, 123 Stat 2984 (2009); The Homebuyer Assistance and Improvement Act of 2010 (HAIA) 124 Stat. 1356, Pub. L. No. 111-198 (July 2, 2010).

17 The Patient Protection and Affordable Care and the Health Care (Affordable Care Act), Pub. L. 111-148, 124 Stat. 119 (Mar. 23, 2010) (to be codified as amended at scattered sections of 42 U.S.C.); Education Reconciliation Act (HCERA), Pub. L. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

18 National Taxpayer Advocate 2009 Annual Report to Congress, Vol. 2, at 75-103 (*Running Social Programs through the Tax System*).

19 *See* Jeremiah Coder, *The New IRS: Expanding Mission?*, Tax Notes Today (Aug. 9, 2010); Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2010-41-069, *Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit* (June 17, 2010); TIGTA, Ref. No. 2010-41-128, *Recovery Act: Verifying Eligibility for Certain New Tax Benefits Was a Challenge for the 2010 Filing Season* (Sept. 30, 2010).

20 TIGTA, Ref. No. 2010-41-069, *Recovery Act: Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit* 2 (June 17, 2010).

2. Not all jurisdictions require signatures on settlement statements, which resulted in the IRS rejecting or delaying a significant number of FTHBC claims. Once the IRS recognized the problem, it changed the Instructions to Form 5404, *First-Time Homebuyer -Credit and Repayment of the Credit*, to state that it would accept any statement that is complete and valid according to local law.[21]

The filters and documentation requirements generally caused taxpayer confusion, substantially increased paper return filing, and drained the IRS's discretionary examination resources.[22] Moreover, to obtain their non-FTHBC portion of their refunds quickly, some taxpayers filed original returns electronically, omitted the FTHBC, then immediately filed amended paper returns claiming the credit. This approach increased demand on the IRS amended return process.[23]

Taxpayer Confusion Resulted from Poor Planning of Making Work Pay Credit Program.

Similarly, the IRS faced unanticipated problems when the American Recovery and Reinvestment Act of 2009 (ARRA) provided for the MWP credit and the one-time Economic Recovery Payment (ERP). The difficulty arose from the requirement that taxpayers not receive the MWP and ERP on the same return. Thus, in order to claim the MWP, the taxpayer had to subtract the ERP received from the amount of the MWP credit on Form 1040, Schedule M, *Making Work Pay and Government Retiree Credits*. However, when filing returns during the 2010 filing season, many taxpayers did not recall whether they received an ERP in 2009. As of October 14, 2010, the IRS had rejected over 3.3 million e-filed Forms 1040, 1040A, and 1040EZ at the point of transmission. A significant percentage of these rejects had one of the following two problems: (1) the taxpayer did not claim the correct amount of the credit or (2) the ERP amount claimed on Schedule M did not match IRS records. Further, among those e-filed and paper returns with Schedule M that the IRS accepted, more than 7.7 million paper and e-filed returns were removed from the processing pipeline and placed in the IRS's Error Resolution System, delaying the processing of the returns and the delivery of refunds.[24] Once the IRS realized the problems, it scrambled in the midst of the filing season to develop a web-based application ("Did I Receive an

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21 Instructions for Form 5404 (Rev. 2010) at 2; IRM 21.6.3.4.2.11 (Oct. 1, 2010); Form 866-H-LTR, *Long-Time Resident Special Rule Supporting Documents* (Feb. 2010); Form 886-H-FTHBC/WHBAA, *First-Time Homebuyer Credit: Worker, Homeownership and Business Assistance Act of 2009 Supporting Documents* (Feb. 2010).

22 The IRS denied FTHBC claims that lacked documentation during initial return processing, using math error authority. It also froze refunds pending civil examinations. TIGTA, Ref. No. 2010-41-069, *Recovery Act: Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit* 2 (June 17, 2010). As of September 14, 2010, over 355,000 original returns claiming FTHBC were selected based on IRS math error authority. In addition, over 118,000 original FTHBC returns were selected and opened for examination. IRS, FTHBC Production Report (Sept. 14, 2010).

23 Since the IRS began processing FTHBC claims in January 2009, over 205,000 taxpayers claimed the FTHBC on a Form 1040X through July 31, 2010. An additional 909,000 claimed the credit either on a duplicate return or in some other manner. IRS CDW-IMF (Production Cycle 2010 30).

24 IRS, Daily Reject Code Report, Data Source ELF1545 (Oct. 14, 2010) (Cum counts year to date for paper and electronic returns for EC1132 and EC1133); IRS W&I, Management Error Report (Sept. 23, 2010) (Cum counts year to date for paper and electronic returns for EC331 and EC346); Phone conversation between W&I and TAS (Oct. 6, 2010) (to clarify reject code amounts and MER Report Data).

Economic Recovery Payment?") and a comparable telephone system to provide taxpayers with information on ERPs.[25]

The IRS Faces Significant Challenges in Implementing Health Care Reform.

As part of the recent health care legislation, the IRS will face a number of decisions and guidance projects unrelated to its employees' traditional expertise and skill set. The IRS must administer the following health care provisions: the Premium Assistance Credit, the Individual Penalty for Lack of Coverage, the Employer Penalty, and the Small Business Tax Credit.[26] The IRS's ability to administer these provisions under its current organizational principles has been questioned from the outset.[27]

The challenges facing the IRS are easily illustrated by the Individual Penalty for Lack of Coverage (also referred to as the Individual Mandate).[28] To deal with this provision, the IRS will need to determine a taxpayer's compliance with the individual mandate and assess a penalty if coverage is inadequate. This determination is based on a concept of "household income." This may differ from the income reported on the taxpayer's return, because it is a composite of all of the income reported by members of taxpayer's household – information that may not be readily accessible to the IRS.

The IRS Needs to Better Position Itself to Implement New and Existing Social Programs.

While the IRS should be applauded for its accomplishments in implementing major legislative provisions with minimal advance notice, better planning would have alleviated a significant level of the burden imposed on taxpayers and the IRS over the last few filing seasons. It is impossible to determine whether more notice would have allowed the IRS to anticipate and plan accordingly for the problems with the FTHBC documentation requirements or the MWP credit. However, unless the IRS learns from its mistakes and stores its "Lessons Learned" from each initiative, it will likely make similar mistakes in the future. In addition, for each of the social benefit programs discussed above, the work involved multiple IRS functions and required significant coordination and communication. Breakdowns in inter-office communication and coordination caused downstream consequences that burdened both taxpayers and the IRS. To avoid similar problems in the future, the IRS should take a hard look at its mission and organizational structure to address knowledge retention, servicewide communication, and coordination of social program initiatives.

25 Application available at http://www.irs.gov/individuals/article/0,,id=219514,00.html (last visited Aug. 21, 2010) (Reject Code 1132 and 1133).

26 The Patient Protection and Affordable Care and the Health Care (Affordable Care Act), Pub. L. 111-148, 124 Stat. 119 (Mar. 23, 2010) (to be codified as amended at scattered sections of 42 U.S.C.); Education Reconciliation Act (HCERA), Pub. L. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

27 *Grassley Questions IRS Ability to Administer Healthcare Reform*, Tax Notes Today (Apr. 16, 2010); Leuyen Dinh, *Former IRS Commissioners Warn of Health-care Reform's Burden on IRS*, Tax Notes Today (Nov. 10, 2009).

28 The Patient Protection and Affordable Care and the Health Care (Affordable Care Act), Pub. L. 111-148, 124 Stat. 119 (Mar. 23, 2010) (to be codified as amended at scattered sections of 42 U.S.C.); Education Reconciliation Act (HCERA), Pub. L. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

Current and Previous IRS Mission Statements Do Not Reflect Social Program Administration.

Historically, the IRS's mission statement has focused on revenue collection. Before the enactment of the IRS Restructuring and Reform Act of 1998 (RRA 98), the IRS worked under the following statement, dating back to 1964:

> The purpose of the Internal Revenue Service is to collect the proper amount of tax at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.[29]

This mission statement was based on the principles set forth in Revenue Procedure 64-22, *Statement of Some Principles of Internal Revenue Tax Administration*.[30]

Section 1002 of RRA 98 directed the IRS to revise its mission statement to reflect a more customer service-based approach.[31] Accordingly, the IRS revised the statement to read: "Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all."[32]

The current and previous mission statements addressed only traditional tax administration functions without reference to social programs. The IRS has not revised its mission statement since RRA 98, even as its duties have increased significantly with the enactment of new Code-based social programs, including health care.

The National Taxpayer Advocate believes the IRS should revise its mission statement to reflect its dual mission of collecting federal revenues and delivering federal social benefits. While some may view a mission statement as trivial, such a revision would provide explicit recognition that the IRS is performing two distinct roles. A revised statement would make clear that the IRS will require sufficient funding to perform effectively as both a tax collector and administrator of social benefit programs. It would guard against the IRS having to assume social program responsibilities at the expense of its revenue collection and taxpayer service functions. The IRS should also work toward revising Revenue Procedure 64-22 to include the IRS's responsibility as social benefit administrator.

In revising both the mission statement and revenue procedure, the IRS should canvass similar documents in other domestic and international agencies to determine how they address the delivery of benefits. An example of a federal agency mission statement referencing

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29 IRS Policy Statement P-1-1.

30 1964-1 C.B. 689 (1964) ("Administration should be reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and it should be reasonable within the bounds of the law and sound administration.").

31 Pub. L. No. 105-206, 112 Stat. 685 (1998). Section 1002 of RRA 98 provides that the IRS "[s]hall review and restate its mission to place a greater emphasis on serving the public and meeting taxpayers' needs." The Senate Finance Committee report stated that "[t]he Committee believes that taxpayer service is of such importance that the Committee should … mandate that a key part of the IRS mission must be taxpayer service." S. Rep. No. 105-174.

32 IRM 1.2.10.1.1; *The Agency, its Mission and Statutory Authority*, http://www.irs.gov/irs/article/0,,id=98141,00.html (last visited July 9, 2010).

the administration of social programs is that of the SSA. In fact, the SSA's one-sentence statement focuses solely on the distribution of benefits by stating, "Deliver Social Security services that meet the changing needs of the public."[33]

The United States Department of Veterans Affairs provides benefits to individuals and has drafted a model vision statement to accomplish its goals: "To provide veterans the world-class benefits and services they have earned - and to do so by adhering to the highest standards of compassion, commitment, excellence, professionalism, integrity, accountability, and stewardship."[34]

The IRS could also study how its counterparts in other countries describe their duties and functions. For example, New Zealand's Inland Revenue has the dual roles of collecting revenue and distributing social benefits.[35] Accordingly, while it does not have a mission statement, the agency always includes both roles in descriptions of its work. For example, in the "Who We Are" section of its website, the agency provides the general description: "We collect most of the revenue that government needs to fund its programmes. We also administer a number of social support programmes."[36] In addition, in the more detailed description under that section, it provides: "Inland Revenue plays a critical role in improving the economic and social wellbeing of New Zealanders. Inland Revenue collects 85 percent of the Crown's revenue as well as collecting and disbursing social support programme payments and providing the government with policy advice."[37] New Zealand's statements are particularly noteworthy because they are phrased in such a way to remind people of the connection between the collection of taxes and the distribution of benefits.

The IRS Should Consider Realigning its Organizational Structure.

In addition to adjusting its mission statement, the IRS should evaluate its organizational structure, which does not reflect the IRS's dual role as tax collector and social benefit administrator. The current IRS workforce generally lacks the social welfare or caseworker background necessary to interact with taxpayers on social benefit issues. This lack of experience is particularly relevant where IRS employees interact with members of special populations, such as low income, English as a Second Language (ESL), Limited English Proficiency (LEP), disabled, and elderly taxpayers.[38]

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33 http://www.ssa.gov/aboutus/ (last visited Aug. 12, 2010).

34 http://www.va.gov/landing2_about.htm (last visited Aug. 12, 2010). The VA's Mission Statement states: "To fulfill President Lincoln's promise 'To care for him who shall have borne the battle, and for his widow, and his orphan' by serving and honoring the men and women who are America's veterans." *Id.*

35 In addition to collecting money for public services, Inland Revenue administers many social programs, including the KiwiSaver Program (Initiative to help individuals with their long-term saving for retirement), Working for Families Tax Credits, Tax Credit for Children, Tax Credit for Income Under $9,880, Independent Earner Tax Credit, Tax Credits for Payroll Donations, Donations Tax Credit, Childcare Tax Credit. *See* http://www.ird.govt.nz/individuals/ (last visited Aug. 13, 2010).

36 http://www.ird.govt.nz/aboutir/ (last visited Aug. 12, 2010).

37 http://www.ird.govt.nz/aboutir/who-we-are/ (last visited Oct. 1, 2010).

38 *See Grassley Questions IRS Ability to Administer Healthcare Reform*, Tax Notes Today (Apr. 16, 2010).

Creation of a Program Office and Third Deputy Commissioner Position Could Improve Administration of Social Benefits.

The IRS should consider creating a permanent office to establish policy and coordinate issues associated with social program administration. This office could be headed by a newly created deputy commissioner position with primary responsibility to create policy and develop strategic direction for all social benefit initiatives.[39] The office would gain experience in implementing social programs, and as a centralized source of stored institutional knowledge, it would be invaluable in developing future programs. By retaining valuable information from experiences and organizing it into an easily accessible format, the IRS could anticipate problems and plan accordingly. Such stored institutional knowledge could effectively address issues such as timing of payments, third-party information reporting, verification of eligibility for benefits, fraudulent payments, communication strategies, and online tools to help taxpayers determine eligibility.

With well-developed institutional knowledge, the IRS would be better positioned for meaningful consultations with congressional offices or committees on the strengths and weaknesses inherent in running social programs through the tax system. Accordingly, the IRS could recommend that Congress design statutory provisions to avoid some of the proven shortcomings of Code-based programs to maximize the effective and efficient delivery of benefits.

The deputy commissioner would have a budget for the office's staff and have resource allocation authority for all social program initiatives. In designing the new organizational structure, the IRS should evaluate and build upon the experience of the EITC program office, which under its current design has shortcomings that impede its effectiveness. For example, the EITC program office controls the use of appropriated funds, but has no jurisdiction over audit and collection procedures with respect to the target population. This bifurcated approach results in the compliance functions' not conforming their traditional enforcement procedures to the needs and characteristics of the target population. As a result, failure to account for the target population's challenges can result in inaccurate audit results and unnecessary harm to the taxpayer.[40]

Upon establishing the program office, the IRS should launch a comprehensive study on the "Lessons Learned" from running various social benefit programs throughout the years. This would enable the IRS to create a checklist of items to consider when planning a new benefit program – both statutory design and implementation issues. Therefore, the IRS would not have to start from scratch each time it plans to implement a new program. The IRS could develop lists of challenges and ways to design the provision or implementation strategy to address these challenges in the future. The checklist would constantly evolve

39 For example, the office would have the authority to determine the best overall administrative structure of each social benefit program, and determine whether in-house operations or an outside contractor could administer a particular program most effectively.

40 For a discussion of the problems with the EITC correspondence exam program, see National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 93-116 (*IRS Earned Income Credit Audits – A Challenge to Taxpayers*); National Taxpayer Advocate 2004 Annual Report to Congress vol. 2 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

as the IRS gains increasing experience with effective and ineffective statutory designs and implementation strategies.[41]

The IRS Should Create Sub-Program Offices for Distinct Components of Social Program Administration.

In our view, the IRS should consider creating a sub-program office for each distinct component of social benefit delivery. For example, one office should focus on financial literacy as well as refund delivery mechanisms, including stored value cards (SVCs) and split-refund options. Other sub-program offices would house expertise with distinct social benefit provisions. This effort would require the IRS to determine which tax provisions constitute social benefits and which require a distinct program office. Some benefits may share enough administrative similarities to warrant sharing a program office. For example, all benefits with eligibility requirements based on family relationships might be best administered through a single sub-program office.

The umbrella program office should be able to control the resources of the sub-programs, including human resource (full-time equivalent or FTE) allocation. As such, each sub-program should have the responsibility to request necessary funds and propose resource allocation, including detailed enforcement and services policies and allocation.

Creation of an Executive Steering Committee Would Improve Coordination of Social Programs Across the IRS.

The IRS should also create a Social Program Executive Steering Committee with senior executives from each organization and function. This council would sign off on initiatives and ensure that each one: (1) is designed to meet the policies of the program office, (2) provides sufficient service to the target population, and (3) does not duplicate another function's efforts. The steering committee members can share their experiences and plan for downstream consequences appropriately. Once the steering committee approves an initiative, the program office would have approval authority and the ability to allocate the appropriate funds.

CONCLUSION

The National Taxpayer Advocate is confident that the IRS is capable of administering social programs, including health care. However, crucial to its success is sufficient funding by Congress and recognition by the IRS that the skills and training required to administer social benefit programs are very different from the skills and training that employees of an enforcement agency typically possess. While enforcement measures are necessary to prevent

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41 The National Taxpayer Advocate set forth preliminary design considerations for social programs in her 2009 Annual Report to Congress. The IRS's checklist could reflect these considerations, but on a more detailed and practical level. National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 75-104 (Research and Related Studies: *Running Social Programs Through the Tax System*). For example, such a checklist would include a main lesson learned from administering the MWP credit: If eligibility hinges upon the receipt of a payment made by the other agency, the IRS should ascertain whether taxpayers have ready access to payment information. With proper planning, it would be helpful to require payors of such payments to include the amount of the payment on year-end tax information statements sent to beneficiaries.

inappropriate claims, the overriding objective of agencies that administer social benefit programs has traditionally been to help as many eligible persons as possible qualify for the benefits. That mission requires outreach and one-on-one contacts with potentially eligible individuals. If the IRS continues to step up enforcement while reducing taxpayer service programs, it may compromise its ability to administer the new health care credits and penalty taxes in a fair and compassionate way. Thus, it is essential that the IRS revise its current mission statement to also reflect its role as social benefits administrator. As a result, the IRS can propose separate budget requests for benefits programs rather than having to divert resources from traditional enforcement activities. The IRS should also consider realigning its organizational structure to effectively administer these programs in an effective and efficient manner. Such restructuring should involve the creation of a program office to work social program issues exclusively.

In conclusion, the National Taxpayer Advocate offers these preliminary recommendations:

1. Revise the IRS mission statement to reflect two distinct administrative roles of tax collection and social benefits delivery.
2. Revise Revenue Procedure 64-22 to include the IRS's responsibility as social benefits administrator.
3. Create a program office, headed by a new deputy commissioner position, to provide strategic direction for all social benefit programs.
4. Determine which distinct components of social program administration warrant separate sub-program offices.
5. Conduct a comprehensive evaluation of the administration of previous and existing social programs to determine "Lessons Learned" to add value to the planning and implementation of future programs.

IRS COMMENTS

While there are a number of very thoughtful and constructive ideas outlined in the Office of the National Taxpayer Advocate's articulation of these issues, the IRS does not agree that the wording of the IRS's mission statement is one of the "most serious problems" faced by taxpayers.

However, the IRS is always open to input from stakeholders, whether internal or external to the IRS, on the mission and strategic plan of the agency. The tax system is dynamic, and includes myriad provisions that are designed by policymakers to promote economic and social outcomes. The concept of administering economic and social benefits through the tax code is implicit in the IRS's role of running the overall tax system, not something separate and apart. In this context, the IRS continuously balances its programs to provide taxpayer services, conduct outreach and education, and enforce the tax law.

There are a number of helpful and thought-provoking ideas in this piece, which we will certainly consider moving forward.

Taxpayer Advocate Service Comments

We appreciate the IRS's willingness to consider revision of its mission statement. However, we are concerned that the IRS does not recognize the significant impact that its mission statement has on taxpayers and tax administration. A business or other organization typically establishes its mission as its foundation and then builds its strategic plan, operational priorities, budget, and performance measures around it. If the IRS's mission statement does not accurately reflect what Congress has directed it to do, its strategic plan, operational priorities, budget, and performance measures are unlikely to align to the work it is performing. The misalignment between the IRS's current mission statement and the scope of its responsibilities impacts each and every U.S. taxpayer. It is for that reason the National Taxpayer Advocate has identified this disparity as a most serious problem.

For the reasons described earlier, revision of the IRS's mission statement is crucial to ensure the IRS will receive sufficient funding to administer social benefit programs, without diverting resources from its core responsibility of revenue collection. Further, recognition of this separate and distinct responsibility in the agency's mission statement will facilitate the training of employees on the skills unique to social program administration, which are very different from those required for traditional enforcement or tax administration programs.

In its response, the IRS states that "[t]he concept of administering economic and social benefits through the tax code is implicit in the IRS's role of running the overall tax system, not something separate and apart." We generally agree, but believe the current mission statement focuses on the enforcement side of the tax system without reference to the payment of social benefits. That is, the mission statement addresses taxpayers' compliance with tax responsibilities. While there is certainly an enforcement component to social benefit administration, an equally significant element is the achievement of a high participation rate of those who are eligible for benefits. We believe the current mission statement does not cover this vital role, which requires a completely different skill set than is typically required of IRS employees.

While we may not agree on the severity of the existing problem, we look forward to working with the IRS to increase the effectiveness of social benefit administration, especially as the IRS implements the recent health care legislation.[42] Both taxpayers and the IRS will benefit if the IRS has the ability to propose separate budgets to ensure adequate funding for both functions. Further, the creation of a program office and executive steering committee to exclusively work social program issues will enable the IRS to store institutional knowledge and improve servicewide coordination of social benefit initiatives.

42 *See The Patient Protection and Affordable Care Act: A Preliminary Analysis of the Challenges Facing the IRS in Implementing Health Care Reform, infra*, vol. 2.

Recommendations

The National Taxpayer Advocate offers these preliminary recommendations:

1. Revise the IRS mission statement to reflect two distinct administrative roles of tax collection and social benefits delivery.
2. Revise Revenue Procedure 64-22 to include the IRS's responsibility as social benefits administrator.
3. Create a program office, headed by a new deputy commissioner position, to provide strategic direction for all social benefit programs.
4. Determine which distinct components of social program administration warrant separate sub-program offices.
5. Conduct a comprehensive evaluation of the administration of previous and existing social programs to determine "Lessons Learned" to add value to the planning and implementation of future programs.

MSP #3 IRS Performance Measures Provide Incentives that May Undermine the IRS Mission

RESPONSIBLE OFFICIALS

Steven T. Miller, Deputy Commissioner, Services and Enforcement
Beth Tucker, Deputy Commissioner, Operations Support
Rosemary D. Marcuss, Director, Office of Research, Analysis and Statistics

DEFINITION OF PROBLEM

The IRS's organizational performance measures focus on the number of activities completed during a short-term measurement period (*e.g.*, cycle time). For example, over two-thirds of the collection measures that appear in the Small Business/Self-Employed (SB/SE) division's quarterly performance reports improve if SB/SE reduces cycle time, as do nearly half of the measures reported in the IRS-wide performance appraisal. Thus, IRS leaders face incentives to adopt policies that reduce program-level processing times, even if those policies produce premature closures that do not resolve taxpayers' problems or promote the IRS's underlying mission to improve voluntary compliance.[1]

In addition, the IRS estimates the direct revenue it receives from enforcement, but not from taxpayer services. This practice makes it easier for Congress to fund initiatives that *generate* direct enforcement revenue than those that *prevent* delinquencies. Because the likelihood of receiving additional funding increases along with a program's direct enforcement revenue, IRS leaders face incentives to adopt policies that maximize such revenue, even if other policies would bring in more revenue by preventing delinquencies.

The incentive for IRS leaders to adopt policies that maximize processing speed and direct enforcement revenue may undermine the IRS's service-oriented mission at a time when Congress is asking the IRS to administer complex social programs, such as health care, where service is critical. Even in connection with the IRS's last reorganization – when it had responsibility for fewer social programs – legislators mandated balanced measures because they determined an excessive focus on short-term productivity and efficiency was inconsistent with the IRS's mission.[2] While it can be difficult to measure short-term results without creating incentives that undermine long-term goals, the IRS could do more to create incentives for IRS leaders to adopt proactive polices.

1 The IRS mission is to "provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all." Internal Revenue Manual (IRM) 1.1.1.1 (Mar. 1, 2006).

2 *See, e.g.*, Report of the National Commission on Restructuring the IRS, *A Vision for a New IRS* 21-22 (June 25, 1997) ("the [IRS's] internal measurement systems ... do not measure long-term quality performance accurately. Consequently, employees put an emphasis on short-term performance and meeting goals of efficiency ..., rather than on a balanced focus on efficiency, quality, and taxpayer service. Many employees and outside observers believe the result is that the performance measures do not align with the ultimate objectives and mission of the IRS."); IRS Restructuring and Reform Act of 1997, H.R. Rept. No. 105-364, at 47 (1997) ("The Committee encourages the IRS to redesign its performance measures to more appropriately align employee behavior with organizational goals... While any system of measures must reflect the *efficiency and productivity* of employees, the Committee expects that the IRS will establish a *balanced system of measures* that will ensure that taxpayer satisfaction is paramount throughout all IRS functions.") (Emphasis added).

ANALYSIS OF PROBLEM

Background

The IRS is required to use measures to evaluate its programs.

The IRS is legally required to establish performance targets and annually report its progress in meeting them.[3] In addition, the Commissioner or Deputy Commissioner meets with Division Commissioners and Chiefs to discuss program-level measures as part of a quarterly Business Performance Review (BPR) process.[4] Many of the same measures also appear in the individual performance appraisals of IRS executives.[5]

It is difficult for the IRS to measure results without creating counterproductive incentives.

About 97 percent of all tax revenues the IRS collects come in without the need for direct enforcement actions – because of voluntary compliance.[6] However, it has always been easier to quantify and measure enforcement actions and direct enforcement revenue than the indirect effect of IRS activities – including taxpayer service – on voluntary compliance.

In the years before 1998, the IRS's enforcement-oriented measures created incentives for enforcement behavior that alienated the public without enhancing tax compliance.[7] The National Commission on Restructuring the IRS found that measures of short-term performance and efficiency did not align with the IRS's mission.[8]

The IRS Restructuring and Reform Act of 1998 (RRA 98) required the IRS to adopt "balanced measures" to counter "efficiency and productivity" metrics.

RRA 98 prohibited the IRS from rating employees based on "records of tax enforcement results" (ROTERS).[9] It also required the IRS to establish a new system to measure both individual and group performance, which was supposed to focus on service.[10] Legislators expected new customer satisfaction measures to counter the negative incentives created by short-term measures of efficiency and productivity.[11] Similarly, policymakers proposed

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3 *See* 31 U.S.C. § 1115. *See also* Department of the Treasury, Annual Performance Report, FY 2009, 133-34 (Feb. 1, 2010), *available at* http://www.ustreas.gov/offices/management/dcfo/accountability-reports/09Treas_APR_full%20book_05.pdf (including the IRS measures).

4 IRM 1.5.1.15 (Aug. 21, 2009). The IRS Oversight Board may also review the BPRs.

5 *See, e.g.*, IRM 1.5.2.20 (June 1, 2010).

6 *See* IRS, *Tax Gap Map for Year 2001* (Feb. 2007), *available at* http://www.irs.gov/pub/irs-utl/tax_gap_update_070212.pdf (estimating that of the $1.822 trillion that would be collected for 2001, 97 percent ($1.767 trillion) would come in timely and voluntarily, and only three percent ($55 billion) would come in as a result of enforcement; another $290 billion – the so-called net tax gap – would remain uncollected).

7 Commissioner Charles O. Rossotti, *Report to the IRS Oversight Board Assessment of the IRS and the Tax System* 3 (Sept. 2002).

8 Report of the National Commission on Restructuring the IRS, *A Vision for a New IRS* 22 (June 25, 1997).

9 *See* RRA 98, Pub. L. No. 105-206, 112 Stat. 722, Title I, §§ 1204, 9508(a)(2) (1998); Joint Committee on Taxation (JCT), JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998* 47-50 (1998). *See also* IRM 1.5.2.2 (June 1, 2010) (noting that both the IRS and Congress had banned the use of ROTERS in rating front line employees before 1998, but the bans were "not necessarily easy to understand and were not interpreted consistently"). The number of liens, levies, or dollars collected or assessed are examples of ROTERS. IRM 1.5.2.6 (June 1, 2010).

10 RRA 98, Pub. L. No. 105-206, 112 Stat. 722, Title I, § 9508(a)(2) (1998). *See also* Report of the National Commission on Restructuring the IRS, *A Vision for a New IRS* 5 (June 25, 1997).

11 IRS Restructuring and Reform Act of 1997, H.R. Rept. No. 105-364, at 47 (1997).

new employee satisfaction measures that would reduce the incentive for IRS managers to apply indirect pressure on employees to meet organizational productivity and efficiency targets.[12] Legislators believed these changes would improve voluntary compliance by creating incentives for activities that would foster trust in the IRS.[13]

Policymakers borrowed this "balanced measures" approach from the private sector where companies use customer satisfaction measures to counter an over-emphasis on short-term financial results at the expense of long-term customer relationships.[14] Accordingly, the IRS established three "balanced measures:" customer satisfaction, employee satisfaction, and business results.[15]

Which "efficiency and productivity" metrics need to be counter-balanced?

Cycle time is an efficiency or productivity metric, but true measures of timeliness are not. Cycle time measures generally reflect the speed with which an IRS program closes cases or takes other actions. By contrast, timeliness measures indicate whether the IRS was timely in taking a discrete action from the taxpayer's perspective (*e.g.*, did the IRS return the taxpayer's call within three days) without regard to how many actions it took or cases it closed during the reporting period. While timeliness measures provide an incentive to move cases along by taking specific actions in a timely manner, they do not necessarily create incentives to close cases prematurely, as efficiency and productivity measures can.[16]

The IRS planned to reevaluate the incentives its measures create.

Following RRA 98, IRS measures continued to evolve, and the current IRS Commissioner pledged to reexamine the unintended incentives they create.[17] We intend this discussion to assist the Commissioner's review.[18]

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12 *See* Report of the National Commission on Restructuring the IRS, *A Vision for a New IRS* 22 (June 25, 1997); T.D. 8830, 64 Fed Reg. ¶ 42,834 (Aug. 6, 1999) (explaining "[t]he presence of measures that evaluate the quality of the work done by the unit, the satisfaction of customers served by the unit (including taxpayers), and the satisfaction of employees working in the unit will obviate the risk that managers place undue emphasis upon the quantity of work completed.").

13 JCT, JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998*, 19 (1998) (noting that RRA 98 was intended to restore public confidence in the IRS, in part, because "the Congress believed that most Americans are willing to pay their fair share of taxes, and that public confidence in the IRS is key to maintaining that willingness.").

14 *See, e.g.*, Government Accountability Office (GAO), GAO-01-234, *IRS Should Enhance Its Performance Management System* 6 (Feb. 2001); Charles O. Rossotti, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America* 112-115 (Harvard Business School Press 2005).

15 26 C.F.R. § 801.1 *et seq.* *See also* IRM 1.5.1 (Aug. 21, 2009).

16 The IRS has issued confusing guidance about whether "cycle time" and "overage" are quality or quantity measures. *Compare* 26 C.F.R. § 801.6(c) (defining "cycle time" and number or percentage of "overage" cases as quantity measures) *and* IRM 1.5.2.8 (June 1, 2010) (same), *with* IRM 1.5.2.9 (June 1, 2010) (defining "overage cases" and "cycle time" as quality measures).

17 Responses to Questions Following the Testimony of Doug Shulman, Nominee for IRS Commissioner, Before the Senate Committee on Finance, Q/A 45 (Feb. 11, 2008) (pledging to review IRS measures to "make sure that they are aligned with the priorities of the IRS as a whole... are clear, and ... engender the desired behavior.").

18 For prior coverage of the impact of IRS measures, see, *e.g.*, National Taxpayer Advocate 2008 Annual Report to Congress 159.

IRS program-level measures focus on processing speed.

IRS leaders focus on "business results" when evaluating programs.

The IRS generally measures customer and employee satisfaction using annual (or sometimes quarterly) surveys.[19] However, the IRS has stated that they are lagging indicators that can be difficult to link to specific activities or programs.[20] Moreover, SB/SE only includes program-level customer satisfaction results in its BPR on an annual basis.[21] Thus, it may be natural for IRS leaders to focus primarily on quarterly "business result" measures, particularly those that regularly appear in the BPR or other highly visible documents.

By design, business-result measures focus on cycle time.

The IRS is supposed to assess operational business results using measures of "output or quantity" and "efficiency or quality."[22] Each of these may reflect cycle time, however, because output or quantity is production over a reporting period, and "efficiency" is simply quantity divided by another statistic such as the number of full time equivalent (FTE) employees. Even measures of "quality" can include measures of cycle time (rather than timeliness, as discussed above).[23] In other words, an improvement (decrease) in cycle time can improve all of the business result measures. Thus, notwithstanding RRA 98's direction for the IRS to focus on customer satisfaction, by design, processing speed (or cycle time) is still the most important measure.

In practice, the BPR focuses on cycle time.

The only measures referenced in SB/SE's discussion of the "performance" of each of its five major programs in the BPR is a table that lists productivity, cycle time, efficiency, or overage.[24] For example, the "collection performance" section of SB/SE's BPR reports only:

- The number of liens, levies, seizures, unfiled return case closures (called "taxpayer delinquency investigations" (TDI)), and unpaid tax case closures (called "taxpayer delinquent accounts" (TDA));

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19 IRM 1.5.1.7 (Aug. 21, 2009); IRM 1.5.1.8 (Aug. 21, 2009); IRM 1.5.1.9 (Aug. 21, 2009); IRM Exhibit 1.5.1-1 (Q5), (Q6) (Aug. 21, 2009); Wage and Investment (W&I) Division, Business Performance Review (BPR) 29-30 (Feb. 2010).

20 As one recent W&I Division BPR explained:

> In Reporting Compliance, the success of previous customer satisfaction improvement projects have [sic] often been measured only by the change in our customer satisfaction scores, even though that measure is a "lagging indicator" at best and is often affected by multiple other variables. We would like to look at adding other metrics for success when we do our projects. W&I, Business Performance Review 29-30 (Feb. 2010).

21 IRS Response to TAS information request (Oct. 27, 2010); SB/SE, Business Performance Review (Feb. 2010) (not listing program-level survey results); SB/SE, Business Performance Review (May 2010) (not listing program-level survey results). In its fourth quarter 2010 BPR, SB/SE plans to explain that the only significant change to customer satisfaction results – a decline in satisfaction with field examinations – is attributable to "changes to the survey and the mix of work." IRS Response to TAS information request (Oct. 27, 2010). It may be more difficult to explain why none of its initiatives have had a significant positive impact on customer satisfaction results. *Id.*

22 IRM 1.5.1.8.2 (Aug. 21, 2009). The IRM seems to equate quality with efficiency.

23 IRM 1.5.1.8.2 (Aug. 21, 2009); IRM Exhibit 1.5.1-1 (Q15) (Aug. 21, 2009) (explaining that cycle time and overage are considered "quality" measures (rather than quantity measures) because they "assess the timeliness in which work is completed [and] do not tell us how much work was competed."); IRM 1.5.2.9 (June 1, 2010).

24 *See* SB/SE, Business Performance Review (May 2010). The five programs include Campus Compliance Services, Fraud/Bank Secrecy Act, Collection, Specialty Programs, and Examination. *Id.*

- The percentage of TDI/TDA cases that are overage (*i.e.*, have been open for 16 months or longer); and
- The percent of field offers in compromise (OIC) closed within nine months, along with an indication of whether Collection is on target to meet its production goals.[25]

Thus, all of the measures the IRS lists in the BPR to assess the success or failure of the Collection Field function improve if the IRS increases processing speed.[26] The IRS does not include any other measures to provide balance (*e.g.*, employee satisfaction, taxpayer satisfaction, future compliance, or delinquencies resolved without the need for a lien, levy, etc.).[27]

SB/SE asserts that it also uses an expanded suite of measures to evaluate the Collection Field function, as shown in the following table.[28]

25 *See* SB/SE, Business Performance Review (May 2010); IRM Exhibit 3.13.2-1 (Jan. 1, 2010) (defining TDI and TDA). The IRS has targets for TDA Closures, TDI Closures, Percent Overage – TDA/TDI Taxpayer Combo, and Percent OIC Field Closures in 0-9 Months. SB/SE, Business Performance Review (May 2010).

26 SB/SE's BPR generally describes actions designed to improve customer and employee satisfaction, but these descriptions are not performance measures.

27 Given the IRS's focus on cycle time, it is not surprising that some IRS employees feel pressure to increase the production figures reflected in the BPR. The 2010 employee survey results show that, notwithstanding RRA 98's prohibition on ROTERS, 17.2 percent of IRS enforcement employees indicated that "enforcement results were verbally communicated as production goals or quotas by either my supervisor or next-higher level manager;" and 9.1 percent indicated that "tax enforcement results were used by either my supervisor or next-higher level manager to evaluate my performance." Sirota Survey Intelligence Data (Sept. 17, 2010).

28 We cannot verify how SB/SE uses these measures because SB/SE declined to provide TAS with the documents in which they appear. SB/SE response to TAS information request (Aug. 19, 2010).

TABLE 1.3.1, Incentives Produced by Other Collection Performance Measures and Indicators[29]

Measure/Indicator	Incentive: Productivity, speed, or efficiency	Timeliness	Accuracy, completeness, or quality	Effect on taxpayers or employees
Number of Taxpayer Closures	X			
Taxpayer Closures per FTE	X			
$ Collected From TDAs Assigned to Field	X			
Number of Total $ Collected	X			
Number of TDA Closures – TDA & Combo Taxpayers	X			
Number of TDA Closures – Module	X			
TDA & Combo taxpayers per FTE	X			
Cycle Time TDA Module – Avg. Weeks	X			
Percent Overage - TDA/Combo TDI Taxpayers Combined[30]		X		
Number Overage-TDA/Combo TDI Taxpayers Combined		X		
Number of Liens	X			
Number of Levies	X			
Number of Seizures	X			
Number of TDI Closures - Stand Alone Taxpayers	X			
Number of TDI Closures – Modules	X			
TDI Stand Alone taxpayers per FTE	X			
Cycle Time TDI Total Investigations – Avg. Weeks	X			
Number of OIC Field Closures	X			
Number of OIC Field Receipts				X
Percent OIC Field Closures in 0 - 9 Months	X			
Employee Satisfaction (Percent Satisfied)				X
Taxpayer Satisfaction (Percent Satisfied)				X
Taxpayer Satisfaction (Percent Dissatisfied)				X
NQRS Quality Score			X	
NQRS OIC Quality Score			X	
Number	**17**	**2**	**2**	**4**
Percentage	**68%**	**8%**	**8%**	**16%**

While this expanded list includes measures of timeliness, accuracy, customer satisfaction, and employee satisfaction, it focuses primarily on measures of productivity, speed, and

29 SB/SE response to TAS information request (Aug. 19, 2010). This table omits two staffing measures: "FTEs - Total FAC 7D plus FAC 7P" and "FTEs – Areas." We omitted them because they are unlikely to create the kind of incentives that we are discussing here. For purposes of the tables included in this discussion, measures included in the "productivity, speed, or efficiency" column reflect the number of actions, such as case closures or dollars collected during the reporting period, whether or not presented as a ratio with another statistic. By contrast, measures included in the "timeliness" column reflect how timely the IRS was in taking a discrete action, such as contacting a taxpayer, without regard to how many actions it took or cases it closed during the period.

30 "Overage" TDA/TDI means "taxpayers in ending inventory that have been in progress for 16 months or longer." SB/SE, Field Collection, FY 2010 Data Dictionary, Business Performance Review Measures (Dec. 2009). While measures of overage inventory have the potential to create incentives similar to productivity measures, for purposes of this analysis, we conservatively include them in the timeliness column because they do not necessarily create an incentive for the IRS to reduce cycle time or to close cases prematurely, particularly if the overage benchmark is not excessively short.

efficiency, which represent over two-thirds of the total. This is because SB/SE breaks out productivity, speed, and efficiency for every type of collection activity separately (*e.g.*, liens, levies, seizures, TDA/TDI closures), but does not similarly break out timeliness, accuracy, completeness, or satisfaction.

Omitting satisfaction and quality measures from the BPR reduces balance.

Disaggregating or separating processes and measures that improve with cycle time (*i.e.*, productivity and efficiency measures), but not doing so for other measures reduces the effectiveness of the balanced measures concept. Moreover, readers of SB/SE's quarterly BPR or other high-level collection reports have no way to know:

- If Collection is processing liens, levies, seizures, offers, TDI, and TDA cases in a way that enhances future compliance;
- If Collection is applying its resources to the right cases to maximize voluntary compliance; or
- How long Collection is allowing delinquencies to remain unaddressed, or only partially or temporarily addressed, from the taxpayer's (and the government's) perspective.

The IRS assumes that an increase in the number (and speed) of quarterly collection activities is the primary way to achieve the IRS mission to improve voluntary compliance.[31] However, the IRS has not done the research necessary to validate this conclusion, and both the IRS and legislators previously rejected it when the balanced measurement system was adopted.[32]

The IRS's focus on processing speed is not due to a lack of other measures. Collection tracks other items that may be better measures of long-term success in promoting voluntary compliance. For example, it tracks the default rate for installment agreements and offers in compromise, the rate at which taxpayers cure delinquencies after receiving an IRS

31 According to the IRS, "we can assess how we are doing on Improving Voluntary Compliance (is it going up or going down) through the budget level measures reported for Examination and Collection coverage." IRS response to TAS information request (Sept. 24, 2010). The Office of Management and Budget (OMB) website similarly states:

> IRS measures the effects of collection program activities on the VCR [voluntary compliance rate] (which includes filing and payment compliance) through the long-term proxy measures of Collection Coverage and Collection Efficiency....the effects of the Collection program on taxpayer behavior is also evidenced through deterrence, though the effect as such is not measured by the IRS.

OMB, *Detailed Information on the Internal Revenue Service Tax Collection Assessment* (2008), http://www.whitehouse.gov/omb/expectmore/detail/10000424.2008.html (last updated Jan. 9, 2009).

32 Research suggests that both enforcement and service activities have an effect on voluntary compliance. *See, e.g.*, Alan H. Plumley, Pub. 1916, *The Determinants of Individual Income Tax Compliance: Estimating the Impacts of Tax Policy, Enforcement, and IRS Responsiveness* 35-36 (Oct. 1996). But, not all enforcement activities have the same effect. *Id.* Some may reduce compliance. *See* National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 29 (finding about 74 percent of those taxpayers with no assessed delinquency at the end of 2001 who did not pay a 2002 assessment, had a subsequent-year delinquency or unfiled return).

notice, and the rate at which delinquencies are resolved without the need for enforcement.[33] However, Collection does not highlight such data as part of the formal BPR process.[34]

Enterprise-level reports also focus on speed.

The IRS places a similar emphasis on processing speed at the enterprise level. Nearly half of the IRS's enterprise-level measures reflected in its Annual Performance Report (called "budget level" measures) provide incenives for productivity, speed, and efficiency, as shown in the folowing table.

TABLE 1.3.2, Incentives Produced by IRS Enterprise-Level Measures and Indicators[35]

Measure/Indicator	Incentive			
	Productivity, speed, or efficiency	Timeliness	Accuracy, completeness, or quality	Effect on taxpayers or employees
Goal 1: Improve Service to Make Voluntary Compliance Easier				
Customer Service Representative (CSR) Level of Service	X			
Customer Contacts Resolved per Staff Year	X			
Customer Accuracy – Tax Law Phones			X	
Customer Accuracy – Customer Accounts (Phones)			X	
Timeliness of Critical Individual Filing Season Tax Products to the Public		X		
Timeliness of Critical Tax Exempt and Government Entities (TE/GE) and Business Tax Products to the Public		X		
Percent Individual Returns Processed Electronically				X
Cost per Taxpayer Served ($) (HCTC)	X			
Sign-Up Time (Days) – Customer Engagement (HCTC)				X
Percent Business Returns Processed Electronically				X
Refund Timeliness – Individual (Paper)		X		
Taxpayer Self Assistance Rate				X
Service Subtotal – Number	3	3	2	4
Service Subtotal – Percent	25%	25%	17%	33%
Goal 2: Enforcement the Law to Ensure Everyone Meets Their Obligation to Pay Taxes				
Examination Coverage – Individual	X			
Field Examination National Quality Review Score			X	
Office Examination National Quality Review Score			X	
Examination Quality – Industry			X	
Examination Quality – Coordinated Industry			X	
Examination Coverage – Business (Corps. >$10M)	X			

table continued on next page

33 SB/SE response to TAS information request (Aug. 2, 2010).

34 According to SB/SE, it is "in the process of establishing objectives and performance measures for key collection notices. Data is available and tracked for the number of case dispositions in notice status." SB/SE response to TAS information request (Aug. 2, 2010).

35 *See* Department of the Treasury, Annual Performance Report, FY 2009, 133-34 (Feb. 1, 2010). This table omits two Business System Modernization measures because they have little impact on incentives facing IRS programs that serve taxpayers.

Measure/Indicator	Incentive			
	Productivity, speed, or efficiency	Timeliness	Accuracy, completeness, or quality	Effect on taxpayers or employees
Examination Efficiency – Individual (1040)	X			
Automated Underreporter (AUR) Efficiency	X			
Automated Underreporter (AUR) Coverage	X			
Collection Coverage – Units	X			
Collection Efficiency – Units	X			
Field Collection Embedded Quality			X	
Automated Collection System (ACS) Accuracy			X	
Criminal Investigations Completed	X			
Number of Convictions	X			
Conviction Rate			X	
Conviction Efficiency Rate ($)	X			
TE/GE Determination Case Closures	X			
Enforcement Subtotal – Number	11	0	7	0
Enforcement Subtotal – Percent	61%	0%	39%	0%
Total – Number	**14**	**3**	**9**	**4**
Total – Percent	**47%**	**10%**	**30%**	**13%**

While only about 25 percent of the service measures provided an incentive to reduce processing time, more than 60 percent of the IRS's enforcement metrics do so.

In addition, none of the IRS's enforcement measures reflect the timeliness of the enforcement from the taxpayer's perspective or its impact on compliance. It is possible to measure how long a taxpayer was delinquent before the IRS fully addressed the problem. It is also possible to measure the impact of the IRS on a taxpayer's future compliance, but the IRS does not do so – at least not for purposes of the highly visible Annual Performance Report or the BPRs described above.

The IRS's inability to measure service revenues combines with budget rules to provide incentives for IRS programs to focus on enforcement revenue.

Enforcement initiatives that will generate direct enforcement revenue receive disproportionate funding compared to other enforcement or service initiatives that could bring in larger – but difficult to measure – revenues by enhancing voluntary compliance. Pursuant to a budget rule called the "program integrity cap," if the IRS estimates the return on investment (ROI) for an initiative is greater than one, Congress can appropriate funds for it without cutting spending elsewhere.[36] ROI is the ratio of the direct revenue the IRS expects an initiative to generate divided by the direct and indirect costs of that initiative (*e.g.*, where direct revenue is $3x and total costs are $1x, the ROI is 3 or 3:1). To date, Congress has

[36] For prior discussion of the budget rules, see National Taxpayer Advocate 2006 Annual Report to Congress 442-446.

only used this budget device to fund enforcement.[37] Congress has not been able to use it to fund services, in part, because the IRS does not estimate the ROI for service initiatives.

However, in some cases the IRS's estimates of enforcement revenue are just as speculative as any estimate of service revenue would be. The IRS cannot reliably project the amount of controversy an enforcement initiative will generate – particularly a new initiative – and does not even try to estimate the impact of initiatives on voluntary compliance (*i.e.*, indirect revenue gains or losses).[38] For example, to the extent taxpayers consider an initiative unfair (*e.g.*, because it is overly automated or rushed as a result of a focus on cycle time), it could potentially generate more TAS cases, Appeals cases, and litigation than expected. In such instances, the initiative could also reduce voluntary compliance and indirect revenue, which the IRS does not attempt to measure.[39] Consequently, the IRS could project an initiative will produce a positive ROI, when in fact the ROI is negative.

In addition, as noted above, about 97 percent of all tax revenues the IRS collects come in without the need for expensive enforcement resources, in part because of IRS services.[40] If the IRS did not process submissions; provide forms, instructions, and guidance; send notices and communicate with taxpayers and practitioners in other ways; and make taxpayers feel the IRS and its processes are fair, it would not collect these "service revenues."[41] Yet, Congress cannot use the program integrity cap to fund services, in part, because the IRS does not measure or quantify the ROI for taxpayer services.

Predictably, funding for enforcement increased more than five times as much as funding for services between fiscal year (FY) 2007 and FY 2010.[42] Thus, notwithstanding RRA 98's direction for the IRS to become more service-oriented and the increasing number of social benefit programs (including Economic Stimulus Payments, the Making Work Pay credit, the First-Time Homebuyer Credit, and a variety of provisions relating to health care reform) that Congress is asking the IRS to administer, it is becoming less of a service organization and more of an enforcement agency.

Moreover, if Congress funds IRS programs likely to produce the most direct enforcement revenue but not those that produce service revenue or improve voluntary compliance, the

37 *See, e.g.*, Department of the Treasury, *Budget in Brief FY 2011*, 2, 10 (2010), http://www.irs.gov/pub/newsroom/budget-in-brief-2011.pdf.

38 Each IRS business unit does attempt to estimate how many FTEs will be required directly and indirectly to handle the down stream consequences of the initiative. IRS response to TAS information request (Aug. 6, 2010).

39 *See, e.g.*, Swedish Tax Agency, *Right From The Start, Research and Strategies* 6-7, (Aug. 2005) (surveying research suggesting that people are less likely to accept a negative decision or voluntarily comply if they do not perceive the tax agency to be fair).

40 *See* IRS, *Tax Gap Map for Year 2001* (Feb. 2007).

41 However, the IRS recently proposed to *save* money by discontinuing tax form mailings. IRS, FY 2011 Congressional Budget Submission 19 (Feb. 1, 2010). It recently discontinued these mailings. *See* IRS, *Tax Package Mailing to End Following Growth of e-File*, *available at* http://www.irs.gov/businesses/small/article/0,,id=228152,00.html (last visited Oct. 12, 2010).

42 Nominal funding for services increased by $141 million or 6.6 percent (from $2.138 billion in FY 2007 to $2.279 billion in FY 2010), while nominal funding for enforcement increased by $818 million or 17.5 percent (from $4.686 billion to $5.504 billion) over the same period. GAO, GAO-10-687R, *Assessment of Budget Justification for Fiscal Year 2011 Identified Opportunities to Enhance Transparency* 10 (May 2010). We divided the increase for enforcement ($818 million) by the increase for services ($141 million) to compute that the increase for enforcement was 5.8 times the increase for services.

implied message to IRS leaders is that they should care more about the impact of a program on direct enforcement revenue than on voluntary compliance. The IRS reinforces this message with measures that focus primarily on cycle time rather than customer satisfaction, accuracy, completeness, timeliness or other factors likely to increase voluntary compliance.

A focus on cycle time measures and enforcement revenue leads to reactive (rather than proactive) policies and procedures.

The IRS's focus on quick closures and enforcement revenue provides incentives for IRS leaders to adopt policies and procedures that result in premature IRS "closures" that do not necessarily further the government's long-term interests or fully resolve the taxpayer's problems.[43] For example, in last year's report TAS discussed how IRS collection executives issued guidance requiring employees to obtain approval not to file a notice of federal tax lien (NFTL) even in cases where the lien would not attach to anything or would impair the taxpayer's ability to earn income needed to repay the government.[44] This policy is likely to increase the NFTL numbers shown on the BPR along with enforcement revenue statistics, but will not necessarily resolve taxpayer delinquencies more quickly, increase government revenue, or improve future compliance.[45] A focus on cycle time and cost also provided an incentive for the IRS to expand its use of correspondence examinations to more complex business returns, even though the procedure's inability to detect unreported income on such returns may actually reduce voluntary compliance.[46] If the IRS's program-level measures focused more on the specific and measurable impact of IRS activities on taxpayers (*e.g.*, satisfaction and future compliance), they would create a stronger incentive for IRS leaders to adopt policies that achieve long-term results and ultimately bring in more revenue.

CONCLUSION

The IRS's organizational measures provide incentives for leaders to promulgate policies that maximize processing speed. Similarly, the IRS's ability to quantify the ROI for enforcement (and thereby obtain funding for it) coupled with its inability to do the same for taxpayer service creates an incentive for IRS leaders to adopt policies that *generate* direct enforcement revenue quickly but not those that *prevent* delinquencies. Such policies are likely to send taxpayers from one program to another without necessarily reducing IRS-wide cycle time, preventing, addressing or resolving taxpayer problems, or promoting

43 For additional discussion of IRS measures, see National Taxpayer Advocate 2008, Annual Report to Congress 159.

44 SB/SE, No. 05-1208-069, *Interim Guidance for Approval of Lien Determinations* (Dec. 22, 2008).

45 For a more detailed discussion, see National Taxpayer Advocate 2009 Annual Report to Congress 17-40.

46 *See, e.g.*, SB/SE, Campus Compliance Services Program Letter for FY 2010 (Sept. 28, 2009) (expressing the goal to "expand workload selection in Correspondence Examination to complex Business Master File (BMF) and Individual Master File (IMF) workloads"); National Taxpayer Advocate 2009 Annual Report to Congress 158, 166-67. Similarly, a focus on minimizing the time IRS employees spend on calls provides an incentive for policies that end communications prematurely. *See, e.g.*, IRM 1.4.16.3.4.2 (Jan. 1, 2009); W&I, Business Performance Review 17 (Feb. 2010) (listing measures of calls answered and resolved, but no measures of how often taxpayers required additional communications that should not have been necessary).

voluntary compliance. Thus, the IRS could do a better job of aligning program-level incentives with its underlying mission to promote voluntary compliance.

The National Taxpayer Advocate offers these preliminary recommendations to the IRS:

1. Report disaggregated satisfaction, accuracy, and completeness metrics at every level at which the IRS reports efficiency, speed, or productivity metrics;
2. Create measures for the BPR and other highly visible reports that reflect the period between the due date of the return and final resolution of any liability (*e.g.*, through full payment, abatement, or compromise), as previously recommended by the National Taxpayer Advocate;[47]
3. Create measures for the BPR and other highly visible reports that reflect the extent to which the IRS's programs completely resolved the noncompliance and prompted the taxpayer to comply in subsequent periods; and
4. Initiate research to quantify the impact of various types of taxpayer service and outreach on voluntary compliance and direct tax revenue so the IRS can estimate the ROI of such initiatives.[48]

IRS COMMENTS

The IRS Restructuring and Reform Act of 1998 initiated sweeping changes that had a dramatic effect on IRS operations. The most visible change was the creation of four business operating divisions, each with end-to-end accountability for a given customer segment. This organizational structure enabled IRS leadership to gain a deeper understanding of the IRS's customer segments and take a more holistic view of their needs. The IRS also adopted a new mission statement, which captured its twin purposes to "[1] provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and [2] enforce the law with integrity and fairness to all."[49] This dual mission recognizes that voluntary compliance depends on a combination of high-quality service delivery and a credible enforcement presence. A final significant change was the introduction of the balanced measures approach encompassing customer satisfaction, employee engagement, and business results, which remains in place today.[50] As a consequence of these changes, we believe that the IRS today effectively balances its twin missions of service *and* enforcement to promote voluntary compliance and ensure that everyone pays their fair share.

The National Taxpayer Advocate contends that "IRS program-level measures focus on processing speed." As evidence, they focus on the quarterly SB/SE Business Performance

47 *See, e.g.*, National Taxpayer Advocate 2006 Annual Report to Congress 62, 81.

48 The National Taxpayer Advocate previously made similar recommendations. *See, e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 35, 38; National Taxpayer Advocate 2006 Annual Report to Congress 442-446.

49 IRS, *The Agency, Its Mission and Statutory Authority*, http://www.irs.gov/irs/article/0,,id=98141,00.html (last reviewed or updated, June 23, 2010) (numbering added).

50 *See* IRM 1.5.1.

Review, and specifically, the Collection Field function. However, the quarterly BPR is a high-level document that cannot reasonably contain all the measures used to manage operations. SB/SE leadership, for instance, regularly reviews additional performance data beyond the measures shown in BPR, including the 25 performance indicators for Collection shown in Table **1.3.1**, *Incentives Produced by Collection Performance Measures and Indicators*. While this is only a subset of the full range of operational measures that Collection management uses to monitor and assess its programs,[51] this list contains the key elements of a balanced measures system—customer satisfaction, employee engagement and business results (both quality and quantity). However, based on this list, the National Taxpayer Advocate concludes that 68 percent of Collection measures incentivize "productivity, speed, or efficiency."

This analysis presumes that a given measure cannot serve multiple purposes. In particular, the classification of cycle time as a measure of speed is incomplete. Clearly, cycle time is also closely related to "timeliness," as maintaining timely interactions throughout the collection process is an essential component of delivering cycle time goals. Moreover, timeliness/cycle time is a significant customer concern. The "amount of time you had to spend on this collection issue" was the top improvement priority for collection customers on the most recent Collection customer satisfaction survey.[52] This question had the highest level of dissatisfaction (25 percent) on the survey. Clearly, customers share with the IRS the desire to reduce the length of the process and resolve their cases efficiently.

Other measures similarly create multiple incentives. Like cycle time, overage measures have a direct effect on taxpayers eager to resolve their IRS issues (and also incentivize speed or efficiency). Quality scores are based on an evaluation of multiple quality attributes, including timely interactions and customer relations as well as accuracy.[53] If these overlapping incentives were captured, a more balanced picture of Collection's suite of measures would emerge. Even then, the mere number of measures is not an indicator of their relative significance. Many of the "productivity, speed, or efficiency" measures are more appropriately viewed as a set (*e.g.*, *Number of TDA Closures – TDA & Combo Taxpayers, Number of TDA Closures – Module, Number of TDI Closures – Stand Alone Taxpayers*, and *Number of TDI Closures – Module*). Such measures capture distinct aspects of the workload for operational purposes, but tend to be considered collectively when evaluating the program overall. Other performance indicators (in particular, measures of dollars collected, and the numbers of liens, levies and seizures) are reported solely for informational purposes but do not have targets established and are not used to evaluate performance.

51 The Enterprise Collection Report, for example, tracks the overall outcome of dispositions by monitoring rework (*e.g.*, installment agreements or offers in compromise that are returned to inventory) to help measure the success of Collection dispositions. The monthly Area Assessment Report breaks down details behind the overall quality score. Quality measures are also routinely analyzed to determine if a correlation exists between a particular quality element and customer satisfaction.

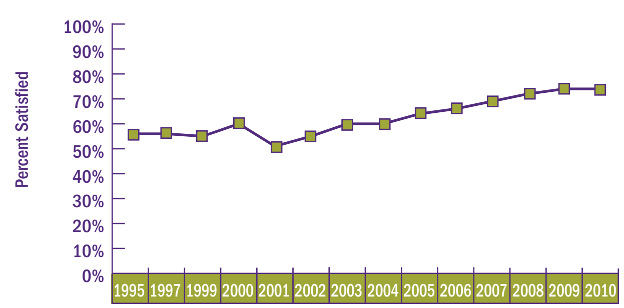
52 Pacific Consulting Group, *SB/SE Field Collection National Report (April – June 2010)*.

53 Relevant attributes include: *Timely Employee Actions*, *Timely Follow-Up Actions*, *Clear Action Dates and Expectations*, *Advised [Taxpayer] of Consequences*, and *Requested/Secured Financial Information*, among others. (Source: Field Collection Embedded Quality Manager and Reviewer Job Aid).

Applying equivalent weights to these metrics to determine the percentage associated with each incentive category is potentially misleading as this approach does not reflect how they are actually used to manage the Collection program.

The National Taxpayer Advocate conducts a similar analysis of the IRS enterprise-level budget measures reported in the IRS's Annual Performance Report, concluding that "IRS places a similar emphasis on processing speed at the enterprise level." Again, however, this source includes only a small subset of the many measures used to monitor and evaluate operational performance. The 30 measures in the Annual Performance Report were selected in conjunction with Treasury to provide a high-level perspective on each IRS budget activity. By contrast, the quarterly BPRs for the four IRS business operating divisions contain over 300 measures, ranging from closures and cycle time to quality and customer satisfaction. Moreover, paralleling the budget-level measures, IRS reports a separate set of enterprise-level measures each quarter to the IRS Oversight Board.[54] The measures monitored by the Board focus solely on cycle time and customer satisfaction, reflecting the Board's perspective that cycle time is a key driver of customer satisfaction.[55]

FIGURE 1.3.3, IRS Employee Satisfaction



Ultimately, though, the significance of IRS program measures lies not in what measures are reported to which level, but in the impact the balanced measures approach has had on the management and operation of the IRS. To address employee engagement, IRS has conducted an all-employee survey since at least 1995 (annually since 1999). Following a decline in 2001 during the agency reorganization, employee satisfaction has risen steadily through the

54 The IRS Oversight Board was created by Congress under the IRS Restructuring and Reform Act of 1998 with responsibility to oversee the IRS in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws.

55 The 16 "enforcement" measures tracked by the Oversight Board are comprised exclusively of cycle time and customer satisfaction measures. The Board also monitors key measures of IRS service and support functions.

current year, as shown in Figure **X**, *IRS Employee Satisfaction*.[56] Meanwhile, the IRS score on the Partnership for Public Service's *Best Places to Work in the Federal Government* index has climbed from 56.1 in 2003 to 68.2 in 2010.[57] While our rank of 79 out of 224 agency subcomponents leaves ample room for continued improvement, the progress made to date evinces IRS's commitment to this aspect of the balanced measures. Moreover, the IRS has received external recognition as an excellent place to work. *BusinessWeek* recognized the IRS as one of only five non-profit / government agencies on its 2009 roster of "Best Places to Launch a Career."[58] Meanwhile, *DiversityInc* and *Equal Opportunity* magazines have both recognized IRS as a leader among government agencies for diversity.[59]

The IRS also maintains an extensive customer satisfaction program. With the institution of balanced measures, the IRS put in place transactional surveys of customer satisfaction in 11 major programs in 1998. Today, that number has grown to over 30 transactional surveys plus additional relationship surveys with small businesses, tax professionals, outreach partners, and others. Satisfaction with IRS service programs has been consistently high, exceeding 90 percent for Toll-Free and Field Assistance programs.[60] The IRS also participates in the American Customer Satisfaction Index (ACSI). Since 2000, ACSI has separately polled individual paper and electronic tax filers about their filing experience. From 2000 to 2009, the ACSI score for individual e-filers increased from 75 to 79 while the score for paper filers increased from 48 to 55.[61]

Not surprisingly, enforcement activities do not enjoy the same levels of satisfaction as service programs. Unlike service programs, these are not voluntary customers, and perceptions of satisfaction are strongly influenced by case outcomes. In SB/SE Field Examination, for instance, respondents with no tax change are four times as likely to express satisfaction as those who disagree with their adjustment.[62] While other factors may certainly be at play, the effect of an unwelcome outcome on overall perception of the examination experience cannot be ignored. Moreover, in contrast to the assumptions underlying the National Taxpayer Advocate's analysis, *length of process* (*i.e.*, cycle time) has a strong influence on customer satisfaction with many IRS enforcement activities. As noted above, *time you spent on issue* is the top improvement priority for Collection customers.[63] *Length of process* is also identified as the top improvement priority in correspondence examinations and

56 Employee satisfaction is measured as the percentage of "4" or "5" responses on a five-point scale to the question "Considering everything, how satisfied are you with your job?"

57 Partnership for Public Service, *The Best Places to Work in the Federal Government*, www.bestplacestowork.org.

58 The Best Places to Launch a Career, *BusinessWeek* (Sept. 14, 2009), www.businessweek.com/bestplaces.

59 The 2010 DiversityInc Top Federal Agencies for Diversity, *DiversityInc*, (Mar. 12, 2010), www.diversityinc.com/article/7320. 2010 Readers' Choice: Top 20 Government Employers, *Equal Opportunity*, www.eop.com/awards-EO.php.

60 Pacific Consulting Group, *Toll-Free National Reports* and *Field Assistance National Reports*.

61 The American Customer Satisfaction Index, www.theacsi.org. The ACSI score is an index, not a satisfaction percentage. The average ACSI for all individual filers has improved over time with the increased adoption of electronic filing, from 56 in 2000 to 71 in 2009. By comparison, the federal agency average was 68.7 in 2009.

62 ICF Macro, *SB/SE Field Examination Customer Satisfaction Survey (April 2009 – March 2010).*

63 *See* Pacific Consulting Group, *SB/SE Field Collection National Report (April – June 2010)*.

large-business industry examinations.[64] Across an array of programs, survey results show that satisfaction decreases as cycle time increases. For example, satisfaction with SB/SE Field Examination for taxpayers whose examinations were more than twelve months long was less than half that of taxpayers whose examinations were resolved in three months or less.[65]

More importantly, however, the IRS uses customer and stakeholder feedback to determine how to improve the taxpayer experience to ensure that all taxpayers are treated fairly and equitably. All the surveys provide detailed response and demographic information to facilitate improvement projects. In the service context, the IRS has collaborated since 2005 with the National Taxpayer Advocate and the IRS Oversight Board to develop and implement the Taxpayer Assistance Blueprint (TAB), which drew from extensive research on customer needs and preferences to provide strategic direction to drive service improvement decisions.[66] On the enforcement side, we have implemented a variety of improvements, such as:

- Developing and implementing the Compliance Assurance Process, through which large-business taxpayers with a history of compliance can work jointly with the IRS to determine tax return accuracy prior to filing. This process leads to early identification of issues and facilitates faster resolution of issues than traditional examinations.
- Developing the Fast-Track Settlement process, which provides taxpayers with unagreed examination issues an opportunity to participate in a mediation process with Appeals before a 30-day letter is issued.
- Revising telephone procedures for correspondence examinations and expanding assistors' online access to all correspondence cases. These enhancements enabled toll-free assistors to provide improved service to callers by explaining the documentation required and the ramifications of not submitted the requested information.
- Producing an online video series ("Your Guide to an IRS Audit") that provides a step-by-step guide through the audit process.
- Simplifying the Form 656, *Offer in Compromise*, making it more user-friendly for taxpayers to complete, as well as pursuing other Collection and OIC improvements.

The National Taxpayer Advocate further argues that IRS measurement approaches favor funding of enforcement over service. They correctly note that "97 percent of all tax revenues the IRS collects come in without the need for expensive enforcement resources, in part because of IRS services." However, this represents only about 84 percent of the

64 Pacific Consulting Group, *Compliance Center Examination SB/SE National Report (April – June 2010)* and *Large and Mid-Size Business Industry National Report (October 2008 – September 2009).* ICF Macro, *W&I Compliance Center Examination Customer Satisfaction Survey (April – June 2010).*

65 *See* ICF Macro, *SB/SE Field Examination Customer Satisfaction Survey (April 2009 – March 2010). See also* surveys of Large and Mid-Size Business (LMSB) division industry and coordinated industry examinations, and Employee Plans and Exempt Organizations examinations.

66 Publication 4701, *Progress Report on the Implementation of the Taxpayer Assistance Blueprint*, http://www.irs.gov/pub/irs-pdf/p4701.pdf describes the guiding principles of the TAB and provides updates on the TAB service improvement portfolio. The next report to Congress is due in February 2011.

total tax liability.[67] Clearly, these revenues could not be collected without IRS processing and assistance operations to help taxpayers meet their obligations. Yet it would be an overstatement to brand these solely as "service revenues." While these revenues may not be collected through any direct enforcement process, some portion of them is nevertheless an indirect effect of IRS enforcement activities. Having a credible enforcement program not only creates a disincentive to those who might otherwise attempt to evade their tax obligation, but as importantly, it reassures compliant taxpayers that the system is fair and equitable. Current enforcement actions may also have an educational result that reduces future non-compliance. These concepts are captured in the IRS's Collecting Principles:

> *Compliance – The public trust requires us to ensure that all taxpayers promptly file their returns and pay the proper amount of tax, regardless of the amount owed.* The public as a whole is our customer, not just delinquent taxpayers. Our customers expect us to promote voluntary compliance by ensuring that all promptly pay their fair share. Employees should work with taxpayers to meet all their filing and paying requirements, not only the delinquency at hand. This involves identifying and addressing non-compliance to prevent future delinquencies.[68]

While we agree that the vast majority of revenue is collected through voluntary compliance, it is likely that the voluntary compliance rate would drop significantly if the IRS did not have a strong enforcement presence. Without diminishing the critical value of providing quality service to help taxpayers understand and fulfill their obligations, we cannot overlook the proper role of enforcement in encouraging taxpayers to seek to comply in the first place. We agree that ensuring this balance is a delicate and sometimes difficult task, but the IRS remains committed to seeking an appropriate balance between these two goals.

While we disagree with elements of the Office of the National Taxpayer Advocate's analysis, we agree with aspects of its four recommendations:

- **Report disaggregated satisfaction, accuracy, and completeness metrics at every level at which the IRS reports efficiency, speed, or productivity metrics.**

  The IRS will continue to employ an extensive set of measures of satisfaction, accuracy, and completeness at appropriate levels of operational management. We have and will continue to review high-level documents to determine whether any changes would be beneficial.

- **Create measures for the BPR and other highly visible reports that reflect the period between the due date of the return and final resolution of any liability.**

  The IRS is always looking for ways to improve its performance measurement. For example, Field Collection is already investigating ways to measure the period from

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67 IRS, *Tax Gap Map for Tax Year 2001* (Feb. 2007).

68 IRS Policy Statement 5-2, IRM 1.2.14.1.2.

the due date of the return to final resolution for the enforcement liability inventory. However, a truly comprehensive measure would include a range of interactions (such as Examination, Collection, Appeals, and even the Taxpayer Advocate Service); it is not clear how such a measure would effectively be used for program management.

- **Create measures for the BPR and other highly visible reports that reflect the extent to which the IRS's programs completely resolved the noncompliance and prompted the taxpayer to comply in subsequent periods.**

  The IRS is always looking for ways to improve its understanding of taxpayer compliance behaviors and our effectiveness. We believe the question of whether IRS programs completely resolve noncompliance and prompt future compliance is better suited to a research project than a program measure. We will consider the feasibility of future research in this area, though the effects of any particular program may be difficult to isolate from other factors that drive taxpayer behavior due to the complex nature of taxpayer behavior and the interactions of various IRS activities.

- **Initiate research to quantify the impact of various types of taxpayer service and outreach on voluntary compliance and direct tax revenue so the IRS can estimate of the ROI of such initiatives.**

  The IRS has already begun a servicewide research effort (with the National Taxpayer Advocate's participation) to estimate the impact of our service and enforcement activities on the voluntary compliance of taxpayers. This effort includes developing new data on services, new ways of segmenting the population, and new ways of applying standard empirical methods to tax compliance measurement (with a particular emphasis on the role of services). However, this research is unlikely to yield specific revenue estimates but rather will improve our understanding of taxpayer needs to better support voluntary compliance.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS agrees that the "vast majority of revenue is collected through voluntary compliance" and that these revenues could not be collected without IRS services. She also commends the IRS for improving employee engagement, for implementing the various improvement initiatives that it highlighted in its comments, and for increasing the number of customer service surveys that it conducts on a regular basis from 11 to more than 30.

Notably absent from the list of achievements highlighted in the IRS comments, however, is any significant and sustained increase in voluntary compliance, future compliance, or in the customer satisfaction reported on any of its surveys other than satisfaction with the tax return filing experience.[69] Nonetheless, the IRS's comments seek to justify continuing its narrow focus on cycle time.

First, the IRS argues that it does not excessively focus on cycle time in all of its reports. It observes that some IRS reports contain a more balanced set of measures than the ones that it reports in its BPRs and Annual Performance Report. However, measures that appear in the BPR and Annual Performance Reports, which are publicly available and reviewed by IRS Commissioners, the IRS Oversight Board, and members of Congress, are more visible than other measures.[70] Because the measures in these reports are highly visible, they are likely to create stronger incentives than those appearing in other reports that few know about. Thus, it is important for the IRS to include a balanced set of measures in these reports.

Next, the IRS argues that even though its most highly visible reports contain a disproportionate number of measures that reflect cycle time, TAS's analysis was "potentially misleading" because other measures are more important because of the way the IRS uses them. By analogy, a grade point average reflected in a report card may be comprised of grades from a disproportionate number of unimportant classes. The fact remains, however, that students have an incentive to get good grades in every class that will appear in their report card. They have less of an incentive to do well in classes for which they will not receive a grade (*e.g.*, classes they are auditing or taking on a pass-fail basis) or that will not appear on the report card, even if those classes are more important. IRS leaders have a similar incentive to improve the measures that appear in the BPR and similarly visible reports. If improving cycle time can raise their scores on more than one measure, they probably have

69 The IRS has not measured the voluntary compliance rate since it reported the National Research Program results in 2001. The IRS asserts that the educational component of its activities, including examinations, improves future compliance, but it does not measure such future compliance, even in cases where it would be feasible to do so.

70 While the Annual Performance Report is legally required (by 31 U.S.C. § 1115), IRS comments acknowledge, "[T]he 30 measures in the Annual Performance Report were selected in conjunction with Treasury to provide a high-level perspective on each IRS budget activity." We believe this perspective should be more balanced.

a stronger incentive to put more resources into improving cycle time than other items that are supposedly more important.

Next, the IRS asserts that if it continues its focus on improving cycle time, timeliness and customer satisfaction will also somehow improve. The IRS reaches this conclusion based on surveys that suggest taxpayers want more timely service. The IRS response appears to confuse cycle time and timeliness.

Although the National Taxpayer Advocate agrees that taxpayers want the IRS to be more timely and responsive, she does not agree that continuing to focus on narrow measures of cycle time will necessarily increase timeliness or customer satisfaction. While some policies aimed at reducing cycle time may do so, others will reduce satisfaction if they leave the IRS less likely to fully resolve or address all of the issues raised by the taxpayer, or to reach the right result before closing the case.

For example, a survey of those audited by the IRS found the items with the greatest impact on customer satisfaction were: fairness of treatment by the IRS, consideration given to the information you submitted, an explanation of why adjustments were made, and the business knowledge of your auditor.[71] Each of these had a greater impact on satisfaction than the length of the audit.[72] Thus, customer satisfaction is likely to decline if IRS policies cause auditors to close cases before they can fairly consider information provided by the taxpayer, even if those policies reduce cycle time.

As the IRS response observes, the IRS's collection survey indicates that the most important driver of satisfaction among its customers is the "time you [the taxpayer – not the IRS] spent on an issue."[73] It would be difficult to imagine any taxpayer actually wanting to spend time dealing with an IRS collection issue. However, a taxpayer is likely to have to spend more time on a collection issue if the IRS is so focused on cycle time that it closes his or her case without completely resolving the problem or fails to offer a realistic collection alternative. As we observed in a 2004 report, the IRS's offer program once achieved remarkable cycle time improvements by simply returning 57 percent of all offer submissions to taxpayers and closing their cases without substantively reviewing the offers or resolving them in any other way.[74] If the taxpayer's case remains unresolved and has to be reopened later or is shifted to another IRS program (*e.g.*, from the Automated Collection System to the Collection Field Function), the IRS's narrow cycle time measures will not reflect the length of time the taxpayer had to spend to resolve the issue. As a result, IRS leaders will have little incentive to minimize it. Moreover, payment delinquencies are much easier to

71 ICF Macro, *Field Examination Program, Customer Satisfaction Survey, Final Annual National Report, Closed Cases: April 2009-March 2010* 11, 32 (July 2010).

72 This could be one reason that those subject to field examinations were significantly more satisfied than those subject to correspondence examinations. ICF Macro, *Field Examination Program, Customer Satisfaction Survey, Final Annual National Report, Closed Cases: April 2009-March 2010* 16 (July 2010)

73 Pacific Consulting Group, *SB/SE Field Collection National Report Covering April through June 2010* L-9 (Oct. 2010).

74 *See* National Taxpayer Advocate 2004 Annual Report to Congress 311, 314-15.

resolve if the IRS begins to work out a payment plan with the taxpayer as soon after the delinquency as possible, rather than waiting for penalties and interest to grow to unmanageable levels. For these reasons, the National Taxpayer Advocate recommended adding a taxpayer-centric measure of timeliness – the period between the return filing and final resolution of any payment delinquency.

Finally, the IRS response does not address the incentives created by the IRS's ability to estimate ROI for – and thereby obtain funding for – enforcement programs but not service programs. TAS is aware of the IRS's long-term efforts to estimate the impact of services on voluntary compliance. For the reasons discussed above, however, it is important for this (or other) research to enable the IRS to estimate an ROI for services.

Recommendations

The National Taxpayer Advocate offers the following recommendations:

1. Report disaggregated satisfaction, accuracy, and completeness measures in the quarterly BPRs and consider adding them to enterprise-wide reports;
2. Report measures in the BPR that reflect the period between the due date of the return and final resolution of any liability (*e.g.*, through full payment, abatement, or compromise), as previously recommended by the National Taxpayer Advocate;[75]
3. Report measures in the BPR that reflect the extent to which the IRS's programs completely resolved the noncompliance and prompted the taxpayer to comply in subsequent periods; and
4. Ensure that the IRS is conducting the research it needs to be able to estimate the ROI of service initiatives.[76]

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75 *See, e.g.*, National Taxpayer Advocate 2006 Annual Report to Congress 62, 81.

76 The National Taxpayer Advocate previously made similar recommendations. *See, e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 35, 38; National Taxpayer Advocate 2006 Annual Report to Congress 442-446.

MSP #4

The Wage & Investment Division Is Tasked With Supporting Multiple Agency-Wide Operations, Impeding its Ability to Serve its Core Base of Individual Taxpayers Effectively

RESPONSIBLE OFFICIALS

Douglas H. Shulman, Commissioner, Internal Revenue Service
Steven T. Miller, Deputy Commissioner, Services and Enforcement
Richard E. Byrd Jr., Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

The IRS Restructuring and Reform Act of 1998 (RRA 98) directed the agency to reorganize into units serving particular groups of taxpayers with similar needs.[1] The legislation led to the creation of four operating divisions (ODs), each charged with full end-to-end responsibility for servicing a distinct set of taxpayers.[2] The Wage and Investment (W&I) division is the largest OD, serving 123 million individual taxpayers with non-business income.[3]

In practice, the IRS has deviated from the goal of providing end-to-end service by taxpayer type in an attempt to achieve efficiencies. Notably, it has charged W&I with performing key servicewide operations such as processing tax returns, staffing IRS telephone lines, managing taxpayer accounts, publishing all forms, instructions, and publications, and maintaining the IRS's e-services. These IRS-wide responsibilities consume a significant majority of W&I's budget and staffing. Because the IRS has limited resources and these servicewide functions must be performed (*e.g.,* the IRS cannot fail to process tax returns), assigning these responsibilities to W&I may dilute W&I's ability to adequately provide service to its "base" – all individual taxpayers with wage and investment income.

Particularly as the IRS gears up to administer health care reform, W&I's ability to focus on its core mission of serving individual taxpayers must be strengthened. Additionally, the structure of the budget devoted to IRS-wide services masks the relatively small amount spent on taxpayer service. The percentage of the IRS budget for Pre-filing Taxpayer Assistance and Education – which is what most people think of as pure taxpayer service – stood at only 5.5 percent in fiscal year (FY) 2010.[4]

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1 Internal Revenue Service Restructuring and Reform Act of 1998, § 1001 (Pub. L. No. 105-26).

2 *Id*.

3 W&I Insider, Wage and Investment Mission and Goals *at* http://win.web.irs.gov/aboutus/aboutus_goals.htm#Customer%20Base (last visited June 23, 2010); IRS Modernization at http://www.irs.gov/newsroom/article/0,,id=98159,00.html (last visited June 30, 2010). W&I taxpayers do not include those filing Form 1040 with accompanying Schedules C, E, F, or who file Form 2106, *Employee Business Expenses*.

4 Overall, the IRS budget is approximately $12.5 billion. Of that amount, $2.3 billion is allocated to the "Taxpayer Services" account. However, most "Taxpayer Services" funding goes toward "Filing and Account Services," which largely covers the costs of processing tax returns. The amount allocated for "Pre-filing Taxpayer Assistance and Education" – which is what most people think of as pure taxpayer service – is only $685 million. *See* Department of the Treasury, *FY 2011 Budget in Brief* at 1.

ANALYSIS OF PROBLEM

Background

The Creation of the IRS

When the IRS was established in 1952, it was built around a system of 17 regions and 64 districts, consolidating over the years until 1995 when there were 33 districts and ten service centers, each reporting to a director charged with administering the entire tax code for every taxpayer within its jurisdiction.[5] The districts and service centers were geographically based and functionally separate, with multiple layers of management. While four regional offices and a national office conducted oversight of the districts, separate functions within each district carried out day-to-day work.[6]

The IRS Restructuring and Reform Act of 1998

While the private sector evolved and redefined its business model, the IRS's structure and organization remained stagnant. As former IRS Commissioner Charles Rossotti noted:

> In the years since 1952 most successful businesses had changed their organizational models, reorganizing into more decentralized business units with authority to meet the needs of specific groups of customers, cut out layers of middle management and used technology to link and control the business.[7]

In 1996, Congress established the National Commission on Restructuring the IRS to review IRS practices and make recommendations for modernizing and improving its efficiency and taxpayer services.[8] By 1997, the IRS's failure to adapt to the changing business landscape left the agency with the largest number of customers and the lowest approval rating of any measured institution in America.[9]

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5 Commissioner Doug Shulman, *Prepared Remarks Before Tax Analysts Conference on RRA '98*, IR-2008-90 (July 18, 2008). District offices conducted the examination, collection, criminal investigation, and customer assistance functions of the IRS within established geographic areas. Service centers processed paper and electronic submissions, corrected errors, and forwarded data to the computing centers for analysis and posting to the taxpayer accounts. Internal Revenue Manual (IRM) 1.1.2.4 (Feb. 26, 1999).

6 Commissioner Doug Shulman, *Prepared Remarks Before Tax Analysts Conference on RRA '98*, IR-2008-90 (July 18, 2008). For example, each district had its own examination and collection functions that were responsible only for taxpayers within that district.

7 Rossotti, Charles O., *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America*, Boston: Harvard Business School Press 168 (2005).

8 The Treasury Postal Service and General Government Appropriations Act of 1996, 109 Stat. 509, established The National Commission on Restructuring the Internal Revenue Service. The 18-member panel was comprised of members of Congress, administration officials, representatives from various private sector firms, taxpayer organizations, the National Treasury Employees Union, a former IRS Commissioner, and a state tax administrator. The Commission held 12 days of public hearings, three field hearings, and numerous private sessions with public and private sector experts, academics and citizens' groups to examine IRS operations and services. It also reviewed thousands of reports on IRS operations, management, governance, and oversight. The Commission's report contained recommendations relating to congressional oversight and executive branch governance, IRS management and budget, IRS workforce and culture, IRS customer service and compliance; technology modernization; electronic filing; tax law simplification; taxpayer rights; and financial accountability. National Commission on Restructuring the Internal Revenue Service: A Vision for a New IRS (June 25, 1997); The Committee on Ways and Means, Subcommittee on Oversight, *Johnson Announces Hearing on the Report of the National Commission on Restructuring the Internal Revenue Service* (July 15, 1997).

9 The American Customer Satisfaction Index, a quality index sponsored by the American Society for Quality Control (ASQC), and the University of Michigan Business School's Customer Satisfaction Index show that taxpayers gave the IRS lower customer satisfaction ratings than any of the other 200 companies and government agencies measured in the index. *Why Was the Commission Created? at* http://www.house.gov/natcommirs/create.htm (last visited June 23, 2010).

After a series of hearings before the Senate Committee on Finance and the House Committee on Ways and Means revealed poor service, alleged mistreatment of taxpayers, and agency mismanagement, Congress enacted RRA 98 on July 22, 1998.[10] RRA 98 served as the impetus for the most significant IRS reorganization in IRS history and required the IRS to reorganize its structure and restate its mission to place a greater emphasis on serving taxpayers' needs.[11]

The Footprint for Redesign

After the passage of RRA 98, the IRS abandoned its existing geographic structure and realigned into four major operating divisions based on specific groups of taxpayers:

- **Wage and Investment (W&I)** – serving individual taxpayers with only wage and investment income;
- **Small Business/Self-Employed (SB/SE)** – serving small businesses and fully or partially self-employed individuals;
- **Large and Mid-Size Business (LMSB)** – serving corporations and partnerships with assets of more than $10 million;[12] and
- **Tax Exempt and Government Entities (TE/GE)** – serving a wide range of customers including small community organizations, major nonprofit entities such as universities and hospitals, pension funds, state governments, and Indian tribal governments.

Each division was given end-to-end responsibility for serving a particular group of taxpayers with similar needs, without regard to where the taxpayers resided.

The Design of W&I

W&I is made up of four operating units:[13]

- **Communications, Assistance, Research and Education (CARE)** – responsible for pre-filing activities, including taxpayer education, taxpayer service, and tax forms and publications for both individuals and businesses;
- **Customer Account Services (CAS)** – responsible for filing activities for individuals and businesses, including processing returns, validating that the proper amounts have been paid, and responding to telephone, written, and electronic account and other inquiries;

10 *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 1-2 (1997), *Recommendations of the National Commission on Restructuring the IRS on Executive Branch Governance and Congressional Oversight of the IRS: Hearings Before the House Comm. on Ways and Means*, 105th Cong. (1997); *Report of the National Commission on Restructuring the Internal Revenue Service: Hearing before the Subcomm. on Oversight of the Comm. On Ways and Means*, 105th Cong. (1997); *Taxpayer Rights: Hearing before the Subcomm. on Oversight of the Comm. On Ways and Means*, 105th Cong. (1997); *IRS Restructuring: Hearings Before the S. Comm. on Finance*, 105th Cong. (1998); *IRS Oversight: Hearings Before the S. Comm. on Finance*, 105th Cong. (1998).

11 RRA 98, Pub. L. No. 105-206, §1002, 112 Stat. 685, 690.

12 LMSB has recently reorganized into the Large Business and International (LB&I) division, which will continue to serve corporations and partnerships with assets greater than $10 million. *IRS Realigns and Renames Large Business Division, Enhances Focus on International Tax Administration* (Aug. 4, 2010) at http://www.irs.gov/newsroom/article/0,,id=226284,00.html (last visited Sept.13, 2010).

13 Modernizing America's Tax Agency, IRS Organizational Blueprint 36 (Apr. 2000).

- Compliance – responsible for post-filing activities such as audits for individuals and addressing delinquent accounts; and
- Electronic Tax Administration and Refundable Credits (ETARC) – responsible for overseeing the exchange of electronic information between the IRS, individual taxpayers, businesses, and practitioners and encouraging eligible individual taxpayers to claim the Earned Income Tax Credit (EITC) and Health Coverage Tax Credit (HCTC).[14]

Servicewide Responsibilities Cause Competition for Resources

W&I Provides the Lion's Share of Filing and Account Services and Relieves Other Operating Divisions of Their Responsibilities

Today, the Wage and Investment division is the largest OD, with nearly 47,000 employees, or over 43 percent of all IRS employees.[15] While W&I serves the largest group of taxpayers within the IRS (*i.e.*, individual taxpayers with wage and investment income), it is also responsible for a number of servicewide operations. Table 1.4.1 illustrates the major duties and responsibilities of the W&I organization. Only one function within W&I – Compliance– is dedicated solely to individual taxpayers.

TABLE 1.4.1, W&I Division Structure and Operations

Organization/Operating Unit	Responsible Functions	Taxpayers Served
Customer Assistance, Relationships and Education (CARE)		
Field Assistance (FA)	Return preparation, tax questions, and account and notice inquiries.	W&I SB/SE
Media and Publications (M&P)	Tax product development (*e.g.*, forms, publications, and notices), publishing, and distribution.	W&I SB/SE LMSB TE/GE
Stakeholder Partnerships, Education and Communication (SPEC)	Outreach and education for the public.	W&I
Customer Account Services (CAS)		
Submission Processing (SP)	Processes tax returns and payments, issues refunds, and post transactions to taxpayer accounts.	W&I SB/SE LMSB TE/GE
Accounts Management (AM)	Responds to taxpayer account inquiries; adjusts taxpayer accounts.	W&I SB/SE LMSB TE/GE

table continued on next page

14 IRS, *Wage & Investment Division At-a-Glance, at* http://www.irs.gov/irs/article/0,,id=101005,00.html (last visited June 21, 2010).

15 *IRS Staffing by Business Unit* (as of Aug. 28, 2010). W&I has 41,300 campus (processing center) and 5,580 non-campus employees. The IRS has a total of 107,435 employees.

Organization/Operating Unit	Responsible Functions	Taxpayers Served
Joint Operations Center (JOC)	Plans, routes, and monitors toll-free telephone call traffic.	W&I SB/SE LMSB TE/GE
Electronic Products and Services Support	Supports electronic products and services for centralized operations, including e-help and Information Returns Branch help desk.	W&I SB/SE LMSB TE/GE
Compliance		
Examination	Audits returns by correspondence.	W&I
Automated Underreporter (AUR)	Matches taxpayer income and deduction documents submitted by third parties such as banks, brokerage firms, and other payers on information returns.	W&I
Collection	Collects delinquent tax liabilities and returns.	W&I
Additional Services		
Earned Income Tax Credit (EITC) Office	Leads and manages an integrated program that works with internal and external stakeholders to deliver established program objectives for the EITC and Pre-Refund programs.	W&I SB/SE
Pre-Refund Program	Provides strategic and operational direction that supports compliance and outreach activities designed to prevent fraud, protect revenue, and ensure taxpayer rights.	W&I SB/SE
Health Coverage Tax Credit (HCTC) program	Informs potentially eligible taxpayers about the credit, enrolls eligible applicants in the program, and makes payments to health plans.	W&I

As a result of its extensive responsibilities, W&I owns and is responsible for maintaining sections in over 50 Internal Revenue Manuals (IRMs) – ranging from servicewide policies and procedures to refund inquiries, Notice of Levy, and mail and transport management – all of which also involve policies or procedures for other operating divisions. Almost all of these IRMs contain technical guidance, forms, and procedures applicable to other ODs. For example, IRM 1.2 *Servicewide Policies and Authorities* is intended for all divisions and functions.

Table 1.4.2 lists the IRMs containing sections that W&I owns.[16] The highlighted IRMs are sections that W&I owns but contain technical guidance, forms, and procedures relevant to other ODs.

16 Wage and Investment Owned Internal Revenue Manuals at http://win.web.irs.gov/IMD/imddocs/IRM_Authors_Listing.xls (May 21, 2010).

TABLE 1.4.2, Wage and Investment Division IRM Sections

IRM Section Number	IRM Name
1.1	Organization and Staffing
1.2	Servicewide Policies and Procedures
1.4	Resource Guide for Managers
1.11	Internal Management Documents System
1.17	M&P Publishing
1.18	M&P Distribution
1.22	Mail and Transportation Management
1.55	Wage and Investment
2.25	Web Services
3.0	General
3.5	Accounts Services
3.8	Deposit Activity
3.10	Campus Mail and Work Control
3.11	Returns and Document Analysis
3.12	Error Resolution
3.13	Campus Document Services
3.14	Notice Review
3.17	Accounting and Data Control
3.21	International Returns and Document Analysis
3.22	International SC Error Resolution
3.24	ISRP System
3.28	Special Processing Procedures
3.30	Work Planning and Control
3.37	International ISRP
3.38	International Tax Returns and Documents
3.40	Block Out of Balance Resolution
3.41	OCR Scanning Operations
3.42	Electronic Tax Administration
3.43	Integrated Management System
4.19	Liability Determination
5.11	Notice of Levy
5.19	Liability Collection
11.55	Wage and Investment
21.1	Accounts Management and Compliance Services Operations
21.2	Systems and Research Programs
21.3	Taxpayer Contacts
21.4	Refund Inquiries
21.5	Account Resolution
21.6	Individual Tax Returns

IRM Section Number	IRM Name
21.7	Business Tax Returns and Non-Master File Accounts
21.8	International Adjustments
21.9	Specialized Accounts Management Programs
21.10	Quality Assurance
22.30	Wage and Investment Outreach Procedures
22.31	Multilingual Initiative
25.6	Statute of Limitations
25.8	OFP Codes
25.12	Delinquent Return Refund Hold Program
25.14	IMPIS Overview for Work Planning and Control (WP&C)
25.15	Relief from Joint and Several Liability
25.19	Health Coverage Tax Credit (HCTC)

Because a wide range of W&I responsibilities impact taxpayers beyond the W&I population, W&I is setting policies for *all* IRS functions and as a result, is relieving the other operating divisions of their responsibility to provide full service to their target taxpayer groups. The question is whether its additional responsibilities limit W&I's ability to meet its core mission – serving individual taxpayers with wage and investment income.

Competition for Resources – A Losing Game for Taxpayers

In FY 2010, W&I served more than two-thirds of all taxpayers, yet its budget amounted to approximately 18 percent of the overall IRS operating budget.[17] Of that amount, more than 75 percent went to activities that serve *all* IRS (not only W&I) taxpayers.[18] Moreover, very little of this money is spent on taxpayer service. A review of the IRS budget shows that the percentage of the FY 2010 IRS budget devoted to Pre-filing Taxpayer Assistance and Education – which is what most people think of as pure taxpayer service – stood at only 5.5 percent in FY 2010.[19] W&I taxpayers are being forced to compete with service-wide priorities, and, as the budget numbers demonstrate, W&I taxpayers are losing out.

17 The IRS serves more than 183 million taxpayers. Of those, 123 million are W&I taxpayers, 57 million are SB/SE taxpayers, over three million are TE/GE taxpayers, and over 270,000 are LMSB taxpayers. Wage and Investment Mission and Goals at http://win.web.irs.gov/aboutus/aboutus_goals.htm#Customer%20Base (last accessed Sept 10, 2010); About SB/SE at http://mysbse.web.irs.gov/AboutSBSE/default.aspx (last assessed Sept 10, 2010); Tax Exempt and Government Entities Division at a Glance at http://www.irs.gov/irs/article/0,,id=100971,00.html (last accessed Sept 20, 2010); LMSB Research Workload and Identification, LMSB Tax Return Statistics, 2009 Taxpayer Population at http://lmsb.irs.gov/hq/srp/LMSB_Statistics/Tables/Sections_PY2009/ Section_1/_print/Figure_1.1.ppt. Overall, the IRS budget was approximately $12.5 billion in FY 2010. This does not include additional operating amounts received through offsetting collections and user fees. Department of Treasury, Budget in Brief FY 2011, *available at* http://www.irs.gov/pub/newsroom/budget-in-brief-2011.pdf (last visited June 24, 2010).

18 W&I's total expenditures for FY 2010 were almost $2 billion. The amount of the W&I budget devoted to CAS, Media and Publications, and Field Assistance was over $1.5 billion in FY 2010. This includes amounts allocated to the National Distribution Center and Filing and Account Services Management. W&I response to TAS research request (Nov. 5, 2010).

19 Overall, the IRS budget is approximately $12.5 billion. Of that amount, $2.3 billion is allocated to the "Taxpayer Services" account. However, the majority of the "Taxpayer Services" funding goes toward "Filing and Account Services," which largely covers the costs of processing tax returns. The amount allocated for "Pre-filing Taxpayer Assistance and Education" – which is what most people think of as pure taxpayer service – is only $685 million. *See* Department of the Treasury, *FY 2011 Budget in Brief* at 65.

One of the results of this competition for resources is that taxpayer service suffers. Each year, tens of millions of taxpayers call the IRS seeking help with a wide variety of issues, including account questions and tax-filing questions. Yet the IRS is unable to answer a large percentage of these phone calls. The CAS Customer Service Representative Level of Service, or "LOS," generally measures the percentage of calls that get through to a representative among all callers seeking to do so. In FY 2004, the IRS answered 87 percent of its calls.[20] Since that time, the LOS has declined, plummeting to a low of 53 percent in FY 2008.[21] In other words, IRS telephone assistors in FY 2008 were unable to answer nearly half the calls they received.[22]

In FY 2010, the LOS rebounded somewhat to about 74 percent, and the IRS's target for the current fiscal year (2011) is 75 percent.[23] While answering 75 percent of calls would be a vast improvement over recent years, it still means one out of every four calls seeking assistance will not get through. Of equal concern is the IRS projection that among calls that do get answered, the average wait time in FY 2011 will be almost ten minutes, up from about four and one-half minutes in FY 2007.[24]

The IRS is also having difficulty keeping up with taxpayer correspondence. Accounts Management (AM) employees who answer the toll-free phone lines also handle paper correspondence (including processing amended returns).[25] One way the IRS adjusts for fluctuating call volume is by moving AM staff from correspondence to the phones (and vice versa).[26] As call volumes have increased and AM employees have been moved to answer phone calls, paper correspondence inventories have substantially increased as well. The correspondence inventory rose from approximately 480,000 at the end of FY 2007 to over 628,000 at the end of FY 2010 – an increase of nearly 30 percent.[27]

While taxpayer service is suffering, the current structure of the IRS budget masks the amount of money the IRS actually dedicates to core taxpayer services. The full cost of processing tax returns – over $600 million in FY 2010 – is included in the Taxpayer Services account, even though return processing is a business requirement that can no more be considered a taxpayer service than an enforcement function.[28] The IRS uses returns

20 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot: Enterprise Total* (week ending Sep. 30, 2005).

21 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot: Enterprise Total* (week ending Sep. 30, 2009).

22 However, this is likely due to the volume of calls related to the Economic Stimulus Act of 2008. On an enterprise-wide basis, the IRS received 166.6 million calls in FY 2008, more than twice the 82.8 million calls it received in FY 2007. IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot: Enterprise Total* (weeks ending Sept. 30, 2007 and Sept. 30, 2008).

23 IRS, *Wage and Investment Business Performance Review*, slide 17 (Oct. 26, 2010).

24 *Id*.

25 IRM 1.4.16.2 (Jan. 1, 2009).

26 IRM 1.4.16.2.2 (3) and (4) (Jan. 1, 2009). *See also* National Taxpayer Advocate's 2009 Annual Report to Congress, 6 (Most Serious Problem: *IRS Toll-Free Telephone Service is Declining as Taxpayer Demand for Telephone Service is Increasing*).

27 IRS, *Joint Operations Center Weekly Enterprise Adjustments Inventory Report* (weeks ending Sept. 29, 2007 and Sept. 25, 2010, respectively).

28 W&I response to TAS research request (Nov. 5, 2010). In FY 2006, the IRS restructured its budget into separate "Taxpayer Services" and "Enforcement" categories.

processing as much to collect taxes due from persons who have underpaid as to issue refunds to those who have overpaid, and the data captured through returns processing are used in IRS enforcement actions. Additionally, the full cost of the Field Assistance budget is included in the Taxpayer Services account, though over half of Field Assistance's work in FY 2010 is attributable to account and notice work.[29] The IRS's account and notice work serves to aid the IRS in collection activities as much as, if not more than, it serves taxpayers looking to resolve account issues. Because W&I manages *all* tax processing and face-to-face assistance for *all individual and business taxpayers*, it is difficult for Congress and taxpayers to determine the adequacy of resources allocated to *W&I* taxpayer service and compliance.

The New W&I – No Longer the IRS's Operations Support Division

W&I's role of providing IRS-wide services consumes a significant majority of its budget and staffing. As a result, W&I has little time or money left to focus on the needs of individual taxpayers. For example, W&I is consumed for much of the year with filing season activities or preparing for the filing season, and is therefore limited in its ability to address other issues related to its taxpayer base. One of the goals of RRA 98 was to organize the IRS to serve "particular groups of taxpayers with similar needs."[30] To meet that objective, the IRS should reevaluate the W&I organization.

The National Taxpayer Advocate recommends that the IRS create a new division – Servicewide Customer Account Service – under the Deputy Commissioner for Services and Enforcement. This new division would contain CAS (Submission Processing, Accounts Management, the Joint Operations Center, Electronic Products and Services Support) and Media and Publications.

As currently structured, CAS is the largest single entity within the IRS and is responsible for filing, accounts management, and telephone services for the *entire* IRS. In addition, the Media and Publications unit of W&I is responsible for *all* IRS forms, publications, and other documents for taxpayer use. To focus attention on the resources required specifically to meet the needs of *individual* taxpayers, CAS and Media and Publications should move out of W&I.

There is precedent for this type of shift. In 2004, the IRS studied options for consolidating W&I and SB/SE CAS headquarters with the goal of eliminating duplicate functions and to "increase efficiency while maintaining the same level of effectiveness."[31] Prior to 2004, both W&I and SB/SE had functions dedicated to processing tax returns, adjusting accounts, and handling taxpayer telephone calls. The IRS consolidated the duplicate functions to eliminate redundancy and placed the consolidated functions under W&I. As a result, W&I inherited responsibility for more than just its own taxpayers, while SB/SE was relieved of

29 W&I response to TAS research request (Nov. 5, 2010).

30 RRA 98, Pub. L. No. 105-206, § 1001, 112 Stat. 685.

31 *CAS Headquarters Consolidation Business Case Support*, slide 4 (Oct. 9, 2004).

service-related tasks and could focus mainly on enforcement. Moving these shared services out of W&I would allow W&I to focus more clearly on its core taxpayer base instead of being distracted by its servicewide responsibilities.

Additionally, the IRS should propose a change to how funding is categorized to increase transparency of how much money the IRS actually spends on core taxpayer service. The entire budget for Submission Processing is allocated to Taxpayer Service. However, we do not believe it is accurate to classify processing tax returns as taxpayer service.[32]

Other IRS services – such as Field Assistance – are now categorized entirely as Taxpayer Service, when in fact more than half of their work is account-related. Accounts Management is also categorized as Taxpayer Service when the vast majority of its work stems from account and notice issues.[33] The IRS's practice of categorizing various functions as Taxpayer Service or Enforcement wholesale, without looking deeper into the different types of services these functions perform, hides the true breakdown of the IRS budget.

CONCLUSION

When RRA 98 was voted out of the Senate Finance Committee, the committee noted:

> [A] key reason for taxpayer frustration with the IRS is the lack of appropriate attention to taxpayer needs. At a minimum, taxpayers should be able to receive from the IRS the same level of service expected from the private sector. For example, taxpayer inquiries should be answered promptly and accurately; taxpayers should be able to obtain timely resolutions of problems and information regarding activity on their accounts; and taxpayers should be treated fairly and courteously at all times.[34]

The Committee believed the proposed reorganization would "enable IRS personnel to understand the needs and problems affecting particular groups of taxpayers, and better address those issues."[35] However, as currently organized, most of W&I's staff and resources serve the entire IRS, instead of focusing on the needs of the division's own taxpayers. Because of the special needs of the W&I population, the current approach is not achieving the goals Congress intended when it enacted the IRS Restructuring and Reform Act of 1998.

In conclusion, the National Taxpayer Advocate offers the following preliminary recommendations:

1. Create a new division under the Deputy Commissioner for Services and Enforcement – Servicewide Customer Account Service. This new division would contain Media and Publications, and CAS.

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32 W&I response to TAS research request (Nov. 5, 2010).

33 *Id.*

34 National Commission on Restructuring the Internal Revenue Service: A Vision for a New IRS (June 25, 1997).

35 *Id.*

2. Recommend removing funding for Submission Processing from the Taxpayer Services budget and placing it in the Operations Support account.
3. Recommend dividing the budget for Field Assistance and other similar organizations that perform both service and compliance activities on the basis of the percentage of their activities that are true taxpayer service as opposed to enforcement or operations support. This will provide a more accurate breakdown of the IRS's budget.

IRS COMMENTS

Background

The delivery of a successful filing season is the single most important aspect of the W&I mission. For most filers with returns reflecting only wage and investment income, their primary (and often only) relationship with IRS is their annual tax filing and payment requirement. These taxpayers expect and are entitled to an efficient, accurate, and courteous filing season experience. In this regard, W&I had another outstanding year. Key accomplishments include:

- Successfully implementing significant and sometimes extremely late tax law changes, including the American Reinvestment and Recovery Act of 2009 (Recovery Act) and the Worker, Homeownership, and Business Assistance Act of 2009 (WHBAA).
- Processing over 137 million individual income tax returns and timely issuing over 107 million refunds, totaling approximately $312 billion.
- Correcting taxpayer errors to ensure receipt of the Making Work Pay Credit by over 4.6 million taxpayers who otherwise would not have received it.
- Increasing electronic filing by three percent over last year with over 96.8 million individual taxpayers (70.4 percent) filing electronically, including over 2.9 million filers who took advantage of the free online filing services offered by the Free File Alliance available through IRS.gov.
- Expanding the functionality of the Customer Account Data Engine (CADE), the modernized system that will eventually replace the IRS Masterfile of taxpayer accounts, providing faster refunds and more up-to-date information to respond to taxpayer account inquiries.
- Creating both telephone and web self-service applications to provide automated responses to 14 million taxpayers seeking prior year Adjusted Gross Income information needed to electronically sign their e-filed tax returns.
- Assisting more than 41.4 million taxpayers during the core filing season (January 1 to April 15), including 26.1 million taxpayers assisted through automated telephone applications, and 15.3 million taxpayers served by IRS assistors.
- Providing face-to-face walk-in services to almost three million customers (through May) at 401 Taxpayer Assistance Centers (TACs).

- Conducting special events to assist customers, including special EITC Saturdays and special Open House events to help taxpayers with account and other unresolved tax issues.
- Increasing state tax return preparation at the TACs from 20 to 27 states and increased its presence in the communities by locating TAC employees at 27 Volunteer Income Tax Assistance (VITA) sites, up from nine sites in 2009.
- Supporting the preparation of nearly 3.1 million federal tax returns and more than 2.2 million state tax returns for free at over 12,000 VITA and Tax Counseling for the Elderly (TCE) sites nationwide.
- Maintaining IRS.gov, which is consistently one of the most heavily used government websites, with more than 284 million visits and 190 million downloads of forms, publications, instructions, and other documents.
- Providing 95.3 percent of the individual critical filing season tax products (tax forms and publications) to the public by the first week of January 2010, despite the tax law changes noted above.

With respect to the National Taxpayer Advocate's report, the IRS appreciates its comments and recommendations regarding the IRS-wide responsibilities of the W&I Division. The IRS takes seriously the National Taxpayer Advocate's concerns regarding the level of funding available each year for pre-filing assistance and education services. However, we do not agree that the recommendations and approach suggested in this report will help mitigate those concerns. The IRS also disagrees with certain points of view expressed by the National Taxpayer Advocate, particularly dealing with the extent to which the IRS fulfills its responsibilities to W&I taxpayers, the organizational placement of responsibility for delivery of IRS-wide services, and the nature of taxpayer service.

Congressional Appropriations for the Internal Revenue Service

The National Taxpayer Advocate's report states that, "The IRS's practice of categorizing various functions as Taxpayer Service or Enforcement wholesale without looking deeper into the different types of services these functions perform hides the true breakdown of the IRS budget." This statement ignores the fact that Congress defines Taxpayer Service and Enforcement activities, and implies that there is some undefined, "true" breakdown of the IRS budget other than that recognized by the IRS and Congress. Each congressional appropriation defines specific tax administration activities and responsibilities to be accomplished with the appropriated funds. Briefly stated, the appropriations[36] are:

- **Taxpayer Service** – "to provide taxpayer services, including pre-filing assistance and education, filing and account services, taxpayer advocacy services, and other services …"[37]

36 H.R. 3170, The Senate of the United States, July 20, 2009.

37 *Id*. at 11.

- **Enforcement –** "to determine and collect owed taxes, to provide legal and litigation support, to conduct criminal investigations, to enforce criminal statutes related to violations of internal revenue laws and other financial crimes..."[38]
- **Operations Support –** "to support taxpayer services and enforcement programs, including rent payments; facilities services; printing; postage; physical security; headquarters and other IRS-wide administration activities; research and statistics of income; telecommunications; information technology development, enhancement, operations, maintenance, and security;..."[39]
- **Business Systems Modernization –** "for the capital asset acquisition of information technology systems, including management and related contractual costs of said acquisitions, including related Internal Revenue Service labor costs, and contractual costs associated with operations;"[40]
- **Health Insurance Tax Credit Administration –** "For expenses necessary to implement the health insurance tax credit included in the Trade Act of 2002 (Public Law 107-210)."[41]

Nature of Taxpayer Service

The National Taxpayer Advocate contends that pre-filing taxpayer assistance and education "is what most people think of as pure taxpayer service," and remarks that this component of the IRS budget represented "only" 5.5 percent of funds allocated to the IRS for FY 2010. As the appropriation definitions cited above reflect, Congress apparently views the nature of taxpayer service somewhat differently. The nature of taxpayer service, as defined by Congress, includes not only pre-filing assistance and education, but also filing services, account services, and taxpayer advocacy services. Indeed, the Senate Finance Committee report on RRA 98 states that, "...taxpayers should be able to receive the same level of *service* expected from the private sector. For example, taxpayer *inquiries should be answered promptly and accurately;* taxpayers should be able to obtain timely *resolution of problems and information regarding activity on their accounts*; and taxpayers should be treated fairly and courteously at all times" (emphasis added).

The IRS strongly agrees with this broader view of taxpayer service. Telephone, face-to-face, correspondence, and electronic services provided by the IRS cover an enormous range of issues and activities, including helping taxpayers, practitioners and tax professionals track the status of refunds, resolve account issues, and correct taxpayer errors. Funds appropriated for taxpayer service also enable taxpayers to obtain assistance from TAS in resolving these same issues. None of these services (refund tracking, account/error resolution) are normally considered to be pre-filing assistance and education.

38 H.R. 3170, The Senate of the United States, July 20, 2009, page 11.

39 *Id.* at 12.

40 *Id.* at 13.

41 *Id.* at 14.

We also disagree with the National Taxpayer Advocate's assertion that return processing "can no more be considered a taxpayer service than an enforcement function." The millions of taxpayers who each year *voluntarily* file and pay their taxes likely would not view the processing of their returns and issuing of their refunds as anything other than a service activity.

Delivery of IRS-Wide Services

Since the creation of the current IRS organizational structure more than a decade ago, the IRS has managed the delivery of certain IRS-wide services from one operating division, W&I. As the National Taxpayer Advocate points out, today these W&I-provided, IRS-wide services include return processing, account services, and the publishing of tax forms and publications, among others.

The National Taxpayer Advocate contends that assigning such IRS-wide functions to W&I "may dilute W&I's ability to adequately provide service to its 'base' – all individual taxpayers with wage and investment income." The IRS does not share this view. We believe our current approach to providing IRS-wide services benefits *all* taxpayers, including the 123 million individual taxpayers with non-business income (*i.e.*, wage and investment taxpayers). Not only is this approach the most efficient, thus benefiting all taxpayers through reduced cost of tax administration, it also allows for the greatest consistency and quality of service delivery.

The National Taxpayer Advocate further states that, "W&I's role of providing IRS-wide services consumes a significant majority of its budget and staffing. As a result, W&I has little time or money left to focus on the needs of individual taxpayers." This statement overlooks two important considerations. First, the majority of taxpayers served via these IRS-wide services are, in fact, individual (wage and investment) taxpayers. Second, the level of funding required for returns processing, account services, tax forms and publications and other IRS-wide services would not change if the organizational management of these services was realigned.

The goal of providing additional resources for pre-filing and education services is admirable, but it is unlikely that realigning responsibility for the delivery of filing, account, or forms and publications services will help achieve it. In fact, because providing these services in a less efficient manner would be more expensive, realigning these functions would quite likely create a situation where less funding is available for pre-filing assistance and education services.

Serving Small Business and Self-Employed Taxpayers, Large Business and International Taxpayers, and Tax Exempt and Government Entities

As the National Taxpayer Advocate correctly points out, the IRS has three operating divisions in addition to the W&I division, each of which serves a largely unique taxpayer segment. The IRS-wide service responsibilities of W&I discussed above are provided to the taxpayer segments of each of these divisions.

The National Taxpayer Advocate contends that because W&I provides certain services, such as return processing, to all taxpayers, it is "relieving the other operating divisions of their responsibility to provide full service to their target taxpayer groups." This suggests that these operating divisions would be doing a better job of fulfilling their respective responsibilities, and their target taxpayer groups would be correspondingly better served, if each division had it own toll-free telephone operation, forms publishing operation, etc.

The IRS disagrees with the characterization that each of these divisions is not meeting its responsibilities to taxpayers. The design and development of IRS-wide services are, in fact, collaborative efforts involving all operating divisions. Whether it is developing procedures to process returns for tax-exempt organizations, developing phone assistor training for self-employed taxpayer issues, or designing a corporate tax form, the other operating divisions are full partners with W&I in each undertaking. The fact that certain services can be most effectively and efficiently delivered to all taxpayers by managing their delivery from one operating division, enhances, rather than diminishes the collective fulfillment of the responsibilities of all IRS operating divisions.

Comments on Preliminary Recommendations

1. Create a new division under the Deputy Commissioner for Services and Enforcement – Servicewide Customer Account Service. This new division would contain Media and Publications, and CAS.

   The IRS does not agree with this recommendation. We see no compelling evidence that creating a fifth operating division would either enable the IRS to better assist individual taxpayers or aid in providing more resources to pre-filing and education activities. In fact, creating an additional operating division could have the opposite effect. In the short-term, a reorganization of this magnitude would be expensive and disruptive, while in the longer-term, a more complicated organizational structure, with higher overhead and administrative costs, could actually diminish funding available for pre-filing assistance and education.

2. Recommend removing funding for Submission Processing from the Taxpayer Services budget and placing in the Operations Support account.

   The IRS does not agree with this recommendation. The congressional definition of Taxpayer Service includes funding for "filing services." For the majority of taxpayers, filing their return is their only contact with the IRS, and they define effective service as timely, accurate processing of their return and, for most taxpayers, delivery of their refund. Conversely, the activities funded by the Operations Support appropriation do not include the outward taxpayer service responsibilities of the IRS. Funding the

Submission Processing function from the Operations Support appropriation appears to be contrary to the fundamental purpose and intent of this congressional appropriation.

Moreover, we do not believe that moving Submission Processing to another appropriation would materially affect the funding for any other IRS activity, including pre-filing assistance and education. Transferring Submission Processing to another congressional appropriation would not provide any additional resources or funding flexibility for the other activities remaining in the Taxpayer Service Appropriation.

3. Recommend dividing the budget for Field Assistance and other similar organizations that perform both service and compliance activities on the basis of the percentage of their activities that are true taxpayer service as opposed to enforcement or operations support. This will provide a more accurate breakdown of the IRS's budget.

   The IRS does not agree with this recommendation. Field Assistance work is primarily in two areas, pre-filing assistance and account services. The IRS views each of these activities as taxpayer service, and the congressional appropriations for the IRS define each as such. Prorating budget allocations and expenditures for Field Assistance or other "similar" organizations among congressional appropriations would be an extremely costly effort that offers no significant benefit.

Taxpayer Advocate Service Comments

The first line of the IRS's comments demonstrates exactly why the existing IRS structure is a most serious problem: "The delivery of a successful filing season is the single most important aspect of the W&I mission." The National Taxpayer Advocate commends W&I for another successful filing season and does not intend to diminish its accomplishments. However, W&I's overriding focus on the filing season raises continuing concerns. It is true, as the IRS response states, that the only contact with the IRS for many taxpayers is filing their annual tax returns. However, this statement glosses over the tens of millions of taxpayers who have other contacts with the IRS, including tax law questions, audits, and collection activities. It is with respect to these contacts – and pre- and post-filing education and outreach – that the particular knowledge base of the operating divisions about their respective taxpayer populations is most important. In W&I, unlike in any of the other operating divisions, these taxpayer service activities are eclipsed by "the single most important aspect of W&I's work" – *i.e.,* the filing season.

As a threshold matter, it is helpful to clarify just what we mean when we talk about taxpayer service. We admit that the term's ubiquitous usage can lead to confusion. The IRS should, of course, provide excellent service to taxpayers in servicewide functions by processing returns timely and issuing refunds promptly. In this sense, "service" means "customer service." In fact, the IRS should provide good customer service within its enforcement activities as well – by processing mail and responding to taxpayer contacts promptly, listening to taxpayer concerns, and taking into consideration the taxpayer's facts and circumstances.[42]

In this most serious problem discussion, however, we use the term "taxpayer service" to refer to those activities that actually assist the taxpayer with understanding their rights and obligations under the tax laws. Thus, IRS outreach and education activities clearly fall within this definition, regardless of whether these activities occur in a pre-filing or post-filing environment and whether they are performed by SPEC personnel or IRS enforcement personnel or TAS personnel. Similarly, when a Customer Service Representative in Accounts Management responds to a taxpayer's call about a specific notice, this may constitute education about his or her tax obligations and be classified as taxpayer service. On the other hand, when that CSR places a taxpayer into an installment agreement, that action is not typically considered taxpayer service, although it may be a "service" to the taxpayer.

A central part of the National Taxpayer Advocate's disagreement with the IRS appears to center on whether activities like the processing of tax returns are more accurately viewed as a taxpayer service or an overhead function. The IRS response states: "The millions

42 This latter component – taking into consideration the taxpayer's facts and circumstances – is not only good customer service but also a statutory requirement and a taxpayer right. *See, e.g.*, IRC § 7122(d)(2)(B), National Taxpayer Advocate 2007 Annual Report to Congress 478-489 (Key Legislative *Recommendation: Taxpayer Bill of Rights and* De Minimus *"Apology" Payments*).

of taxpayers who each year voluntarily file and pay their taxes likely would not view the processing of their refunds as anything other than a service activity."

The IRS provides no justification to support this statement, and we believe most taxpayers would take a very different view. In processing returns (which generally are compelled by law), the IRS is seeking to ensure that taxpayers have fulfilled their reporting and payment obligations.

Moreover, while it is true (as the IRS points out) that refunds are issued to many taxpayers in the course of return processing, it is also true that the IRS uses processing to collect payments from taxpayers who file balance-due returns and to compute risk scores for each return to help determine which ones to audit.

If collecting tax payments and facilitating audit selection are the types of "services" the IRS provides, the National Taxpayer Advocate believes most taxpayers would take a pass. Simply put, most taxpayers would vigorously disagree with the IRS's view that returns processing is a "taxpayer service." Rather, it is a function that is a necessary prerequisite for all tax administration.

The Treatment of Taxpayer Service in the IRS Budget, Which Was Originally Proposed by the IRS, Masks the Low Level of Funding for Taxpayer Service Activities and Distorts Return on Investment Calculations.

Sound accounting principles generally require that revenues be matched with the expenses that generate them. If the IRS enforcement functions propose and collect additional tax amounts, any costs associated with this collection should be treated as part of the costs of enforcement. If the IRS treats revenue as resulting from an enforcement action but apportions the associated costs of working with taxpayers to the Taxpayer Services account, the net amount of IRS Enforcement revenue will be overstated, perhaps considerably so.

The IRS's discussion of congressional support for its current budget structure also warrants a response. In arguing that returns processing is a "taxpayer service," the IRS response cites congressional appropriations language to support its view. In one statement, the IRS notes that, "Congress defines Taxpayer Service and Enforcement activities." In another section, the IRS response says our proposal for "[f]unding the Submission Processing function from the Operations Support Appropriation appears to be contrary to the fundamental purpose and intent of this Congressional appropriation."

The IRS is correct that recent appropriations bills fund filing and account activities as a subset of the Taxpayer Services account. However, Congress did not adopt this approach on its own. To the contrary, the IRS pressed Congress hard to abandon its previous, long-standing budget structure and substitute the current one. Through FY 2005, the IRS was funded primarily under three accounts titled "Processing, Assistance, and Management," "Tax Law Enforcement," and "Information Systems."[43] Submission processing and related servicewide functions were included in the Processing, Assistance, and Management account. In our view, that was a logical fit.

Beginning in 2003, the IRS adopted a "working equation" of "Service + Enforcement = Compliance."[44] That phrase was placed on every page of the IRS strategic plan, and the Commissioner sought to restructure the IRS budget to reflect a clear division between service and enforcement activities – a black-and-white view of tax administration that acknowledged no overlap between service and enforcement, and few activities that fell in between. Under that black-and-white view, return processing was not an "enforcement" activity, so it almost necessarily had to be classified as a "service."

When the IRS budget for FY 2006 was submitted to Congress, the Administration asked Congress to consolidate its Processing, Assistance, and Management account, its Tax Law Enforcement account, and its Information Systems account into a single category that would fund all taxpayer service and enforcement activities and be subdivided into Taxpayer Service and Enforcement categories.[45] Congress flatly rejected the request. The House Appropriations Committee report stated plainly: "The Committee denies this request and retains the existing, discrete account structure."[46] Similarly, the Senate Appropriations report stated:

> The bill includes a new provision requiring the IRS to submit its fiscal year 2007 budget justification in the same format provided under this Act [*i.e.*, rejecting the IRS's proposed budget categories and retaining the previous ones]. While the Committee appreciates the IRS's effort to align and integrate performance goals and measures with budget resources, the proposed budget structure under the request is overly simplistic and reduces the Committee's ability to ensure accountability on the expenditure of appropriated funds.[47]

In connection with the FY 2007 budget proposal, the IRS launched a full-court press to persuade the Appropriations Committees to restructure the IRS budget accounts to align between Taxpayer Service and Enforcement, and the Appropriations Committees eventually acceded to the IRS request after requiring certain changes.[48] While it is therefore accurate for the IRS to say the Appropriations bills currently treat certain servicewide functions such as returns processing as a taxpayer service, any implication that the Appropriations Committees are strong and long-time proponents of this structure would

43 Department of the Treasury, *Budget in Brief FY 2005: Internal Revenue Service*, Document 9940 (Rev. 2-2004).

44 See IRS Strategic Plan 2005-2009; *see also* IRS, *Remarks of Mark W. Everson Commissioner of Internal Revenue Before the National Press Club*, IR-2004-34, available at http://www.irs.gov/newsroom/article/0,,id=121226,00.html (Mar. 15, 2004).

45 Department of the Treasury, *Budget in Brief FY 2006: Internal Revenue Service* 1.

46 *See* H. Rep. No. 109-153 76 (2005).

47 *See* S. Rep. No. 109-109 140 (2005).

48 *See* Consolidated Appropriations Act, 2008, Pub. L. No. 110-161; Department of the Treasury, *Budget in Brief FY 2008: Internal Revenue Service* 2.

be misleading. The record suggests the Appropriations Committees much preferred the budget structure in which returns processing was treated as part of "Processing, Assistance, and Management."

Looking forward, the question that needs to be addressed is whether the current budget structure makes sense. For two reasons, we suggest that it does not. First, the IRS will necessarily (and appropriately) prioritize its "must do" work over its "should do" work. If important "should do" work is contained within the same account as "must do" work, the "should do" work will suffer when resources are constrained. The IRS must process tax returns, and if doing so requires more resources than anticipated, any other programs in the same budget account will unavoidably be cut. As a consequence of placing "must do" servicewide functions within the Taxpayer Services account, the IRS has been performing less taxpayer outreach and education than it should. For reasons we have detailed elsewhere, scrimping on outreach and education not only makes for poor taxpayer service but it has a compliance impact as well

The other drawback to including filing and account activities within the Taxpayer Services account is that it paints an extremely distorted picture of how much taxpayer service the IRS performs. Since the IRS adopted the "Service + Enforcement = Compliance" formula, it has sought to portray its activities as providing some sense of balance and equivalence between "service" and "enforcement" – even placing service first in the equation. Of the total amount appropriated for the Taxpayer Services and Enforcement accounts in FY 2010 ($7.783 billion), the current budget methodology makes it appear that 29 percent is spent for Taxpayer Services.[49] That is considerably less than the 71 percent for Enforcement, but it does suggest a sense of balance. If filing activities are removed from Taxpayer Services and placed into the Operations Support account, Taxpayer Services spending as a percentage of combined Taxpayer Services and Enforcement spending would fall to approximately 21 percent.[50] And if the budget of the Accounts Management function, which performs both service and compliance functions, is appropriately bifurcated between the Taxpayer Services and Enforcement accounts, it would become clear that the percentage of the IRS budget spent on taxpayer service is even lower.[51]

For these reasons, the National Taxpayer Advocate remains concerned that the IRS's current budget structure does not reflect truth in packaging. Responding to criticism from Congress and others in the 1990s that taxpayer service was being neglected in favor of enforcement, the IRS adopted its current mission statement, which begins by saying that the

49 Department of the Treasury, FY 2011 Budget-in-Brief 65 (2010).

50 Percentage calculated by subtracting actual FY 2010 Submission Processing spending from FY 2010 Taxpayer Service account allocation. W&I response to TAS research request (Nov. 5, 2010).

51 Account services should be allocated between Taxpayer Service and Enforcement. For example in FY 2009, about 40 percent of the installment agreements accepted by the IRS (1,270,239/3,197,862) originated from Toll-Free Accounts Management rather than collection. IRS, Collection Activity Report (CAR) NO-5000-6 (May 25, 2010).

goal of the agency is to "[p]rovide America's taxpayers top quality service."[52] As the budget numbers make clear, however, the IRS is currently executing its role as the tax collector by devoting a great deal of resources to enforcement, a great deal of resources to basic overhead functions like the processing of tax returns, and comparatively limited resources to core taxpayer service. The current budget structure masks this reality. (In another section of this report, we recommend that the IRS revise its mission statement to reflect its increasing role as a benefits administrator as well as tax administrator. We offer that recommendation in part to encourage the IRS to become more service-oriented with respect to social benefits programs, particularly as it gears up to administer the new health care law.)

The recommendation to move Submission Processing out of the Taxpayer Service account and allocate other functions between Taxpayer Service and Enforcement accounts does not assume that doing so will automatically result in additional funding for taxpayer service activities. However, it will improve understanding of how much of the IRS's budget is spent on true taxpayer service activities and make clearer to Congress where the IRS's needs lie, increasing the likelihood that those needs will be met.

Creating a New Division to Handle Servicewide Functions Like Submission Processing Will Enable W&I to Focus Exclusively on the Needs of its Taxpayer Population.

Finally, the IRS seems to be missing the point of the National Taxpayer Advocate's recommendation to create a new division including Media and Publications and CAS. The IRS states that, "certain services can be most effectively and efficiently delivered to all taxpayers by managing their delivery in one operating division…" TAS does not disagree. However, the IRS has not made clear why that one operating division should be W&I. Without the burden of managing or participating heavily in the design and development of *all* IRS-wide services – such as the design of a corporate tax form to cite an example from the IRS – W&I would be better able to focus on its core taxpayer base. A successful filing season would no longer have to be "the single most important aspect" of W&I's activities. Instead, it would be one aspect of a larger mission of providing top quality taxpayer service to individual taxpayers – both during and outside of the filing season.

The IRS itself notes "[t]he design and development of IRS-wide services are, in fact, collaborative efforts involving all operating divisions … The other operating divisions are full partners with W&I in each undertaking." If the operating divisions all collaborate now on these service-wide initiatives, there is no reason why they cannot collaborate with a new separate function charged with administering these activities. In this way, W&I can give its full attention to both identifying and addressing the service and compliance needs of its specific taxpayer base, just as the other operating divisions do.

The purpose of raising these concerns is to start a discussion over whether the IRS's current structure best serves taxpayers and the IRS. The National Taxpayer Advocate

52 RRA 98, Pub. L. No. 105-206, §1002, 112 Stat. 685, 690.

commends W&I on the work it performs for individual taxpayers and for *all* taxpayers. However, we remain concerned that the IRS's response reflects a reflexive commitment to maintaining the status quo and an unwillingness to consider whether taxpayer service could be improved by changing the existing organizational structure or budget structure.

Recommendations

In consideration of the IRS's response, the National Taxpayer Advocate makes the following recommendations:

1. Create a new division under the Deputy Commissioner for Services and Enforcement – Servicewide Customer Account Service. This new division would contain Media and Publications, and CAS.
2. Remove funding for Submission Processing from the Taxpayer Services budget and place it in the Operations Support account.
3. Divide the budget for Field Assistance and other similar organizations that perform both service and compliance activities on the basis of the percentage of their activities that are assistance, outreach, and education as opposed to enforcement or operations support. This will provide a more accurate breakdown of the IRS's budget.

MSP #5 IRS Policy Implementation Through Systems Programming Lacks Transparency and Precludes Adequate Review

RESPONSIBLE OFFICIALS

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DEFINITION OF PROBLEM

The IRS needs automation to administer tax laws and tax-based social programs efficiently. Automation can enhance speed, accuracy, and comprehension while promoting consistency and fairness. To be effective, tax policies and procedures applied using automated systems and software applications require transparency, and employee guidance embedded in systems must be reviewed and continually analyzed for proper application. However, not all IRS systems have a continuous feedback cycle to assess and update embedded policies. In other words, unlike guidance to IRS employees published in the Internal Revenue Manual (IRM), policy guidance embedded in systems is neither reviewed internally nor published externally. As a result, IRS systems may be programmed with incorrect, incomplete, or outdated guidance, and employees relying on this information may make decisions that harm taxpayers. Further, the IRS may not be fulfilling its duty to update or publish instructions or procedures affecting taxpayers under the Freedom of Information Act (FOIA) and the Electronic FOIA Amendments of 1996 (E-FOIA).[1]

ANALYSIS OF PROBLEM

Background

The IRS established the Servicewide Policy, Directives and Electronic Research (SPDER) office to manage the process of administering and communicating consistent internal management directives and policies that employees can rely upon and use to treat taxpayers fairly.[2] Prior to the existence of SPDER, the Internal Management Document (IMD)[3] review process lacked oversight. Through the SPDER office, the IRS now establishes the policy and writes procedures for reviewing and approving all written policy, procedures, and guidance before these materials are issued and published.

1 5 U.S.C.A. § 552. The Electronic Freedom of Information Act Amendments (E-FOIA), Pub. L. No. 104-231, 110 Stat. 3048 (1996).

2 IRS Memorandum from Deputy Commissioner Operations, to All Heads of Offices re: Servicewide Policy, Directives, and Electronic Research (SPDER) (Dec. 22, 1999).

3 IRS Internal Management Documents (IMDs) include the IRM, delegation orders, and policy statements. IRM 1.11.5.1 (Sept. 1, 2009).

Proposed IRS written policies and guidance go through a stringent vetting process. Each IRS operating division (OD) and function, including the Taxpayer Advocate Service (TAS), reviews proposed written guidance from other functions to ensure conformance with established policies, statutes and regulations, and identify any conflicts with current procedures and systems. TAS employees review IRS proposed guidance not only for technical accuracy, but also to identify policies or procedures that may harm taxpayers, and offer solutions and alternatives to alleviate these burdens. While OD review of proposed guidance is an internal process, legal rule-making is subject to public scrutiny.[4]

In the case of regulations, the IRS is required to give public notice and an opportunity for review and comment under § 553 of the Administrative Procedure Act (APA).[5] The IRS publishes all substantive and procedural rulings of importance or general interest to promote a correct and uniform application of the tax laws by IRS employees. The IRS uses the Internal Revenue Bulletin (IRB) to circulate guidance and solicit comments and feedback from the community at-large before regulations and procedures are finalized. Further, statements of internal practices and procedures affecting rights and duties of taxpayers are published in the IRB.[6] However, the IRS is not required to circulate IMDs for public comment.[7]

The IRS also issues and publishes guidance (such as IRMs, legal opinions, and policy guidance) because it is required to be transparent under the law.[8] FOIA requires the IRS to state separately, and publish in the Federal Register, guidance for the public concerning its organization structure, the method and process for obtaining information, general procedures for its functions, forms and instructions, substantive rules of general applicability, and general policies and interpretations.[9] Further, the IRS makes available for public inspection and copying any statements of policy and interpretations adopted by the IRS, but not published in the Federal Register, as well as administrative staff manuals and instructions to staff that affect the public.[10] E-FOIA requires government agencies to provide these

4 The Secretary of the Treasury, or his delegate, is authorized to prescribe all needful rules and regulations for the enforcement of the tax code. IRC §§ 7701(a)(11)(B) & 7805(a).

5 5 U.S.C.A. § 553. Regulations and Treasury decisions are prepared in the Office of Chief Counsel. After approval by the Commissioner, they are forwarded to the Secretary for further consideration and final approval. Treas. Reg. § 601.601(a)(1). Where required by 5 U.S.C. § 553 and in such other instances as may be desirable, the Commissioner publishes general notice of proposed rules in the *Federal Register* (FR). Treas. Reg. § 601.601(a)(2). Interested persons may submit any data, views, or arguments in response to the notice of proposed rule making, and interested persons may petition for the issuance, amendment, or repeal of a rule. Treas. Reg. § 601.601(b) & (c). Once the comment period expires and the regulation is finally approved by the Commissioner, all internal revenue regulations and Treasury decisions are published in the FR and Internal Revenue Bulletin (IRB). Treas. Reg. § 601.601(d)(1).

6 Treas. Reg. § 601.601(d)(1).

7 The review and comment procedures generally do not apply to notices, revenue rulings, or revenue procedures that are published in the IRB. Treas. Reg. § 601.601(d)(2)(i). However, the IRS may grant a conference for public comment on these documents where the IRS determines it is justified by special circumstances. Treas. Reg. § 601.601(d)(2)(v)(f).

8 *See generally* 5 U.S.C.A. § 522. *See also* National Taxpayer Advocate 2006 Annual Report to Congress 10-29 (Most Serious Problem: *Transparency of the IRS*).

9 5 U.S.C.A. § 552(a)(1). Treas. Reg. § 601.702(a). Any matter which imposes an obligation on a taxpayer and which is not published or incorporated by reference in the Federal Register shall not adversely change or affect a taxpayer's rights. Treas. Reg. § 601.702(a)(2)(ii).

10 5 U.S.C.A. § 552(a)(2).

records by computer or electronic means and electronically redact any personally identifiable information in such records.[11]

FOIA exempts certain items from disclosure, including internal personnel rules and practices, inter-agency or intra-agency memoranda, letters regarding the deliberative process, and other private matters.[12] The IRS specifically identifies items exempt under FOIA as Official Use Only (OUO).[13] For example, the IRS designates tolerance levels (*i.e.*, a level of noncompliance that the IRS will not pursue in exam or collection) used in enforcement functions as OUO.

Moreover, FOIA creates a "strong presumption in favor of disclosure."[14] Thus, the President has suggested that all agencies, including the IRS, ". . . harness new technologies to put information about their operations and decisions online and readily available to the public," and solicit public commentary to identify information most useful to the public.[15]

Policies embedded in IRS systems do not go through the same stringent vetting and review process as written instructions or policies.

Instructions embedded in an electronic system do not go through the formal clearance process and are not made public. As such, there is no reasonable assurance the systems created to implement specific policy and guidance operate as intended. Nor will TAS or other affected IRS functions necessarily have the opportunity to indentify systemic problems that may burden or harm taxpayers through programming errors, or flaws in the underlying assumptions that ignore statutory requirements or eliminate discretion.

For example, the Reasonable Cause Assistant (RCA) program uses taxpayer information to assist IRS employees in making penalty abatement decisions.[16] RCA generally permits a first-time abatement (FTA) of failure to file, failure to pay, and failure to deposit penalties if the taxpayer has otherwise been compliant with filing and payment obligations for the past three years.[17] However, when processing abatement requests for spouses who file jointly, RCA is programmed to limit the three-year compliance check to the taxpayer identification

11 In enacting E-FOIA, Congress found that FOIA has been responsible for uncovering fraud, waste, abuse, and wrongdoings in government; has led to the identification of unsafe consumer products, harmful drugs, and serious health hazards; government agencies increasingly use computers to conduct agency business and to store records; and that government agencies should use new technology to enhance public access to agency records and information. H.R. Rep. No. 104-795, at Sec. 2(a) (1996).

12 5 U.S.C.A. § 552(b). FOIA also exempts matters concerning the national defense or foreign policy, items specifically excluded by statute, trade secrets or other privileged and confidential information from disclosure.

13 IRM 11.3.12.2 (Oct. 30, 2009).

14 Open Government Act of 2007, Pub. L. No. 110-175, § 2(3), 121 Stat. 2524 (2007) (*quoting U.S. Dep't of State v. Ray*, 502 U.S. 164, 173 (1991)).

15 President Barack Obama, *Memorandum for the Heads of Executive Departments and Agencies*, 74 FR 4683 (Jan. 21, 2009). In response, the Attorney General issued guidelines requiring defense of a denial of a FOIA request only if the agency reasonably foresees that disclosure would harm an interest protected by a statutory exemption, or disclosure would be prohibited by law. Office of the Attorney General, *Memorandum for the Heads of Executive Departments and Agencies* (Mar. 19, 2009).

16 The Reasonable Cause Assistant is a decision tree program that uses information from taxpayers and the IRS Master File to help employees review and process penalty abatement requests.

17 IRM 20.1.1.3.6.1 (Dec. 11, 2009).

number (TIN) of the primary spouse. Thus, the IRS fails to check the compliance history of the secondary spouse before making the FTA determination, and automatically denies relief to potentially eligible taxpayers. If the IRS had implemented this policy through IRM guidance to employees, it would undergo extensive internal review and comment. However, because the IRS implemented the policy through programming, the National Taxpayer Advocate and other IRS employees were unaware of it until actual taxpayers were harmed by the programmed results from the RCA.

The IRS does not use a continuous feedback mechanism on programs that make or guide substantive decisions.[18] This type of mechanism would allow the IRS to evaluate systems and update embedded assumptions as needed (*e.g., Were the assumptions correct? Based on experience, are there exceptions that require programming changes? Are there programming loops that create problems instead of resolutions?*). This sort of continual feedback and analysis can help the IRS analyze results for exceptions, anomalies, and inaccuracies.

Policy not programmed can create disparity in tax administration.

Vetting embedded guidance before programming also provides an opportunity to identify situations where policy *should* be programmed into an automated system. For example, a taxpayer who has been a non-filer for the past 20 years may decide to become compliant. Upon contact with the IRS, he or she should be informed of the IRS policy to generally limit its look-back period for unfiled returns to six years when a non-filer comes to the IRS voluntarily, before receiving contact.[19] This policy is not programmed into any IRS automated decision trees.

The omission of this guidance from automated systems has the potential to create great inequity. A taxpayer not informed of this policy statement *may* file, and the IRS *will* process, 20 years of returns. Another taxpayer, informed of this policy by an IRS employee and thereby prompted to do so, may only file six years of returns. This inconsistency creates a windfall for one taxpayer with no rational basis for the disparate treatment of the other taxpayer.

Overreliance on programmed policy can be problematic.

Sometimes, automation creates a false sense of security. Embedded assumptions in programming that are not reviewed and continually analyzed can create a false sense of assurance. For example, the IRS maintains the Centralized Authorization File Program (CAF), which uses signed power of attorney (POA) forms to track taxpayers' authorizations for certified public accountants (CPAs), attorneys, and enrolled agents (EAs) to perform specific

[18] The IRS uses two formal feedback methods – Servicewide Electronic Research Program (SERP) Feedback and an RCA e-mail address for questions to RCA experts. While these methods apprise the IRS of systemic issues, they do not systemically assess embedded assumptions.

[19] Taxpayers failing to file tax returns due will be asked to prepare and file all such returns. All delinquent returns will be accepted. Normally, application of these criteria will result in enforcement of delinquency procedures for not more than six years. IRM 1.2.14.1.18, *Policy Statement 5-133* (Aug. 4, 2006).

acts on their behalf.[20] CAF examiners input a POA indicator on the IRS master file without verifying the credentials or practice status of representatives identified on the POA form.[21] Various online tools and inventory management systems remind employees to check the IRS master file, not the underlying credentials, to determine authority to practice before the IRS.[22]

Practice before the IRS encompasses all matters connected with a presentation to IRS officers or employees relating to a taxpayer's rights, privileges, or liabilities under the tax code and regulations.[23] Practitioners before the IRS are required to represent taxpayers diligently, promptly, and without any conflicts of interest.[24] However, representatives who are not authorized to practice before the IRS may harm taxpayers (by misrepresenting rights and obligations, or by taking fees for delayed or careless representation) without reprisal from the Office of Professional Responsibility (OPR), which has the authority to only discipline those who are authorized to practice before the IRS.[25] TAS analysis of representatives claiming EA status in the CAF in FY 2009 revealed 30 percent of representatives listed as EAs were not recognized as such by the OPR.[26] If the IRS verified practitioners' credentials, it could contact a taxpayer directly and explain that the representative is unauthorized to practice before the IRS, allowing the taxpayer to reconsider the representation. The IRS could improve its protection of taxpayers by cross-checking with OPR databases through automation, thereby creating a continuous feedback loop.

Automation must leave room for employee judgment and review.

For every policy and procedure, there generally are exceptions based on the taxpayer's circumstances. Automation is not a substitute for an employee's independent judgment and discretion. For example, the IRS automatically sends notices of intent to levy or files Notices of Federal Tax Lien (NFTLs) before the cases have been forwarded to the

20 *See generally* IRM 21.3.7 (Aug. 2009). Most taxpayers authorize third parties to practice before the IRS on their behalf by submitting Form 2848, *Power of Attorney and Declaration of Representative* (June 2008). If a representative is not authorized to practice before the IRS, he or she may only represent the taxpayer as a designee for a year in which he or she prepared the taxpayer's tax return. IRM 4.11.55.1.2.2(1) (Apr. 20, 2010); IRM 5.1.23.2.1.4.1(3) (Oct. 12, 2010).

21 IRM 21.3.7.1.4 (Oct. 1, 2008). CAF examiners will record a power of attorney form into the file as long as the taxpayer's identity, the representative's identity, the type of tax return, the tax periods, the taxpayer's signature and date, and the representatives designation, jurisdiction, signature, and date are provided. IRM 21.3.7.5.2 (Aug. 25, 2009).

22 *See, e.g.*, IRM 5.19.5.3.6(2) (Dec. 1, 2007). In the Automated Collection System (ACS), a CAF indicator displays on the employee's computer screen if there is a representative authorized to practice before the IRS.

23 Treasury Department Circular No. 230 (Circular 230) § 10.2(a)(4) (Apr. 2008).

24 Circular 230 §§ 10.22, 10.23 & 10.29 (Apr. 2008).

25 Circular 230 § 10.50 (Apr. 2008).

26 TAS Research, for FY 2009, of 4,959 enrolled agent (EA) powers of attorney entered in the CAF, 1,496 could not be matched against the Office of Professional Responsibility (OPR) database of valid EAs. OPR provides search features on its website for enrolled agents (http://nhq.no.irs.gov/opr/). IRM 4.11.55.1.2.2(3) (Apr. 20, 2010). In addition, the IRS web site provides contacts for searching the status of an Enrolled Agent via e-mail or telephone. *See* http://www.irs.gov/taxpros/agents/article/0,,id=123388,00.html (last visited Nov. 22, 2010).

Automated Collection System (ACS) or the Collection Field function (CFf).[27] TAS reviewed FY 2009 cases and found the IRS issued proposed levy or lien filing notices on 11 percent of taxpayers' tax year modules before their cases were ever assigned to Collection.[28] The IRS takes automated collection action without using automation to determine if the taxpayer is low income, classified as currently not collectible (CNC) with respect to another tax matter, or working with another IRS function, including TAS.

New systems present an opportunity for artificial intelligence.

Artificial intelligence, and specifically "machine learning" as employed by the IRS Risk-Based Collection Model, creates rules specifying treatment for certain cases based on the data input, yet only works when the IRS has experience and history with the process.[29] For the system to succeed, the IRS must have a valid data set of positive and negative learning experiences that are continually updated on a periodic schedule to create an experiential database. Similarly, rule based applications, such as RCA, need a continually updated database of positive and negative experiences to work effectively.

The IRS is currently designing and implementing the Information Reporting and Document Matching (IRDM) program, in response to legislation that allows the IRS to collect merchant card data, cost basis data on security sales, and information on government payments. Much of this third-party data will be consolidated into an existing system and matched against filing data to detect underreporting or non-filing. The IRS will use the results of these processes to develop an inventory of potential cases.[30]

While the IRDM program plans to collect data to monitor and improve the effectiveness of the case selection process, the IRS can also improve efficiency and effectiveness by employing the principles of artificial intelligence.[31] Without an effective feedback mechanism based on positive and negative learning experiences, IRDM will create burden for taxpayers and IRS alike.

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27 *See* Most Serious Problem: *The IRS's Failure to Provide Timely and Adequate Collection Due Process Hearings May Deprive Taxpayers of an Opportunity to Have Their Cases Fully Considered, infra;* National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*); Letter 1058, *Final Notice, Notice of Intent to Levy and Notice of Your Right to a Hearing* (Oct. 2008); Letter 3172, *Notice of Federal Tax Lien Filing and Your Rights to a Hearing Under IRC 6320* (Mar. 2009).

28 IRS, CDW, Integrated Data Retrieval System (IDRS), analysis of IDRS transaction code (TC) 971, action codes (ACs) 69 (for levy Collection Due Process (CDP) notices) and 252 (for lien CDP notices) for status 22, ACS, and status 26, CFf, cases for FY 2009. Further, 24 percent of the modules were not in Collection before issuance of CDP lien notices, and almost ten percent of the modules were not in Collection before the issuance of a CDP levy notice. Of those modules not in Collection, 28 percent of modules were in the queue on or before a CDP levy notice was issued and 47 percent of modules were in the queue on or before a CDP lien notice was issued.

29 IRS, 2005 IRS Research Conference, *Risk-Based Collection Model Development and Testing* 142-143 (June 7, 2005). The IRS team used data mining and machine learning techniques to identify patterns in historical collections data to reveal predictors of collections outcomes.

30 *See* http://mits.web.irs.gov/es/default.htm (last visited June 26, 2010).

31 The term "artificial intelligence" was coined by a gathering of Dartmouth computer scientists in 1956 and means the intelligence of machines and the branch of computer science aimed at creating the underlying supporting systems. Jonathan Skillings, *Getting Machines to Think Like Us*, CNET News (July 3, 2006).

CONCLUSION

Policy embedded in IRS systems is just as important as written policy and should be subject to similar vetting. IRS decision systems should maximize artificial intelligence by including a continuous feedback cycle mechanism. The IRS must document any new system and changes made through artificial intelligence and disclose non-OUO changes to provide transparency to taxpayers.

The National Taxpayer Advocate offers these preliminary recommendations:

1. Expand the SPDER clearance process to include a review of IRS systems that include embedded policy decision tools and programs;
2. Require an artificial intelligence support system of continuous feedback in new IRS systems to continually assess and improve programming;
3. Plan and allocate funding for information technology hardware, software, and support of artificial intelligence and continuous feedback in new programs, such as the IRDM program; and
4. Provide for the public disclosure of non-OUO embedded policy decision tools and programs needed for transparency.

IRS COMMENTS

Overview

The IRS appreciates the National Taxpayer Advocate's recognition that automation is needed to administer the tax laws efficiently and consistently. The IRS agrees that tax policies and procedures require transparency. The IRS also agrees that policy guidance implemented in automated systems should accurately reflect that guidance and that internal processes, such as feedback loops, should be present to ensure automated tools and systems are aligned with policy guidance. The IRS disagrees with the statement that policy guidance programmed into automated systems is not transparent or adequately reviewed. The IRS also disagrees with the statement that programmed requirements should be published for external review.

The IRS defines policy decisions through the IRM, internal directives, published guidance and other means. There is a well-defined process for review and clearance including external publication. These policies and guidance are published or available externally ensuring transparency. These same policies and procedures may be translated into business requirements for implementation into IRS automated systems. The IRS uses industry standard processes for systems development to ensure systems deliver accurate, quality, cost effective, and timely solutions to meet the defined business requirements. Business customers review and concur that requirements are being met throughout the design, development, testing, deployment, and update stages of systems development.

Policy Defines Business Requirements for Automated Systems.

The National Taxpayer Advocate reports that policies embedded in IRS system do not go through the same stringent vetting and review process as written instructions or policies. Policies are established before programming changes are made. These policies are subject to vetting and review before the act of programming is performed. Programming changes are made to effectuate policies that have been previously determined. The programming changes are defined and governed by process disciplines that allow for confirmation of business requirements.

The IRS has a mandatory procedure in place for effectuating policy decisions into program changes.[32] Each business organization within the IRS has policy analysts that author the IRM where the policies, procedures, and guidelines are written. The IRM is the central source for standard operating procedures and directives within the IRS, and it is the official source for IRS policies, directives, guidelines, and procedures. These analysts also "own" the policies and are responsible for reviewing them throughout the year to determine impacts for all required changes. They also ensure the IRM content is properly coordinated and cleared through all impacted organizations prior to publishing. Impacted organizations, in turn, are responsible for accurately and timely effecting those policies and guidance into business processes and automated systems.

Once a policy is defined or updated and it is determined that automated systems will be used to implement the policy, business requirements are developed. Requirements are provided by the business to the information technology organization (MITS) through a work request or change request process.[33] The computer programming to deliver these requirements is guided by stringent and structured processes. The processes are defined by the Enterprise Life Cycle (ELC)[34] for new applications or Change Management (CM) for updates to current systems. Each process has multiple steps or milestones which allow the business owner to review and confirm that the automated systems will accurately deliver the requested requirements. These steps occur during the design, development, testing, and deployment stages. In addition, the IRS employs a governance structure of business and technology partners to oversee business applications throughout the lifecycle to identify and mitigate any potential impacts or risks to users, customers and stakeholders.

Keeping IRS Systems Aligned with Policies

Given the large volume of programming changes made every year to hundreds of IRS business applications, it is possible that the programmed business requirements result in

32 Legislative, judicial and other changes drive IRS policies and procedures. SPDER is the owner of the IMD process, which supports the IRS goal of ensuring the IRM is the official source of all procedures, policy, directives, delegations, and guidelines. SPDER is responsible for setting Service policy for and designing, implementing, and monitoring a strategic servicewide approach to managing the internal directives process.

33 A Unified Work Request (UWR) provides a formal, documented notification to MITS that a service or support is needed. The UWR provides the documentation and describes the type of work needed. It is vetted with all stakeholders and approved by management to ensure the needs are complete and articulated to achieve established policy.

34 http://elc.nc.no.irs.gov/.

unintended or inconsistent results. When the IRS becomes aware of such results, steps are taken by the business and MITS to correct the situation. The National Taxpayer Advocate cites the Reasonable Cause Assistant as the only example of an embedded programmed policy. As discussed in another portion of the National Taxpayer Advocate's report, the IRS is aware of the issues related to the RCA and is taking steps to address this issue.

The IRS recognizes the importance of feedback to continuously improve and align our automated systems and tools. The IRS uses industry standard processes to receive and solicit feedback. These include an Enterprise Service Desk to report operational incidents and problems for monitoring and resolution. Change requests and work requests are used to capture, describe, evaluate, and prioritize customer requests for changes or updates to business applications. The application development process provides multiple opportunities for feedback during design, development and testing. Business unit and enterprise IT governance bodies also provide venues for review and change to systems requirements. While the IRS recognizes that the processes described require human initiation and intervention and are not generated systemically from the business applications themselves, these procedures have been effective at identifying issues and opportunities for improving systems.

Minor Variations in Programming Do Not Suggest Fundamental Differences in Policy.

The National Taxpayer Advocate claims that policy not programmed can create disparity in tax administration and cites the IRS policy of limiting the look-back period for unfiled returns. The comparison made in the report is flawed. The IRS policy to limit its look-back period to six years is not inconsistent with systems allowing the acceptance of tax returns for periods prior to the general-look back period. The law requires, and IRS systems must accept, unfiled returns for all prior years. The presence of a policy to limit the look-back period does not affect the necessity for IRS systems to handle acceptance of returns for years prior to the look-back period.

The National Taxpayer Advocate's report claims that automation creates a false sense of security and uses the Centralized Authorization File program as an example. The IRS acknowledges that improvements could be made to verify information of representatives; however, it is incorrect that the current process creates a false sense of security. Employees are aware of the current limitations in systems for cross checking in all cases.[35]

Public Disclosure & FOIA

The National Taxpayer Advocate states that the IRS may not be fulfilling its duties under the FOIA and E-FOIA. The IRS disagrees. The IRS has consulted with the Office of Chief Counsel and confirmed that current practices are fully compliant with these legal requirements.

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35 Note that in connection with the IRS's Return Preparer Initiative, it is expected that the process will be enhanced so that there is a more integrated process to validate preparer credentials.

Systems may include internal enforcement policies (such as certain tolerance levels, etc.), but these policies are of a type that should not be available to the public given their sensitive nature. These policies are generally included in the IRM, but are classified as OUO and not disclosable to the public.

Using Advanced Technology and Tools to Improve Business Requirements

The IRS agrees with the National Taxpayer Advocate that new technology creates opportunities to improve how our automated tools and business applications are designed, used, and updated. The IRS deploys numerous tools that allow for analysis, development, testing, feedback, and updating of our business logic programmed into the automated systems. Current software options include decision analytics, data and predictive modeling, business rules engines, document repositories, integrated data models, management information reporting, and federated data queries. For example, the examination function uses tools for inventory selection: 1) machine learning which applies algorithms on a data set which then automatically recognizes complex patterns and makes intelligent decisions based on the data;[36] and 2) use of expert rules and models to first identify the probable non-compliant issues on an individual income tax return and then prioritizes returns with the most audit potential.

The value of acquiring new software, adopting additional program languages, and building new testing and evaluation methods needs to be evaluated in the context of the IRS's unique business and systems environment - particularly with respect to the effects and time constraints of annual changes to tax legislation and the interpretation of tax law. In the current fiscal environment, pursuit of the proposed process must be predicated on a substantive understanding of the costs and benefits and a reasonable sense of the life expectancy of any policies, practices, or procedures that will be implemented to support the process.

The IRDM program provides a current business example of how the IRS's suite of tools can and will be used to deliver the business objectives, align with the prescribed policies and guidance, and implement feedback mechanisms to ensure that alignment. The IRS concurs it is important to create an effective feedback mechanism during IRDM development to avoid creating burden for taxpayers and IRS alike.[37]

36 The IRS is currently conducting an Exam inventory test entitled "Compliance Data Environment, Release 3 (CDEr3)/Machine Learning Test." This test involves using a combination of two artificial intelligence models for inventory selection.

37 The Business Underreporter (BUR) portion of IRDM will have a robust Case Inventory Selection and Analytics (CISA) component enabling us to accurately track case resolutions. This will also contain a feedback loop, allowing for refinement of case selection in subsequent cycles, years, and tax periods. A Customer Satisfaction Survey similar to the one used in Individual Master File Automated Underreporter will be developed and utilized in a similar manner to aid in determining possible areas for improvement. Along with the survey, all relevant feedback from practitioners, preparers, and small business taxpayers via mail, fax, or phone, will be documented and considered.

Preliminary Recommendations

The National Taxpayer Advocate recommends that the IRS expand the SPDER clearance process to include a review of IRS systems that include embedded policy decision tools and programs. The IRS does not believe that the SPDER clearance process should be expanded to review programming changes. As previously discussed, IRS systems should not define or create new policy decisions, only reflect and implement established policy. These policy decisions should be subject to review by management before the system change is requested. The IT systems development life cycle provides the process and mechanism to review and confirm the policy has been accurately programmed.

The National Taxpayer Advocate also recommends that the IRS require an artificial intelligence support system of continuous feedback in new IRS systems to continually assess and improve programming. An IRS decision to require the use of artificial intelligence technology would be based on an approved business case and associated resource investments. As noted above, the IRS already supports the implementation and use of multiple feedback mechanisms within automated systems and across business processes which are designed to ensure requirements and being met and to identify continuous improvement opportunities.

The National Taxpayer Advocate also recommends that the IRS plan and allocate funding for information technology hardware, software, and support of artificial intelligence and continuous feedback in new programs, such as the IRDM program. As with the prior recommendation, an IRS decision to require the use of this technology would be based on an approved business case and associated resource investments. The IRS does and will continue to leverage available technologies during design, build, test, and deployment of new systems such as IRDM.

Finally, the National Taxpayer Advocate recommends that the IRS provide for the public disclosure of non-OUO embedded policy decision tools and programs needed for transparency. The IRS agrees that tax policies and procedures should be transparent. However, as previously discussed, necessary transparency should, and already does, take place distinct from the programming of systems.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS "agrees that tax policies and procedures require transparency." However, the IRS response does not support its own position. For example, the IRS states that "[p]olicies are established before programming changes are made. These policies are subject to vetting and review before the act of programming is performed. Programming changes are made to effectuate policies that have been previously determined." Yet TAS has provided several examples (of which there are many more) where policies are programmed into automated decision trees or probes-and-response that were not subject to the level of cross-functional review achieved in the IRM clearance process.

As the IRS itself states, "automation is needed to administer the tax laws efficiently and consistently." We also believe automation must help administer the tax laws *accurately* and *effectively*. When the IRS fails to comprehensively vet the underlying assumptions and policies of programming that impacts taxpayers' lives – *i.e.*, any matter which imposes an obligation on a taxpayer – and then publish those policies (with appropriate redaction for OUO matters), it impairs the effectiveness of tax administration and increases the risk of inaccurate results. The Enterprise Life Cycle and Change Management requests generated by the business owner are not substitutes for a substantive cross-functional clearance process and public transparency. In our opinion, this failure raises significant concerns about the IRS's compliance with FOIA and E-FOIA. The potential for harm grows as the IRS increasingly automates the decision-making process pertaining to substantive tax matters.

In its response, the IRS cites a Chief Counsel opinion as its basis for its statement that it is in compliance with E-FOIA. However, the IRS has not produced a copy of this opinion.[38] The Office of Chief Counsel is generally required to disclose certain Chief Counsel advice (CCA),[39] and we find it ironic that the IRS would not disclose legal advice from Chief Counsel finding that the IRS was compliant with E-FOIA. Moreover, even SPDER has expressed concerns that it may not be in compliance with E-FOIA in its handling of the Servicewide Electronic Research Program (SERP) interim procedural updates (IPUs).[40]

The National Taxpayer Advocate is disappointed that the IRS would not disclose systems information to IRS employees or the public because the information may include "internal enforcement policies." The IRS routinely discloses the IRM, including OUO material, to IRS and TAS personnel electronically, but removes (redacts) OUO information from the manual for public consumption. The IRS should disclose systems information the same way.

38 TAS sent an e-mail on December 20, 2010, requesting a copy of the opinion. In response to our request, the IRS confirmed that this conclusion has not been reduced to writing. Thus, we cannot evaluate the basis on which Counsel so concluded.

39 IRC § 6110(i)(1) generally requires disclosure of certain Chief Counsel advice (CCA), which means any written advice or instruction, under whatever name or designation, prepared by any national office component of the Office of Chief Counsel.

40 *See* SPDER, *FY 2008 Annual Report of the Internal Management Documents (IMD) Program* 11 (Feb. 6, 2009).

The National Taxpayer Advocate is pleased that the IRS uses "industry standard processes for systems development." However, the IRS has routinely disclosed material weaknesses in its internal controls for the management of unpaid tax assessments that industry standard processes have not corrected.[41] While the use of outdated systems may be a large part of the problem, the IRS should consider review of systems processes by all affected internal stakeholders, such as TAS, to ensure that programs achieve their intended results and that all laws and regulations are followed.

Tax administration benefits from transparency. Analysts who "own" and review policies are generally not relying on the systems used to carry out the guidance. For example, while analysts in the Centralized Authorization File program office may be aware of the current limitations in systems for cross checking a valid power of attorney, the Customer Service Representative (CSR) relying on this data is not. The lack of transparency creates a false security, and the CSR's reliance on the system may cause an unauthorized disclosure.

Systems not only include return processing and penalty determination tools, but online account guidance. Consider the IRS policy of limiting the look-back period to six years to determine full compliance. The concern is not whether the IRS can process prior year returns: it can and it should. The concern is whether all taxpayers facing the challenge of coming into compliance are properly informed of this policy and treated equally. They are not. The disclosure of non-OUO embedded policy tools, in particular to practitioners, helps taxpayers and the IRS achieve the best and most equitable resolution of an account.

The National Taxpayer Advocate realizes that the IRS has been effective at identifying issues and opportunities for improving systems. She challenges the IRS to continue these improvements, while recognizing the agency's current budget constraints and considerations. Finally, she urges the IRS to increase the use of artificial intelligence to promote an environment of continuous feedback and improvement not dependent on human initiation.

41 IRS Commissioner, *Statement of Qualified Assurance of Achievement of Management Control Objectives* for FYs 2009 and 2010 (Nov. 5, 2009 and Nov. 5, 2010). Government Accountability Office (GAO), GAO-09-11913, *Financial Audit: IRS's Fiscal Years 2008 and 2007 Financial Statements* 13 (Nov. 2008). The Office of Management and Budget (OMB) Circular No. A-123 defines a material weakness as a reportable condition that the agency head determines to be significant enough to report outside of the agency. GAO, GAO-09-232G, *Federal Information System Controls Audit Manual (FISCAM)* 130 (Feb. 2009). OMB Circular No. A-123 and the Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. § 3512) provide, among other things, that federal employees must ensure that programs operate and resources must be used consistent with agency missions, in compliance with laws and regulations, and with minimal potential for waste, fraud, and mismanagement.

Recommendations

In consideration of the IRS's response, the National Taxpayer Advocate renews the following recommendations:

1. Expand the SPDER clearance process and change standard practices to include a review of IRS systems that include embedded policy decision tools and programs;
2. Provide for the public disclosure of non-OUO embedded policy decision tools and programs needed for transparency; and
3. Consider and weigh the benefits of adding an artificial intelligence support system of continuous feedback in new IRS systems to continually assess and improve programming.

MSP #6 IRS Collection Policies and Procedures Fail to Adequately Protect Taxpayers Suffering an Economic Hardship

RESPONSIBLE OFFICIALS

Richard E. Byrd Jr., Commissioner, Wage and Investment Division
Chris Wagner, Commissioner, Small Business/Self-Employed Division
Diane Ryan, Chief, Appeals

DEFINITION OF PROBLEM

In her 2008 Annual Report to Congress, the National Taxpayer Advocate urged the IRS to reconsider its longstanding collection enforcement policies and procedures, and recommended the IRS exercise more flexibility in dealing with taxpayers experiencing economic difficulties.[1] Last year, in *Vinatieri v. Commissioner*, the Tax Court held that the IRS abused its discretion by proposing to levy on a taxpayer who had shown that she was in economic hardship.[2] The error arose because the IRS interpreted the Internal Revenue Manual (IRM) as preventing it from placing the taxpayer's account into currently not collectible (CNC) status due to unfiled returns.[3]

More than a year has passed since *Vinatieri* was decided, yet IRS guidance still does not adequately explain procedures for placing an account with unfiled returns into CNC status rather than proceeding with a levy. To date, the IRS has not revised IRM sections that lead it to propose to levy on a taxpayer in economic hardship. Moreover, the IRS lacks sufficient procedures to monitor economic hardship among taxpayers. For example, the 136-page Appeals Quality Management System (AQMS) Reviewer's Guide, which provides guidance to Appeals employees on how to evaluate the quality of case dispositions, does not contain the word "hardship."[4] TAS continues to see cases involving situations similar to *Vinatieri*, some of which required Taxpayer Assistance Orders to resolve.

ANALYSIS OF PROBLEM

Background

IRC § 6343(a)(1)(D) states that a levy shall be released if "the Secretary has determined that such levy is creating an economic hardship due to the financial condition of the taxpayer."

1 *See* National Taxpayer Advocate 2008 Annual Report to Congress 15-38 (Most Serious Problem: *The IRS Needs to More Fully Consider the Impact of Collection Enforcement Actions on Taxpayers Experiencing Economic Difficulties*).

2 133 T.C. No. 16 (Dec. 21, 2009), discussed *infra*.

3 The National Taxpayer Advocate issued guidance to TAS employees explaining the Tax Court's decision and how to advocate for taxpayers who are facing IRS levies even though they are in economic hardship. TAS Interim Guidance Memorandum (IGM), *Interim Guidance on Handling Collection Cases Where Economic Hardship Is Present but the Taxpayer Has Not Filed All Required Returns* (Mar. 23, 2010), *available at* http://www.irs.gov/pub/foia/ig/tas/tas-13_1-0110-01.pdf.

4 The Appeals Quality Management System (AQMS) Reviewer's Guide in Collection Cases (Rev. Dec. 31, 2009), *available at* http://appeals.web.irs.gov/aqms/Documents/Collection_Reviewers_Guide.pdf.

Treasury Regulation § 301.6343-1(b)(4) provides that economic hardship is present "if satisfaction of the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses."[5] To determine if economic hardship is present, IRS compliance employees consider a number of factors such as the taxpayer's general earning potential, basic living expenses, and the cost of living in the taxpayer's geographic location.[6]

Existing Guidance May Lead to Inappropriate Levy Action.

In *Vinatieri,*[7] where the taxpayer, who had unfiled returns, established that she was in economic hardship, the Tax Court held that the IRS's proposed levy was not appropriate given that under IRC § 6343(a)(1)(D), the IRS must release a levy if economic hardship is present. Proceeding with a levy that would have to be immediately released constituted an abuse of discretion.

The IRM provision the IRS considered in *Vinatieri* states:

> A compliance check will be made and the results documented in the case history for all hardship determinations per IRM 5.16.1.1(5). Any open filing requirements or Taxpayer Delinquency Investigation (TDI) modules [*i.e.,* years for which the taxpayer has not filed a return] must *be resolved* and *closed appropriately* when reporting an account currently not collectible under hardship provisions.[8]

The Appeals settlement officer interpreted this provision to mean that unfiled returns must be secured as a prerequisite for placing an account into CNC status because of the taxpayer's economic hardship. Other provisions in the IRM describe conditions under which an account may be "resolved" or "closed appropriately" without securing unfiled returns,

5 The IRS makes economic hardship determinations in a variety of other contexts. IRM 5.1.12.20 (May 20, 2008) permits IRS employees to issue manual refunds if the taxpayer is in economic hardship; IRM 5.8.11.2.1 (Sept. 23, 2008) permits IRS employees to consider an effective tax administration offer in compromise where the taxpayer's liability could be collected in full but collection would create an economic hardship, and IRM 5.16.1.1 (June 29, 2010) permits IRS employees to remove accounts from active inventory and report them as currently not collectible (CNC) where collection of the liability would create a hardship for the taxpayers by leaving them unable to meet necessary living expenses. In addition, a taxpayer may raise as a defense the inability to pay due to hardship in a hearing under IRC § 6330 as a "challenge to the appropriateness of collection action." *See* IRC § 6330(c)(2)(ii); IRM 8.22.2.4.2 (Mar. 11, 2009).

6 IRM 5.19.4.4.10(4)(j) (Mar. 8, 2010), based on IRC § 6343 and Treasury Regulation § 301.6343-1(b)(4)(ii). Specific factors include the taxpayer's age, employment status, employment history, future income earning ability, number of dependents, and status as someone else's dependent; the amount reasonably necessary for food, clothing, housing, medical expenses, current tax payments, court ordered payments, and expenses necessary to the taxpayer's production of income; the amount of property exempt from levy and available to pay the taxpayer's ordinary and necessary expenses; extraordinary circumstances; and other factors the taxpayer brings to the attention of the IRS that show an economic hardship.

7 133 T.C. No. 16 (Dec. 21, 2009).

8 IRM 5.16.1.2.9(8) (Dec. 1, 2006) (emphasis added), as in effect when the IRS proposed to levy on the taxpayer in *Vinatieri*. The provision was revised in May 2009 and in June 2010. The only relevant change was to insert "generally." Such modules must now "generally" be resolved and closed appropriately when reporting an account CNC. As in the 2006 version, no guidance or cross reference explains how this "general" rule applies.

but none of them include economic hardship as an overriding condition that must be taken into account when the IRS is contemplating a levy.[9]

The IRM provision the IRS relied on in *Vinatieri* is not the only one that leads to the erroneous conclusion that an account with unfiled returns cannot be placed into CNC status. Similar provisions include:

- IRM 5.1.7.7.3(5) – "Caution: Do NOT report any cases as CNC (hardship) until all delinquent returns are filed and the cause of the delinquency addressed."[10]
- IRM 5.16.1.1(6) – "All open filing requirements or Delinquent Return (Del RET) modules must generally be resolved and closed appropriately when reporting an account CNC."[11]
- IRM 5.19.1.3.4.1(6) – "Installment agreements and CNC hardships cannot be established if a return is required to be filed."[12]
- IRM 5.19.1.7.1(6) – "Accounts with both a return delinquency and balance due that may qualify for a CNC hardship consideration, but have an open TDI module, a.k.a. Del Ret module, and the taxpayer refuses to file the delinquent returns, must be sent to QUEUE as unresolved. Before transferring to the QUEUE, *all levy sources MUST be exhausted* and a lien filed if appropriate (emphasis added)….Do not refer the TDI for Automated Substitute for Return (ASFR) processing or close the Taxpayer Delinquent Accounts (TDAs) as CNC hardship."[13]
- IRM 5.19.1.7.1(8) – "Do not report any cases as CNC (hardship) until all delinquent returns are filed. Discuss options with the taxpayer to address and avoid future liabilities, such as increase withholding, etc. *Enforce collection action* if the taxpayer refuses to clearly correct the cause of the delinquency unless there would be no balance due on delinquent or future tax periods" (emphasis added).[14]

9 *See e.g.*, IRM 1.2.14.1.18 (Aug. 4, 2006), Policy Statement P-5-133 (where reference to factors ensuring compliance and evenhanded administration of staffing and other Service resources would not require enforcement of delinquency procedures); IRM 5.1.11.7.3 (June 2, 2004) (where it can be substantiated that the taxpayer has no filing requirement for a given year); IRM 5.1.11.6.1(4) (Jan. 15, 2010) (where the delinquent module is six years or older); IRM 5.1.11.6.1(8) (Jan. 15, 2010) (where the delinquent module is less than six years old, but it is clear from information available that the non-filer does not have or will not have the ability to pay some if not all of the potential tax liability over the ten-year statutory collection period). Additionally, when a taxpayer fails to file a timely return, IRC § 6020(b) authorizes the IRS to make a return, referred to as a substitute for return (SFR), based on information reported to the IRS. An SFR is sufficient to close a delinquent tax module. IRM 5.18.1.3 (Oct. 1, 2005); IRM 5.18.1.3.4 (Jan. 25, 2008). Moreover, the *Vinatieri* case might not have reached Appeals if all IRS employees had the same authority to close accounts with unfiled returns. Automated Collection System (ACS) employees must refer to IRM 5.19 for all case actions; they are not authorized to proceed according to the Collection Field function (CFf) portion of the IRM, *i.e.*, IRM 5.1.11.

10 Where unfiled returns (referenced in various IRM provisions) not only prevent the account from being placed into CNC status, but also lead the IRS to levy or propose to levy, the IRS will have abused its discretion under *Vinatieri*.

11 This provision is very similar to the one relied on by the Appeals settlement officer in *Vinatieri*, and leads to the same erroneous conclusion that returns must be secured as a prerequisite to placing an account in CNC status. As in *Vinatieri*, this conclusion may in turn lead the IRS to levy or propose to levy despite the taxpayer's economic hardship, which would constitute an abuse of discretion.

12 Reliance on this provision would exemplify the error the Appeals settlement officer made in *Vinatieri* because it leads to the conclusion that returns must be secured before CNC status is allowable, which in turn may lead the IRS to abuse its discretion by levying or proposing to levy despite the taxpayer's economic hardship.

13 Imposing a levy in reliance on the penultimate sentence of this IRM would constitute an abuse of discretion, under *Vinatieri*.

14 Imposing a levy in reliance on the last sentence of this IRM would constitute an abuse of discretion, under *Vinatieri*.

- IRM 5.19.18.5(4) – "If the taxpayer is unable to pay, report the case Currently Not Collectible (CNC) using the unable to pay closing code. Caution: Do NOT report any cases as CNC (hardship) until all delinquent returns are filed and the cause of the delinquency addressed."[15]

IRS employees would benefit from additional training on the principles outlined in the *Vinatieri* decision – independently of any other circumstance, the IRS should not levy or propose to levy if the levy will cause economic hardship. Any such levy will be *required* to be released immediately; thus, proposing or placing a levy that must be released immediately constitutes an abuse of discretion. Because of the potential for grievous harm, in addition to training on this issue, the IRM should provide that economic hardship *alone* is a sufficient basis for placing it in CNC status.

The National Taxpayer Advocate in March 2010 issued guidance to TAS employees discussing the *Vinatieri* decision and the IRM provisions that could lead to levies required to be immediately released.[16] In addition, TAS submitted draft language to the IRS recommending changes to the misleading IRM provisions, and is actively engaging the IRS in discussion.[17] As of October 1, 2010, the IRS has not implemented any of the suggested changes.[18] Thus, taxpayers continue to encounter the same situation as Mrs. Vinatieri and some of them have come to TAS for help.[19]

On January 19, 2010, shortly after the Tax Court issued the *Vinatieri* opinion, IRS Appeals Tax Policy & Procedures, working with the Office of Chief Counsel, reviewed and revised its IRM guidance. The revised IRM 8.22.2.4.2 will provide, in part, "if a taxpayer is entitled to CNC status based on economic hardship, he or she should be granted CNC status based on economic hardship, even if he or she has not filed all required returns."[20] Additionally, Appeals provided training to its settlement officers about the *Vinatieri* decision.[21] The

15 Where unfiled returns (referenced in various IRM provisions) not only prevent the account from being placed into CNC status, but also lead the IRS to levy or propose to levy, the IRS will have abused its discretion under *Vinatieri*.

16 TAS IGM, *Interim Guidance on Handling Collection Cases Where Economic Hardship Is Present but the Taxpayer Has Not Filed All Required Returns* (Mar. 23, 2010), *available at* http://www.irs.gov/pub/foia/ig/tas/tas-13_1-0110-01.pdf.

17 E-mail from Special Counsel to the National Taxpayer Advocate, Office of Chief Counsel, to Director, Collection Policy (Mar. 24, 2010); E-mail from TAS Collection Technical Liaison to Supervisory Revenue Officer, Small Business/Self Employed (SB/SE) Collection Policy (Sept. 16, 2010).

18 According to Wage &Investment (W&I), "there is not a need to make additional changes to the IRM guidance or training material as it relates to addressing economic hardship situations." W&I response to TAS research request (July 9, 2010) (response to question 3). However, on Aug. 20, 2010, W&I issued a Servicewide Electronic Research Program (SERP) Alert 100440, *Vinatieri Decision: Guidance When a Taxpayer Who Has Been Levied Indicates That the Levy Is Creating a Hardship* (Aug. 20, 2010) reminding its employees of two circumstances in which accounts can be closed without securing an unfiled return, and that accounts can be referred for SFR processing or the delinquent return module can be sent to the queue. According to SB/SE, "Since the Vinatieri decision…analysts have been working on an IRM revision [sic] CNC procedures for the IRM 5.19.1. Any changes will be incorporated in the IRM rewrite." SB/SE response to TAS research request (July 13, 2010) (response to question 2).

19 As of Sept. 9, 2010, TAS issued 62 Operations Assistance Requests (OARs) to the IRS operating divisions (ODs), advocating for taxpayers suffering from economic hardship when the IRS has issued a notice of levy or a Final Notice of Intent to Levy but will not place the account in CNC status or release a levy because of unfiled returns. While often the required returns are ultimately secured, TAS successfully advocated for placing the taxpayer's account in CNC status in five cases despite unfiled returns and successfully advocated for a levy release in 11 cases (one of these cases is included in the five CNC cases), despite unfiled returns.

20 IRS Office of Appeals response to TAS research request (July 12, 2010) (response to question 3).

21 *Id.*

National Taxpayer Advocate applauds the Appeals division for its willingness to revise procedures and provide guidance to employees to avoid repeating the error in *Vinatieri*. However, taxpayers will continue to face inappropriate levies unless the IRS compliance functions take a similar approach to *Vinatieri* servicewide.

The IRS Has Insufficient Internal Oversight and Review Procedures to Monitor for Economic Hardship.

An examination of IRS quality reviews illustrates the need for change. The Wage & Investment and Small Business/Self Employed divisions carry out quality reviews of randomly selected cases using the National Quality Review System (NQRS).[22] The reviewer evaluates, among other things, whether a collection employee considered a taxpayer's ability to pay and secured the taxpayer's financial information.[23] However, there is no specific rating for failing to properly manage the account of a taxpayer in economic hardship.[24] With respect to CNC determinations, the guidance references IRM 5.16.1, the same provision the settlement officer consulted in *Vinatieri*. Therefore, a quality reviewer today considering a case identical to *Vinatieri* would not be prompted to assign a negative rating based on the decision to proceed with a levy that would have to be immediately released. In addition to a revised IRM, taxpayers would benefit from an NQRS standard that prompts the reviewer to actively consider whether the employee dealt appropriately with any economic hardship.

The Office of Appeals, which reviews cases through the AQMS,[25] considers whether the case file reflects a "quality decision," but does not specifically measure whether the taxpayer's possible economic hardship has been addressed.[26] An additional quality review standard, measuring whether a taxpayer's economic hardship, if any, was properly considered, would implement the spirit as well as the specific holding of *Vinatieri*.

CONCLUSION

To bring the IRS into compliance with the letter and the spirit of the *Vinatieri* decision regarding economic hardship, the National Taxpayer Advocate offers these preliminary recommendations:

1. The IRS should work with TAS to revise its IRM and other procedural guidance to clarify that all collection employees have authority to put a taxpayer's account into

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22 W&I response to TAS research request (July 9, 2010) (response to question 4); SB/SE response to TAS research request (July 13, 2010) (response to question 3). National Quality Review System (NQRS) reviewers use appropriate Embedded Quality Job Aids in carrying out their reviews. IRM 5.13.1.6(2) (Sept. 9, 2007).

23 *See* IRS Doc. 12359, *The Collection Field function Attribute Job Aid, available at* http://core.publish.no.irs.gov/docs/pdf/48360j09.pdf.

24 W&I, in its response to TAS research request dated July 13, 2010 (response to question 4), indicated that it is proposing a new code that would measure "case disposition incorrect" or "case disposition not substantiated." An example of the latter would be a case where a taxpayer wants to make monthly payments, but IRS records do not substantiate that the taxpayer can pay, or they indicate that the account qualifies for CNC status.

25 *See* About the Appeals Quality Measurement System (AQMS), *available at* http://appeals.web.irs.gov/aqms/about_AQMS.htm.

26 IRS Appeals response to TAS research request (July 12, 2010). The AQMS Reviewer's Guide in Collection Cases (Rev. Dec. 31, 2009), *available at* http://appeals.web.irs.gov/aqms/Documents/Collection_Reviewers_Guide.pdf, is 136 pages long and does not contain the word "hardship."

CNC status based on economic hardship even when the taxpayer has unfiled returns, independently of any other criteria.

2. The IRS should work with TAS to train collection employees how to manage taxpayer accounts when the taxpayer is facing economic hardship.
3. The IRS should establish quality review procedures that measure whether employees considered the possibility that a taxpayer was in economic hardship and managed accounts appropriately.

IRS COMMENTS

The IRS recognizes the importance of properly addressing economic hardship. Current guidance provides direction to collection employees on addressing situations and resolving cases when taxpayers experience economic hardship.[27] Written guidance also advises employees to use collection alternatives such as an installment agreement, an offer in compromise, and CNC to assist taxpayers who are experiencing financial hardship and are unable to pay their tax liability.

Since 2008, the IRS has expanded outreach efforts to ensure taxpayers understand the availability of payment alternatives and where to go for assistance in resolving their tax liability if they are experiencing hardship. A recent Treasury Inspector General for Tax Administration's (TIGTA) report stated, "New provisions, along with modifications to and re-emphasis of existing procedures, provide many viable alternatives to help resolve taxpayers' balance due accounts. The provisions were widely communicated to the public and tax preparers through various public media outlets and presentations. In addition, the provisions and procedures were communicated to IRS employees through various channels and in updates to the Internal Revenue Manual."[28] TIGTA also observed, "overall the IRS effectively implemented or re-emphasized options that will help economically distressed taxpayers who are now having difficulties paying their balance due accounts."

The IRS believes IRS collection policies and procedures maintain the proper balance between protecting the interest of the government and the rights of taxpayers. The fiscal year (FY) 2010 collection program letter outlined collection priorities to improve customer service and monitor taxpayer compliance.[29] The 2011 program letter includes a specific priority to continue identifying and implementing procedures to assist taxpayers who are experiencing economic challenges.[30] The expanded outreach and the priorities of the collection program demonstrate the IRS' commitment to assist taxpayers experiencing hardship.

27 IRM 5.11.2.2.1.4 (Aug. 8, 2010); IRM 5.19.1.7.1 (Dec. 4, 2009); IRM 5.16.1.2.9 (June 29, 2010); IRM 5.19.4.4.10 (Mar. 8, 2010).

28 TIGTA, Ref. No. 2010-30-032, *Collection Alternatives Were Available to Economically Distressed Taxpayers, but Some New Processes Need Improvement* (Mar. 15, 2010).

29 SB/SE, Collection Program Letter for FY 2010.

30 SB/SE, Collection Program Letter for FY 2011.

In the report, the National Taxpayer Advocate cites the court decision *Vinatieri v. Commissioner*[31] in which the court held:

- IRC § 6343(a)(1)(D) and related regulations require release of a levy that creates an economic hardship regardless of the taxpayer's noncompliance with filing.
- A levy on the taxpayer's wages or car would cause the taxpayer to be unable to pay reasonable basic living expenses creating an economic hardship that would require release of the levy pursuant to IRC § 6343(a)(1)(D) and related regulations.
- The IRS determination to proceed with a levy was wrong as a matter of law and therefore an abuse of discretion.

The IRS agrees that the decision to proceed with a levy in the *Vinatieri* case was not consistent with IRS policy or related laws and regulations. We recognized the need to clarify this guidance and subsequently worked with the Taxpayer Advocate Service to improve the economic hardship guidance contained in IRM 5.11.2 for release of levies. Specifically, guidance was added to address levy releases involving economic hardship (IRC § 6343(a)(1)(D)) on accounts where there are unfiled returns.[32] The revisions to the IRM were published August 8, 2010.

The IRS provided additional internal guidance changes to employees resulting from the *Vinatieri* decision.[33] These internal guidance changes will be published in the next revisions of the IRM. Additional IRM revisions, including sections for which the IRS has received and reviewed input from TAS based on the *Vinatieri* decision, are currently in process.[34] As part of the routine clearance process for the IRM, the Office of the Taxpayer Advocate serves as a reviewer.

While the court correctly held in *Vinatieri* that a levy must be released due to economic hardship even when there are unfiled returns, it did not hold that the IRS should not pursue those returns. The IRS believes that it is entirely appropriate—as well as sound tax administration and good customer service—to fully address and resolve delinquent returns even though a levy cannot proceed or must be released. The IRS will continue to address and resolve unfiled tax returns in such cases, as the decision in *Vinatieri* did not question or undermine this policy.

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31 *Vinatieri v. Comm'r*, 133 T.C. No. 16 (Dec. 21, 2009), discussed *infra*.

32 IRM 5.11.2.2.1.4(5) (Aug. 8, 2010) ("Where the financial analysis shows that the taxpayer merits a full or partial levy release to relieve economic hardship, the taxpayer has a statutory right to enough relief to end the hardship. Document the financial analysis in the history and communicate the decision to the taxpayer. The levy release should be faxed or given to the taxpayer to provide to the levy source. Caution: When the Service determines that the levy is creating an economic hardship, do not refuse, delay or understate the release amount as a means to secure other compliance, *e.g.*, missing tax returns.").

33 IRM Procedural Updates (IPUs) are provided internally to collection employees via SERP. SERP is designed to provide employees from all IRS functions with intranet access to IRMs and other reference materials, and to retrieve frequently referenced documents required to perform their jobs. The IRS issued IPUs for IRM 5.19.1.7.1(6) on August 17, 2010, IRM 5.19.1.7.1(8) on August 17, 2010, IRM 5.19.18.5(4) on September 1, 2010, IRM 5.19.1.3.4.1(6) on November 3, 2010, and for multiple related sections of IRM 5.19.1 on October 27, 2010.

34 E-mail from TAS to Collection Policy regarding IRM 5.16.1.1(5) and (6) (Aug. 19, 2010).

Further, we do not believe that *Vinatieri* requires the immediate closure of a case as CNC upon a determination that a levy is causing or would cause economic hardship. The issue presented and decided in Vinatieri was whether the proposed levy should proceed. Closing a case as CNC is not governed by *Vinatieri* and refers to an IRS administrative decision to remove an account from active inventory based on a determination that there is little or no current collection potential.[35] Although a CNC closure due to inability to pay is often referred to as a "hardship" case, such a determination may be made even when a levy is not a consideration.

As evidenced by the actions taken in response to *Vinatieri*, court decisions and changes in law are continually monitored by the IRS to determine potential impact. Based on the nature of the changes, the IRS updates policy and procedures to ensure employees are aware of any changes and take appropriate actions.

The IRS recognizes the importance of monitoring employee actions and maintaining adequate controls to ensure employees are taking appropriate actions when addressing economic hardship. Managerial safeguards and controls are incorporated into current IRS polices and procedures.

IRS management uses an employee performance review and a national review system to assess and monitor the quality of case actions in collection cases.[36] In addition to whether a collection employee correctly analyzed a taxpayer's ability to pay and secured the taxpayer's financial information, the IRS reviews for appropriate case disposition, use of appropriate enforcement tools-including levy, customer impact, and observation of the taxpayer's rights.

There are opportunities available to ensure that taxpayers experiencing an economic hardship have recourse if they do not agree with a decision regarding an issuance of levy or a release of levy. Taxpayers have multiple appeal rights throughout the collection process; the most fundamental is an appeal to the manager.[37] The Collection Appeals Program (CAP), the Collection Due Process (CDP) hearing, and the opportunity for a taxpayer to request a judicial review of the Appeals determination by petitioning United States Tax Court all provide review and oversight opportunities to review collection actions.[38]

An in-depth managerial review process, a national review process, and the taxpayer's ability to request a review through the independent Office of Appeals collectively foster a robust and thorough internal oversight and review control to ensure that taxpayers who may be experiencing economic hardship are handled appropriately.

35 IRM 5.16.1.2.9 (June 29, 2010). Cases closed as CNC due to inability to pay that subsequently meet certain income thresholds may be reactivated to the collection inventory to determine if the taxpayer had a change in financial condition that would allow the taxpayer an ability to pay toward the outstanding tax liability.

36 *See* IRS Doc. 12359, *The Collection Field function Attribute Job Aid*, *available at* http://core.publish.no.irs.gov/docs/pdf/48360j09.pdf.

37 IRS Pub. 1, *Your Rights as a Taxpayer* (May 2005).

38 IRS Pub. 1660, *Collection Appeal Rights* (Mar. 2007).

Additionally, external oversight ensures employees follow IRS policies and procedures authorized by IRC and Treasury regulations.[39] For example, TIGTA found, for the sixth year in a row, in its FY 2010 annual audit regarding IRS compliance with legal guidelines when issuing levies, "The IRS is protecting taxpayers' rights when issuing systemically generated and manually prepared levies."[40]

The National Taxpayer Advocate makes three preliminary recommendations to address IRS compliance with the *Vinatieri* decision regarding economic hardship. The IRS is taking or has taken the following actions with respect to these recommendations:

The IRS has proactively updated many of the internal procedures and is actively updating the remaining procedures based on the *Vinatieri* decision. IRM procedures currently advise employees that they must generally resolve unfiled returns prior to reporting an account CNC. IRM procedures also provide guidance for situations where an account may be reported CNC when an employee determines that the taxpayer is unable to pay the tax liability and has unfiled tax returns. In all situations, however, the unfiled returns must still be addressed. As part of the routine clearance process for the IRM, the Office of the Taxpayer Advocate serves as a reviewer.

The IRS agrees proper training and guidance for our employees is very important and, as such, continually looks for ways to improve. The IRS has drafted training materials to address economic hardship for collection field function employees for delivery in FY 2011 Continuing Professional Education. In FY 2010, the IRS delivered training on how to address economic hardship to Automated Collection System employees, Appeals settlement officers, and Appeals account resolution specialists.

Within the employee performance review, and the national review systems, there are many reviewed actions that are associated with ensuring taxpayer accounts are handled appropriately. These review systems look at many different facets of a case to ensure collection employees take the appropriate actions throughout the life of the case to arrive at a correct and complete case resolution with no material adverse impact on the taxpayer.[41] The IRS utilizes contact recording and contact analytics to gather facts about specific complaints and conduct targeted reviews to identify areas needing improvement and training needs.

39 The Government Accountability Office (GAO) and TIGTA conduct independent reviews of IRS enforcement programs, including levy.

40 TIGTA, Ref. No. 2010-30-068, *Fiscal Year 2010 Statutory Review of Compliance with Legal Guidelines When Issuing Levies* (June 15, 2010).

41 *See* IRS Doc. 12359, *The Collection Field function Attribute Job Aid, available at* http://core.publish.no.irs.gov/docs/pdf/48360j09.pdf.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate acknowledges that the SB/SE Collection Program Letter for FY 2011 states that the IRS will "continue to identify and implement procedures to assist taxpayers who are experiencing economic challenges."[42] However, because the IRS routinely issues final notices of intent to levy as part of an automated process, without contacting the taxpayer, the IRS is not necessarily aware that a taxpayer is in economic hardship when it proposes to levy.[43]

In the *Vinatieri* case, the IRS proposed to levy even though it *knew* of the taxpayer's hardship. While the IRS has revised a few offending sections of the IRM that would pertain to cases like *Vinatieri*, it has not corrected other sections. Thus, more than one year after the *Vinatieri* decision, taxpayers continue to be harmed because of the IRS's failure to correct its instructions to its employees.[44]

The errors in the *Vinatieri* case occurred because: (1) the IRM did not simply state that the IRS cannot levy or propose to levy on a taxpayer known to be in economic hardship (because if it does, it will be required by law to immediately release the levy); and (2) the IRM that permits CNC status for taxpayers in economic hardship was contradictory and incomplete in explaining the availability of CNC status where there were unfiled returns. The IRS has not corrected either of these conditions.[45]

As the IRS observes, the Tax Court did not hold in *Vinatieri* that whenever the IRS becomes aware a taxpayer is in economic hardship, it must place his or her account into CNC status. As long as the IRS does not levy or propose to levy on a taxpayer it knows is in economic hardship, it operates consistently with the holding of *Vinatieri*.[46]

However, we wonder why the IRS would *not* put the account of a taxpayer experiencing economic hardship into CNC status when this status is the mechanism that prevents issuance of levies. Failure to put an eligible account into CNC hardship status creates an

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42 SB/SE Collection Program Letter for FY 2011, *available at* http://mysbse.web.irs.gov/AboutSBSE/ProgramLetters/17840.aspx.

43 *See* Most Serious Problem: *IRS Policy Implementation Through Programming Systems Lacks Transparency and Precludes Adequate Review, supra*; Most Serious Problem: *The IRS's Failure to Provide Timely and Adequate Collection Due Process Hearings May Deprive Taxpayers of an Opportunity to Have Their Cases Fully Considered, supra*.

44 The IRS does not always submit its interim guidance that announces changes to the relevant portions of the IRM for TAS for review. Examples are SERP Alert 100539 dated Oct. 27, 2010, and SERP Alert 10040 dated Aug. 20, 2010. As of Dec.1, 2010, the only proposed revisions to the collection part of the IRM submitted to TAS for clearance using normal review procedures are IRM 5.9.16, received by TAS for review on Nov. 16, 2010; IRM 5.19.2, received on Nov. 26, 2010; and IRM 5.19.1, received on Nov. 30, 2010. TAS is working to clarify the IRM clearance process (for example, by participating on an Interim Guidance Task Force sponsored by the IRS's Servicewide Policy Directives and Electronic Research office) to ensure that proposed changes to the IRM are submitted to TAS for review when appropriate.

45 The IRS in its response does not provide a reference to the training materials it used in 2010 on how to address economic hardship, and we are unable to identify any training materials that take into account or refer to the *Vinatieri* decision. TAS welcomes the opportunity to assist the IRS in developing 2011 training materials for collection employees.

46 As the IRS also notes, nothing in the *Vinatieri* decision suggests that the IRS should not pursue unfiled returns. The National Taxpayer Advocate's position has never been that the IRS should not request unfiled returns.

ongoing risk of a *Vinatieri*-type violation of law. Thus, we are baffled by the IRS's position in this regard.

The IRS has revised some of the CNC provisions in the IRM to conform to the *Vinatieri* decision.[47] For example, IRM 5.19.1.7.1.5, *CNC Unable to Pay - Hardship,* was revised on November 3, 2010, to instruct employees how to respond when a taxpayer contacts the IRS and claims that he or she is unable to pay, or that a levy on salary or wages is creating a hardship. The provision makes clear that the IRS must release the levy, and explains how to manage the taxpayer's accounts thereafter, including accounts with unfiled returns. However, according to the revised provision, tax years with unfiled returns will be closed and removed from active collection only in certain circumstances.[48] If those conditions are not present, or the IRS cannot determine whether they are present, it will not close those tax years, but rather will place them in the Queue.[49] Unlike tax years in CNC status, where collection activity is reactivated by changes in the taxpayer's financial condition, the IRS routinely transfers cases into and out of the Queue to balance inventory levels. Therefore, tax years assigned to the Queue may return to the collection stream as IRS inventories fluctuate, with the attendant risk that the IRS may once again propose or issue a levy without considering the previously determined hardship.[50] It is unclear why the IRS adopted the practice of placing tax years in the Queue because of unfiled returns when the taxpayer has already shown economic hardship and the IRS has released any levies because of the hardship. Adopting a policy of simply closing these tax years and placing them in CNC status would be easier to administer and would more effectively ensure that the errors in *Vinatieri* are not repeated.[51]

As the IRS notes, it may learn that a taxpayer is in economic hardship when a levy is not a consideration. If it does not place the account into CNC status at that point, the IRS may repeat the error of *Vinatieri* by later proposing or issuing a levy that it would immediately have to release. For example, a taxpayer requesting an offer in compromise based on effective tax administration may demonstrate that he or she is in economic hardship. The IRM

47 *See, e.g.*, IRM 5.19.1.7.1(8); 5.19.18.5(4), discussed *supra*. As the IRS also notes, it has revised other provisions of the IRM pertaining to levy releases to clarify that a levy must be released if it is causing economic hardship, which is commendable, although we note that between Sept. 24, 2010, and Nov. 23, 2010, TAS successfully advocated for levy release due to economic hardship in five cases. In any event, however, the problems Mrs. Vinatieri encountered were not due to misapplication of IRM provisions that require the IRS to *release* a levy. Rather, the IRS, by *proposing* to levy when it knew the levy would cause hardship (and would therefore have to be immediately released), abused its discretion.

48 One of the conditions is where the tax year for which there is an unfiled return "meets P-5-133 criteria," in which case the employee is to "close the [unfiled return year] little or no tax due, see IRM 5.19.2.6.4.5.3 [titled *IMF Little or No Tax Due*]." As explained *supra* note 9, Policy Statement P-5-133 enumerates factors that the IRS is to take into account in determining whether to enforce filing requirements. "Factors to be taken into account include, but are not limited to: prior history of noncompliance, existence of income from illegal sources, effect upon voluntary compliance, anticipated revenue, and collectibility, in relation to the time and effort required to determine tax due. Consideration will also be given any special circumstances existing in the case of a particular taxpayer, class of taxpayer, or industry, or which may be peculiar to the class of tax involved." IRM 5.19.1.7.1.5 as revised inappropriately reduces the application of Policy Statement P-5-133 to a single inquiry: the amount, if any, of tax due.

49 The Queue is an electronic holding area for accounts that will not be worked immediately. *See* IRM 1.4.50.2.1.5 (July 1, 2007).

50 *See* Most Serious Problem: *IRS Policy Implementation Through Systems Programming Lacks Transparency and Precludes Adequate Review, supra*.

51 Moreover, closing tax years with unfiled returns and placing the accounts into CNC status would "simplify or eliminate processes that unnecessarily burden taxpayer or IRS resources" and accomplish the seamless approach to service the IRS adopted in its FY 2009-2013 Strategic Plan. *See* IRS Pub.3744, *IRS Strategic Plan 2009-2013* (Apr. 2009), *available at* http://www.irs.gov/pub/irs-pdf/p3744.pdf.

does not make clear that from the moment the hardship is established, those accounts can be closed and placed into CNC status despite unfiled returns.[52] Instead, the IRM references the same unrevised IRM provision the settlement officer relied on in *Vinatieri*.[53] The IRS should revise other portions of the IRM (not only those pertaining to levies) to permit classification of taxpayers' accounts as CNC when the IRS learns they are in economic hardship, independently of the context in which it acquires this information, and independently of any other consideration such as unfiled returns.

Moreover, some IRM provisions are still contradictory or inconsistent with the *Vinatieri* decision. For example:

- IRM 5.19.1.3.4.1(6) was revised and released through SERP on November 3, 2010, but continues to state: "When speaking to the taxpayer, address compliance on current year return filing as follows…Installment agreements and CNC hardships cannot be established if a return is required to be filed… you can not allow the installment agreement or CNC hardship without securing all required returns."
- IRM 5.19.18.5.7 was revised and released through SERP on September 1, 2010, but now provides: "Cases are manually assigned to this inventory prior to initiating a currently-not-collectible (CNC) when…**All** levy sources have been exhausted."
- IRM 5.19.18.5.8(5) was revised and released through SERP on September 1, 2010, but now directs: "CAUTION: **Do not** report any cases as CNC (hardship) until all delinquent returns are filed and the cause of the delinquency addressed."
- Various IRM provisions, particularly those that collection field employees rely on, still instruct employees to "resolve" or "close" tax years with an unfiled return before placing an account into CNC status (IRM 5.16.1.1; IRM 5.16.1.1(6); IRM 5.16.1.2.9(8); IRM 5.19.1.7.1(6) (which cross-references 5.19.1.3.4.1, above)), without specifying that where there is economic hardship, "resolving" or "closing" does not necessarily mean securing unfiled returns. As long as these provisions are intact, and are relied upon by compliance employees and sustained by quality reviewers, the IRS may repeat the same errors it made in the *Vinatieri* case.

52 Part 5.8 of the IRM deals with offers in compromise. IRM 5.8.5.1, *Overview* (Sept. 23, 2008), references IRM 5.15, *Financial Analysis Handbook*, and directs that it be used in conjunction with the offer section. IRM 5.15.1.3, *Expectations* (Sept. 17, 2010), provides that the analysis of a taxpayer's financial condition is a basis on which to place an account into CNC status, but then cross-references IRM 5.16 rather than IRM 5.19. IRM 5.15.1.35, *Making the Collection Decision* (Oct. 2, 2009), contains the same provision.

53 As another example, a taxpayer requesting innocent spouse relief may demonstrate economic hardship. IRM 25.15.2.1, *Employees with Taxpayer Contact* (July 17, 2009), found in the Relief from Joint and Several Liability portion of the IRM, simply directs the employee to refer the taxpayer to TAS ("If during a taxpayer contact it appears a hardship situation may exist, complete Form 911, Request for Taxpayer Advocate Service Assistance (And Application for Taxpayer Assistance Order), and refer the taxpayer to the Taxpayer Advocate Service (TAS).")

Recommendations

In summary, the National Taxpayer Advocate recommends that the IRS:

1. Continue to work with TAS to revise its IRM and other procedural guidance to clarify that all collection employees are authorized to close tax years with unfiled returns, and place a taxpayer's account into CNC status based on economic hardship, without securing unfiled returns, independently of any other criterion or condition.
2. Work with TAS to train collection employees how to manage accounts when the taxpayer is facing economic hardship and submit its 2011 collection CPE training materials on this issue to TAS for review.
3. Establish quality review procedures that measure whether employees considered the possibility that a taxpayer was in economic hardship and managed the account appropriately.

MSP #7 The IRS Does Not Know the Impact of Ignoring Non-IRS Debt When Analyzing a Taxpayer's Ability to Pay an IRS Debt

RESPONSIBLE OFFICIALS

Chris Wagner, Commissioner, Small Business/Self-Employed Division
Richard E. Byrd Jr., Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

In determining how much a delinquent taxpayer can pay to satisfy a tax debt (*e.g.*, the minimum acceptable offer in compromise (OIC) amount or installment payment, or whether the account is currently uncollectible), the IRS does not take into account (*i.e.*, disallows or ignores) some of the taxpayer's other debts. Such disallowed debts may include credit card bills, delinquent state or local taxes, court-ordered payments, excessive mortgage expenses, and any bill the taxpayer is not current in paying, including student loans, medical bills, and even secured debts.[1]

The IRS's approach is unrealistic because other creditors do not go away – the state tax agency does not stop garnishing a paycheck and a credit card collection company does not stop calling – just because the taxpayer is in an IRS payment plan that ignores these expenses. Moreover, the IRS policy of ignoring these actual debts may prolong unresolved delinquencies, create hardships, encourage taxpayers to enter into installment agreements they cannot afford, and make it more difficult for them to pay taxes due in future periods. By contrast, resolving a financially struggling taxpayer's debts holistically – as at least one other country's tax administrator does – may increase the amount the taxpayer is able to pay in the long run while improving his or her future tax compliance and avoiding economic hardship.

ANALYSIS OF PROBLEM

The IRS analyzes a taxpayer's ability to pay in deciding how to resolve a delinquency.

The IRS's decision about how to collect a tax debt often depends on its analysis of the taxpayer's ability to pay.[2] Based on this analysis, the IRS may:

- Request a full or partial payment;
- File a notice of federal tax lien (NFTL);

1 *See, e.g.*, Internal Revenue Manual (IRM) 5.15.1.10 (Oct. 2, 2009) (chart).

2 The IRS generally may accept an installment agreement (IA) without conducting a financial analysis if the taxpayer owes $25,000 or less and proposes payments that are sufficient to pay the liability in full within five years. IRM 5.14.5 (Sept. 26, 2008). About 94 percent of all IAs accepted in FY 2010 did not involve an analysis of the taxpayer's ability to pay. Small Business/Self-Employed Division (SB/SE), CAR Report 5000-6 (Oct. 4, 2010). For a discussion of problems with these IAs, see Most Serious Problem, *IRS Collection Policies Channel Taxpayers into Installment Agreements They Cannot Afford, infra.*

- Levy or seize assets;
- Accept an installment agreement;
- Accept an offer in compromise; or
- Classify the taxpayer's account as currently not collectible (CNC) and put collection on hold.[3]

The IRS adds up a taxpayer's income and subtracts allowable expenses to determine how much he or she can pay on a monthly basis. IRS employees must use the allowable expense standards (ALE) – an estimate of what an average taxpayer spends on certain items – along with IRS policy guidance in deciding how much to allow for a given expense.[4]

When analyzing a taxpayer's ability to pay, the IRS ignores (*i.e.*, disallows) payments on certain debts.

When conducting financial analysis, the IRS sometimes ignores debt payments it considers unnecessary.[5] Such debts (called "disallowed debt") may include:

- Unsecured debt that the taxpayer does not currently need for the production of income (*e.g.*, past-due medical bills and credit card debt);
- Student loans or secured debts that the taxpayer is not currently paying;
- Delinquent state and local taxes that do not have priority over the federal tax liability;
- Payments required by a state court order that would not otherwise be allowable (*e.g.*, a child's tuition); and
- Payments on a home mortgage that exceed the ALE – an estimate of average housing expenditures – unless documented as "necessary."[6]

The IRS typically only allows these expenses (called "conditional" expenses) if the taxpayer enters into an IA to fully repay the tax debt within five years.[7] For IAs that will not repay the debt within five years, the IRS will not allow conditional expenses after the first year.[8] This so-called one-year rule is supposed to give the taxpayer an opportunity to eliminate conditional expenses.[9]

3 IRM 5.15.1.35 (Oct. 2, 2009); IRM 5.15.1.1 (Oct. 2, 2009).

4 For a discussion of difficulties with these standards, see National Taxpayer Advocate 2006 Annual Report to Congress 83-109 (Most Serious Problem: *Collection Payment Alternatives*); National Taxpayer Advocate 2005 Annual Report to Congress 270-291 (Most Serious Problem: *Allowable Expense Standards for Collection Decisions*).

5 Bankruptcy courts also use the ALE to determine if an individual is eligible for the Chapter 7 bankruptcy process. *See, e.g.*, 11 U.S.C. § 707(b)(2)(A)(ii)(I).

6 *See, e.g.*, IRM 5.15.1.10 (Oct. 2, 2009) (chart); IRM 5.15.1.9 (Oct. 2, 2009) (noting "[T]axpayers are allowed the standard amount for housing and utilities or the amount actually spent, whichever is less. If the amount claimed is more than the total allowed by housing and utilities standards, the taxpayer must provide documentation to substantiate those expenses are necessary."); IRM Exhibit 5.15.1-1 (Q/A 5) (Oct. 2, 2009) (suggesting that if a taxpayer could rent for less, an unspecified portion of a taxpayer's actual mortgage payments may be ignored immediately, and he may be expected to sell his house within one year even if he has no home equity).

7 *See, e.g.*, IRM 5.15.1.10 (Oct. 2, 2009); IRM 5.8.5.6.4 (Sept. 23, 2008).

8 IRM 5.15.1.2(4) (Oct. 2, 2009).

9 *Id*.

However, many taxpayers are unlikely to be able to eliminate all disallowed debt expenses in one year, especially taxpayers with delinquent liabilities. One review of no-asset, non-business Chapter 7 bankruptcy cases closed between 2000 and 2002 found the debtors owed an average of $17,738 in credit card debt (excluding store credit cards).[10] At an interest rate of 18 percent, it would take a cardholder about 56 years to repay this debt if he or she made the minimum payment.[11]

Moreover, if the terms of an IA will not fully pay the tax debt before the end of the period of limitations on collection, the IRS will not allow *any* conditional expenses.[12] Similarly, it does not allow conditional expenses when computing an acceptable offer amount or determining whether to classify an account as CNC based on hardship.[13]

Why does the IRS disallow some debt payments?

Notwithstanding the importance of the ALE and related policies such as the disallowed debt rules, the IRS generally updates them without giving the public prior notice, an opportunity to provide comments, or an explanation of the reasons for its policies.[14] As a result, we can only speculate as to the reasons for the IRS's disallowed debt rules.[15]

Avoid abuse

The IRS may disallow debt payments because it does not want to provide an incentive for taxpayers to incur non-IRS debts in anticipation of compromising with the IRS. However, the IRS already addresses this concern through more narrowly tailored case-specific anti-abuse policies.[16]

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10 Ed Flynn and Gordon Bermant, *Credit Card Debt in Chapter 7 Cases*, ABI J. (Dec./Jan. 2004), http://www.justice.gov/ust/eo/public_affairs/articles/index.htm. Pursuant to the Chapter 7 bankruptcy process, the debtor's non-exempt assets are liquidated and distributed to creditors and most debts are discharged, thereby giving the debtor a "fresh start." *See generally* IRM 5.17.9 (Aug. 1, 2010).

11 *See* Board of Governors of the Federal Reserve System, *Credit Card Repayment Calculator*, http://www.federalreserve.gov/creditcardcalculator/Default.aspx (last visited Oct. 6, 2010). The minimum payment would start out at $355 per month and decline each month. *Id*. A level payment of $355 per month would repay the liability in about 8 years. *Id*.

12 IRM 5.14.2.1.1(4) (Aug. 5, 2010) ("Conditional expenses are not allowed for PPIAs [partial payment installment agreements].").

13 IRM 5.15.1.10 (Oct. 2, 2009) (conditional expenses); IRM 5.16.1.2.9 (May 5, 2009) (CNC hardship determination); IRM 5.8.5.6.4 (Sept. 23, 2008) (offers).

14 *See, e.g.*, SB/SE Research (Brooklyn/Hartford), Project BKN0086, *2007 Allowable Living Expenses Project* (Dec. 2007); SB/SE Research (Brooklyn/Hartford), Project BKN0152, *2010 Allowable Living Expenses* (Feb. 2010). However, the IRS did solicit comments when it redesigned the ALE in 2007. *See* IR-2007-163 (Oct. 1, 2007).

15 In response to TAS's inquiry about "[T]he reason(s) for the policy of disallowing payments on debts that are treated as conditional expenses," the IRS formally responded as follows:

> As stated in IRM 5.15.1.7, the IRS allows necessary expenses which provide for the taxpayer and his or her family's health and welfare and/or the production of income. Under IRM 5.15.1.10, all other expenses, including conditional expenses, can be allowed if the taxpayer can pay the liability within a five year period.

IRS response to TAS information request (June 11, 2010).

16 The IRS may disallow the repayment of debt for an unnecessary purchase (*e.g.*, a luxury car) incurred after becoming aware of the tax liability, even if the taxpayer enters into an agreement to fully repay the tax liability within five years. *See* IRM Exhibit 5.15.1-1 (Q/A 10) (Oct. 2, 2009). Similarly, for purposes of considering whether to accept an offer in compromise, the IRS discourages taxpayers from dissipating assets by adding the amount of any dissipated assets to the minimum acceptable offer amount. *See* IRM 5.8.5.5 (Sept. 23, 2008).

Collect before other creditors

Another possible reason for the IRS's policy of disallowing payments to junior creditors is to discourage taxpayers from making such payments because they will reduce the amount the IRS could collect in bankruptcy.[17] The IRM explains: "Determine the priority of the [Notice of Federal Tax Lien] NFTL when considering whether to allow or disallow payments to other creditors," which is consistent with this reasoning.[18] However, the IRS is applying the disallowed debt rules outside of bankruptcy – in situations where debtors are not under the protection of the bankruptcy court, and thus, generally need to pay all creditors, including those that would receive a lower priority in a bankruptcy. In fact, junior creditors are often much more persistent than the IRS, which does not even send monthly balance due notices. Thus, the IRS appears to base its disallowed debt policy on unrealistic assumptions, at least for some taxpayers.

Other approaches to pre-existing debts

Not all taxing jurisdictions follow the IRS in ignoring junior debts. Some recognize the importance of putting the taxpayer in a position to meet future tax obligations.

Sweden's debt relief program

The Swedish Enforcement Authority recognizes that being in debt is a self-perpetuating cycle and leads to ongoing tax noncompliance.[19] When a taxpayer enters the debt relief program (a one-time administrative process – not bankruptcy), the agency looks at all debt owed by the taxpayer – federal, local, and private creditors – and works out a payment plan over a period of years that, if adhered to, will result in forgiveness of any outstanding debt at the end of the agreement. The payment plan does not ignore unsecured debt. Although the government may have priority over other creditors, it voluntarily accepts less than full payment because it has found that a taxpayer is more likely to pay future tax debts if all pre-existing debts are taken into account. If the taxpayer fails to complete the debt relief program, the debts stand and the government is in the same position as before the taxpayer

Most Serious Problem

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17 *See* 11 U.S.C § 726; 11 U.S.C. § 507; IRM 5.17.8 (Oct. 16, 2007). The federal priority statute may also give the IRS priority over certain debts including state tax debts. *See* 31 U.S.C. § 3713; IRM 5.17.13 (Oct. 16, 2007). Similarly, a federal tax lien gives the IRS priority over most other creditors. *See* IRC § 6323. These priorities may determine which creditors are legally entitled to be paid when there is not enough money for all of them (*e.g.*, in the context of a bankruptcy or other disposition or collection of a particular piece of property).

18 IRM 5.15.1.2(2)(g) (Oct. 2, 2009). *See also* IRM 5.8.5.6.4 (Sept. 23, 2008) (explaining that "[M]onthly payments to state or local taxing agencies should not be allowed as a necessary expense, even if the state or local taxing agency has a lien that is senior to the IRS's lien or is collecting funds through a wage attachment or approved installment agreement....Since future earnings of the taxpayer are after-acquired property, the Service has first right to the earnings. Explain to the taxpayer that although the payment may be allowed in an installment agreement, where the tax will be paid in full, it will not be allowed for computation of an acceptable offer amount because the Federal government has priority rights to the funds.").

19 For general information about Swedish debt relief, see, *e.g.*, Jason Kilborn, *Out with the New, in with the Old: As Sweden Aggressively Streamlines Its Consumer Bankruptcy System, Have U.S. Reformers Fallen off the Learning Curve?* 80 Am. Bankr. L.J. 435 (2006); More on Kronofogden (the Enforcement Authority), http://www.kronofogden.se/omkronofogden/allmantomkronofogden/paandrasprakinotherlanguages/engelska.4.7856a2b411550b99fb7800086559.html (last visited Sept. 10, 2010). Our discussion is based in large part on information provided to the National Taxpayer Advocate by the Swedish Enforcement Authority in May 2009.

entered the program.[20] However, if the taxpayer completes the program, he or she is better able to pay future tax liabilities.[21]

Joint federal-state installment agreements

Even the IRS has acknowledged the benefit of allowing taxpayers to pay junior creditors outside of bankruptcy. Before April 2008, the IRS and the state of New York allowed taxpayers with both federal and state tax delinquencies to enter into a joint federal and state installment agreement based on their ability to pay.[22] Thus, the IRS allowed taxpayers to make payments to satisfy a state tax delinquency.[23] The IRS described one benefit of the program as allowing taxpayers to avoid pressure from each agency for more money.[24]

Disallowing actual debt may produce unrealistic payment expectations.

Junior creditors do not go away – the state tax agency does not stop garnishing a paycheck and a credit card collection company does not stop calling – just because the taxpayer is in an IRS payment plan that ignores these expenses. Research supports this analysis. A 2009 TAS Research study examined a group of individual taxpayers who had no prior unpaid tax delinquencies, but failed to pay taxes assessed in 2002 (*i.e.,* following a previous recession).[25] The study found that more than half of the taxpayers who declared bankruptcy appeared able to pay based on the IRS's standard collection financial analysis.[26] The study concludes the IRS overestimates these taxpayers' ability to pay because it fails to consider their disallowed debts.

Unrealistic payment expectations may contribute to subsequent noncompliance.

The 2009 TAS study also found that about 74 percent of those taxpayers with Taxpayer Delinquent Accounts (*i.e.,* delinquent accounts forwarded to Collection employees for resolution using the financial analysis described above), had one or more subsequent tax delinquencies or unfiled returns, even though they had no outstanding balance due prior

20 Because this program is generally available only once, it is less likely to be subject to abuse.

21 *The Swedish Enforcement Authority*, May 2009 (presentation to the National Taxpayer Advocate) (stating that "a person in very deep indebtedness may be forced to live at the level of subsistence for the rest of his/her life if he/she does not get a debt relief.").

22 *See, e.g.*, IRM 5.19.1.5.4.2 (Dec. 15, 2002); Memorandum of Understanding Between the IRS and New York State Department of Taxation and Finance, *Joint Installment Agreements* (Sept. 2000); IRM 5.19.1.5.5.24 (Apr. 28, 2008) (noting that the fed-state IA program was discontinued in April 2008).

23 *See* IRM 5.19.1.5.4.2(4) (Dec. 15, 2002). *See also* Memorandum of Understanding between the IRS and New York State Department of Taxation and Finance, *Joint Installment Agreements* § 3(c) (Sept. 2000). However, a taxpayer's liability to the IRS could not exceed $25,000 because he or she had to meet streamlined IA criteria to be eligible for the program. SB/SE Research, Detroit/Milwaukee, 09.08.002.04, *New York State and IRS Joint Installment Agreement Project* (Nov. 2004). Between October 1, 2004, and May 31, 2005, the IRS and NY received 51 and 168 inquiries, respectively, but initiated only five joint IAs, in large part because taxpayers who made inquiries were ineligible for the program. Memorandum for Department Manager 1 from Manager, Team G, *Eligibility Versus Non-eligibility for the Federal/State Joint Installment Agreement Program* (2005).

24 IRM 5.19.1.5.4.2(4) (Dec. 15, 2002).

25 *See* National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 21-33 (*Subsequent Compliance Behavior of Delinquent Taxpayers: A Compliance Challenge for the IRS*).

26 National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 21, 30. Similarly, more than half of the taxpayers who reported cancellation of indebtedness income – meaning another creditor cancelled the taxpayer's debt – also appeared able to pay. National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 21, 30.

to 2002.[27] Thus, although the study did not definitively identify the causes of subsequent noncompliance, it confirms that the IRS's current approach fails to promote future compliance for an extraordinarily large percentage of these taxpayers.

CONCLUSION

Outside of bankruptcy, junior creditors will continue collection efforts, even if the debtor also owes the IRS. Thus, IRS policies that ignore these debts could prolong unresolved delinquencies, create hardships, encourage taxpayers to enter into IAs that they cannot pay, and promote future delinquencies.

The National Taxpayer Advocate offers these preliminary recommendations:

1. Study the effect of more realistic financial analysis policies on taxpayer hardship, IA defaults, and future compliance.[28] For one group of taxpayers, the IRS should use its current financial analysis. For another, it should allow payments on debts to government entities (*e.g.*, student loans and state and local tax debts). For a third group, it should allow all currently disallowed debts. As part of this study, the IRS should survey the taxpayers who default to find out why;
2. Solicit public comments on the methodology the IRS uses to compute the ALE, how the IRS should apply the ALE, and related policies for conducting financial analysis (including the disallowed debt policy); and
3. Incorporate the public comments into published guidance that addresses the public's concerns and fully explains the reasons for the policies adopted by the IRS.

IRS COMMENTS

In collecting revenues owed to the United States, the IRS must balance the needs of the government and taxpayers while at the same time administering the tax laws consistently and fairly to all.

The IRS offers a number of options for taxpayers to satisfy their tax liabilities. In the majority of cases, balance due accounts that are resolved are done so without the need for extensive analysis of the taxpayer's income and expenses. In these cases, the IRS is willing to accept payment over time without asking the taxpayer to reveal and substantiate other debts, let alone forgo payment of the other debts. Less often, situations require a detailed financial analysis. When a taxpayer requests terms of payment that present a heightened risk that the taxes owed will go uncollected if the agreement terms are not met, sound financial analysis and an accurate determination of ability to pay are essential to making the correct collection determination. IRS financial analysis guidelines provide a

27 National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 29. However, TAS could not determine how many of these taxpayers actually had a filing requirement.

28 The IRS should stratify the results of this study by taxpayer debt and income levels.

comprehensive structure for making this determination. The treatment of other debts and expenses in these guidelines is intended to balance the needs of the government and the taxpayer while at the same time fostering confidence across the taxpaying public that all taxpayers are being held to the same standard of compliance.[29]

The IRS routinely conducts financial analysis training for collection employees and performs periodic reviews of casework to ensure compliance with financial analysis and Allowable Living Expense guidelines. In addition, the IRS strives to make the ALE data driven and fair to taxpayers, and continues to consider new data sources to produce the ALE, as demonstrated by the 2007 redesign of the ALE.[30]

In determining ability to pay, the IRS allows for all "necessary expenses," defined as expenses that are necessary to provide for a taxpayer's and his or her family's health and welfare and/or production of income. The expenses must be reasonable. The total necessary expenses establish the minimum a taxpayer and family needs to live.[31] IRS guidance explicitly lists all of the necessary living expenses identified in the Treasury Regulations as relevant when determining whether collection action would cause economic hardship,[32] but goes on to state that other expenses should be allowed if they meet the necessary expense definition. Where standards for a specific expense are provided, those amounts are based on what an average citizen spends for basic living expenses. Nevertheless, the IRS recognizes the fact that no set of standards can be expected to fit every circumstance; therefore, IRS employees are directed to consider a taxpayer's extraordinary circumstances and to make exceptions to the application of the ALE when warranted to allow taxpayers the means to adequately meet living expenses.[33] For expenses such as food, clothing, and out-of-pocket medical expenses, taxpayers are allowed the standard amount even if they report that they spend less, and are not required to provide documentation unless the amount they claim exceeds the standard amount.[34]

In FY 2010, the IRS granted over three million installment agreements for individuals and businesses.[35] Fewer than six percent of these agreements required financial analysis where ALE standards were considered. The vast majority of agreements secured are guaranteed and streamlined agreements, which essentially allow individuals owing less than $25,000 to choose their own payment plans as long as the debt will be paid in five years of when the

29 IRS Policy Statement P-5-2, Collecting Principles. IRM 1.2.14.1.2 (Feb. 17, 2000).

30 *See, e.g.*, SB/SE Research (Brooklyn/Hartford), Project BKN0086, *2007 Allowable Living Expenses Project* (Dec. 2007).

31 *See* IRM 5.15.1.7 (Oct. 2, 2010).

32 The amount reasonably necessary for food, clothing, housing (including utilities, homeowner insurance, homeowner dues, and the like), medical expenses (including health insurance), transportation, current tax payments (including federal, state, and local), alimony, child support, or other court-ordered payments, and expenses necessary to the taxpayer's production of income (such as dues for a trade union or professional organization, or child care payments which allow the taxpayer to be gainfully employed). *See* Treas. Reg. § 301.6343-1.

33 *See* IRM 5.15.1.7(5). National and local expense standards are guidelines. If it is determined a standard amount is inadequate to provide for a specific taxpayer's basic living expenses, allow a deviation. Require the taxpayer to provide reasonable substantiation and document the case file.

34 *See* IRM 5.15.1.7(3).

35 CAR 5000-6, *Installment Agreement Cumulative Report*, Oct-Sep FY 2010.

agreement starts. Cases in which taxpayers owe more than $25,000 are subject to financial analysis, but those cases qualify for their own "five-year rule" which accounts for the payment of all or some junior debts or other "conditional expenses" if the tax liability can be full paid in five years. These conditional expenses include unsecured debts, and other debts, that do not have priority over the federal tax liability. In those situations where the taxpayer does not qualify for the five-year rule, the IRS still allows one year for the taxpayer to pay off other debts or adjust their expenses to be able to pay the tax liability. Thus, it is only in the cases posing the greatest risk of nonpayment (*i.e.,* those in which the agreement covers large balances due or for which final payment would come very late in the ten-year statutory period for collection) that the IRS asserts the full measure of its priority over junior creditors.

If a taxpayer has a secured debt that he or she is not paying, the IRS would normally not allow it when determining ability to pay; however, if the taxpayer does start paying the debt or the creditor garnishes the taxpayer's wages, the IA would be amended to reduce the payment amount to the IRS. IAs can also be amended if a taxpayer incurs additional necessary living expenses, such as car payment if an old vehicle needed to be replaced.[36]

The National Taxpayer Advocate cites the Swedish Debt Relief Program as one that recognizes junior debts. This program is an administrative approach to the consumer debt relief process, but is the functional equivalent of a bankruptcy. The state Enforcement Agency, Kronofogdemyndigheten (KFM), posts a notice of case opening and holds a meeting of creditors, creating an open record of the proceeding. Unlike the IRS, KFM has the power to impose final, binding payment plans on dissenting creditors.[37] The Swedish law also requires the debtor to attempt to pay off debts by liquidating all nonessential property as a precursor to seeking formal relief, whereas the IRS rarely requires taxpayers to liquidate assets when they are able to full pay the liability through installment payments. Although an administrative, rather than judicial process, it appears that implementation of a system such as the Swedish system could only be effectuated by legislative changes by Congress. One could reasonably question whether such system would have benefits not already provided by the Bankruptcy Code.

Although taxpayers on installment agreements may incur additional liabilities, it does not appear as though disallowance of other debts for our financial analysis is the primary cause for subsequent tax delinquencies or unfiled returns. In 2009, TAS found similar and even

36 *See* IRM 5.14.1.4.4.

37 Jason Kilborn, *Out with the New, In with the Old: As Sweden Aggressively Streamlines Its Consumer Bankruptcy System, Have U.S. Reformers Fallen off the Learning Curve?* 80 Am. Bankr. L.J. 435 (2006).

higher rates of noncompliance for taxpayers assigned to the queue or reported currently not collectible, with no payments being made toward the delinquent tax liabilities.[38]

Regarding the preliminary recommendations for the IRS to consider when analyzing a taxpayer's ability to pay, we are taking or have taken the following actions with respect to these recommendations.

The National Taxpayer Advocate recommended studying the effects of different financial analysis policies by deducting debt payment to other creditors from the ability to pay determination, allowing the taxpayers to make lesser payments based on this change in policy, and then tracking the results in terms of future taxpayer behavior. We do not agree that giving priority to other debts in this manner is sound tax administration. Given the flexibility already in existence, we will consult with research as to whether existing data — *i.e.*, closed cases in which conditional expenses were allowed — can be used to measure this effect.

The National Taxpayer Advocate recommends that we solicit public comments on the methodology used to compute the allowable living expenses and incorporate those comments into published guidance. Normally, annual changes to the ALE standards only involve updating the standard amounts to reflect changes in the cost of living. The methodology for calculating the ALE standards was recently revised in 2007. Significant changes had not occurred for several years prior to this revision. Prior to redesigning the ALE standards in 2007, the IRS solicited input from practitioners, as well as TAS, as noted in the 2007 Annual Report to Congress.[39] Since 2007, the IRS has continued to solicit input on the ALE standards at various presentations, including the Taxpayer Advocacy Panel and the American Bar Association. In 2010, the IRS conducted surveys with the IRS Advisory Council and practitioners at the Nationwide Tax Forums to evaluate the effectiveness of the 2007 changes and to seek recommendations for future updates.

While the IRS cannot implement every suggestion, we give consideration to all comments received and will continue to work with SB/SE Research to make improvements to the ALE standards whenever possible. The IRS agrees that the methodology should be transparent. We will consult with our communication function as to appropriate outreach channels, but do not believe that a lengthy formal notice and comment is necessary at this time.

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38 National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 21-33 (Subsequent Compliance Behavior of Delinquent Taxpayers: A Compliance Challenge for the IRS). Taxpayers whose accounts were placed in the queue or in CNC status at first disposition had high levels of subsequent noncompliance. In addition, all taxpayers whose liabilities reached TDA status and were worked in the Automated Collection System or by the Collection Field function had especially high levels of subsequent noncompliance, regardless of the disposition.

39 "The IRS has recently made changes, some positive, to the ALE standards. The IRS initiated an in-depth study in response to the 2005 Annual Report to Congress and provided TAS with a set of proposals in March of 2007. This led to interaction with SB/SE Collection Policy and Research to seek the most efficient means of determining an accurate picture of a taxpayer's ability to pay. As a result of these discussions, the IRS published a set of revised standards on October 1, 2007, that took into consideration some of TAS concerns. More importantly, the IRS committed to continue to collaborate on developing standards that might better reflect taxpayers' actual living expenses and needs for self-sufficiency. This collaboration will ensure that the application of these standards does not force lower income taxpayers to remain at or below the poverty level." National Taxpayer Advocate 2007 Annual Report to Congress 430, 435.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS agrees the ALE methodology should be transparent. She is also pleased the IRS has continued to solicit comments from the public. However, the public does not know what comments the IRS has received or have any evidence that the IRS has actually considered them.[40]

While it may not be necessary for the IRS to publish regulations, which would be subject to the public notice and comment process, additional public dialog could (1) help the IRS develop policies that are more coherent and (2) help the public understand the rationale behind policies that may otherwise seem arbitrary. In this spirit, we address several of the IRS's substantive comments below.

As described above, in determining the minimum acceptable IA payment, offer amount, or whether to classify a taxpayer's account as CNC, the IRS sometimes ignores the taxpayer's other debts, even if another creditor (*e.g.*, a state tax authority) is actually garnishing the taxpayer's wages.[41] As justification for doing so, the IRS states:

> [i]t is only in the cases posing the greatest risk of nonpayment (*i.e.*, those in which the agreement covers large balances due or for which final payment would come very late in the ten-year statutory period for collection) that the IRS asserts the full measure of its priority over junior creditors.

This explanation is confusing. Taxpayers seeking offers, CNC designations, and IAs (including PPIAs) are not in bankruptcy or any other proceeding where the priority of a debt is necessarily relevant. The debts that the IRS is ignoring will not be discharged, and the IRS is not actually asserting "priority" over anyone. If the IRS is considering a collection alternative, it is not attempting to collect the debt by levy or other enforcement mechanism. Rather, it is simply ignoring the fact that a taxpayer is obligated to make payments to a third party. Thus, the IRS had not explained how the priority that these other debts would receive in a bankruptcy is relevant to its analysis.

Other statements in the IRS response suggest that the reason for the policy may have something to do with the IRS's conclusion that taxpayers who cannot fully pay the liability in full within five years "present a heightened risk that the taxes owed will go uncollected if the agreement terms are not met." This is similarly confusing. In the case of offers, CNC designations, and PPIAs, the IRS is conducting a financial analysis to determine if it should allow some amounts to go uncollected even if the terms of the agreement *are* met.

40 For a discussion of the benefits of transparency, see National Taxpayer Advocate 2006 Annual Report to Congress 10-30 (Most Serious Problem: *Transparency of the IRS*).

41 *See, e.g.*, IRM 5.15.1.10(3) (Oct. 2, 2009) (stating: "Delinquent state and local taxes are allowable depending on the priority of the FTL and/or Service agreement with the state and local taxing agencies."). In the case of IAs, however, the IRS does not ignore these expenses if the taxpayer can repay the federal tax liability in full within five years. *See, e.g.*, IRM 5.15.1.2(4) (Oct. 2, 2009).

Policymakers have concluded that doing so may foster future compliance, avoid economic hardship, and allow the IRS to collect what is reasonably feasible at the earliest possible time and at least cost.[42] Ignoring actual debts may frustrate these goals.

In addition, the IRS comments attempt to distinguish the Swedish debt relief program from the U.S. system. The IRS notes that under the Swedish program, the government can impose a payment plan upon other creditors (which they can appeal), and observes that legislation would be necessary to establish such a program in the U.S.[43] The National Taxpayer Advocate is not suggesting the IRS recreate the Swedish debt relief program. She is merely observing that at least one other country takes a more holistic approach when analyzing a taxpayer's financial condition, rather than ignoring a taxpayer's other debts.

The IRS comments also conclude that its policy of ignoring actual debt when computing taxpayer's minimum IA payments is not the primary cause of subsequent tax delinquencies or unfilled returns. The IRS bases this conclusion on a 2009 TAS study, asserting that it found similar rates of future noncompliance for taxpayers who entered IAs, were assigned to the queue, or whose accounts were reported as CNC. As the IRS comments point out, fewer than six percent of individual IAs involve any financial analysis (*i.e.*, most IAs are streamlined IAs). Thus, we cannot draw broad conclusions about the impact of the IRS's financial analysis on future compliance by looking at the future compliance of taxpayers entering into IAs that did not involve financial analysis.[44]

Finally, the IRS discounts the benefit of studying the impact of allowing certain normally disallowed debt using random selection techniques. It suggests that even studying the matter is inconsistent with "sound tax administration." However, it has done so before.[45] Moreover, the IRS's own multifunctional Collection Process Study team recommended revising the IRS's financial analysis to "allow for minimum payments on certain debts junior to a Notice of Federal Tax Lien (NFTL): [including] (1) Payments on state tax installment agreements, [and] (2) Payments on unsecured debts (*e.g.*, student loans, credit cards)."[46]

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42 *See, e.g.*, Policy Statement 5-71, IRM 1.2.14.1.14 (Nov. 19, 1980) (CNC to avoid hardship); Policy Statement P-5-100, IRM 1.2.1.5.18 (Jan. 30, 1992) (offers). Indeed, one justification for the offer program is for offers to replace "protracted" IAs. *Id*. (stating "[A]n OIC is a legitimate alternative to declaring a case currently not collectible or to a protracted installment agreement. The goal is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the Government...an adequate offer will also result in creating for the taxpayer an expectation of a fresh start toward compliance with all future filing and payment requirements.").

43 The IRS also attempts to distinguish the Swedish approach to debt relief on the basis that debtors generally must liquidate all nonessential property as a precursor to seeking relief. However, the IRS similarly expects taxpayers utilize any equity in assets before pursuing collection alternatives, including installment agreements. *See, e.g.*, IRM 5.14.1.4 (June 1, 2010) (directing IRS employees to "inform taxpayers installment agreements will be recommended for rejection … if there is sufficient equity or cash available to [fully or] partially pay the taxes…."). Moreover, any such equity will be considered in determining an acceptable offer amount, whether to CNC the account, and whether to accept a PPIA. *See, e.g.*, IRM 5.16.1.2.9 (June 29, 2010) (CNC); IRM 5.14.2.1.2 (Sept. 26, 2008) (PPIA); IRM 5.8.5.5 (Oct. 22, 2010) (offers).

44 Moreover, the IRS may accept streamlined IAs even when taxpayers cannot afford the payments, see *IRS Collection Policies Channel Taxpayers Into Installment Agreements They Cannot Afford*, *supra/infra*. Thus, streamlined IA default rates may not provide an appropriate benchmark for comparison.

45 *See, e.g.*, SB/SE Research, Ft. Lauderdale/Greensboro, Project 04.08.002.03, *The Impact on the Installment Agreement Default Rate When Using a "Financial Calculator"* (June 2005); Memorandum of Understanding between the IRS and New York State Department of Taxation and Finance, *Joint Installment Agreements* (Sept. 2000).

46 IRS Collection Process Study, Final Report § 6.3.3.4 (Sept. 30, 2010).

When you add the team's recommendation to the National Taxpayer Advocate's analysis (above), it seems inconsistent with sound tax administration for the IRS *not* to study this recommendation properly.

Recommendations

The National Taxpayer Advocate offers the following recommendations:

1. Study the effect of more realistic financial analysis policies on taxpayer hardship, IA defaults, and future compliance, as described above. As part of this study, the IRS should survey taxpayers who default to find out why;
2. Solicit public comments on the methodology the IRS uses to compute the ALE, how the IRS should apply the ALE, and related policies for conducting financial analysis (including the disallowed debt policy); and
3. Incorporate the public comments into published guidance that addresses the public's concerns and fully explains the reasons for the policies adopted by the IRS.

MSP #8

The Failure of the Office of Appeals to Adequately Document Prohibited *Ex Parte* Communications May Violate Taxpayer Rights and Damage the Public's Perception of its Independence

RESPONSIBLE OFFICIAL

Diane Ryan, Chief, Appeals

DEFINITION OF PROBLEM

Since 1927, the IRS Office of Appeals (Appeals) has played a vital role in effective tax administration by resolving taxpayer disputes without litigation.[1] A critical component of the organization's success has been its independence. In 1998, Congress codified this independence by prohibiting certain *ex parte* communications between Appeals and the rest of the IRS.[2] The IRS defines prohibited *ex parte* communications as those that take place between Appeals and another IRS function without the participation or consent of the taxpayer or the taxpayer's representative.[3]

Appeals recognizes that Congress designed the *ex parte* prohibition to ensure its independence.[4] However, Appeals does not maintain a separate database of *ex parte* violations. Without such a database, Appeals does not know to what extent the violations occur and what remedies it should prescribe.

Surveys indicate that approximately one out of every three taxpayers who have dealt with Appeals is other than satisfied with its independence.[5] This is an unacceptably low customer satisfaction score for an attribute so critical to Appeals' mission. The National Taxpayer Advocate is concerned that taxpayers may perceive Appeals as allowing *ex parte* violations to occur, thereby diminishing the public's confidence that Appeals provides an independent review of a taxpayer's case. In addition, 25 percent of American Bar Association (ABA) member practitioners responding to a 2007 survey reported an *ex parte* violation while in Appeals.[6] Although Appeals' internal quality scores indicate a very high rate of *ex parte* compliance, Appeals must make a stronger effort to reconcile this with its customer satisfaction scores and the 2007 ABA survey.

Congress granted the Commissioner explicit authority to establish administrative rules to enforce the *ex parte* prohibition. The IRS chose to implement these rules first by IRS Notice

1 Internal Revenue Manual (IRM) 8.1.1.1(1) (Oct. 23, 2007).

2 *See* Internal Revenue Service Restructuring and Reform Act, Pub. L. No. 105-206, § 1001(a)(4), 112 Stat. 685 (1998) (RRA 98).

3 *See* Rev. Proc. 2000-43, 2000-2 C.B. 404.

4 *See* IRM 8.1.6.3 (Oct. 23, 2007).

5 *Appeals Customer Satisfaction Survey FY 2009 Results* 29 (reporting a 65 percent satisfaction rate).

6 American Bar Association Section on Taxation, *Survey Report on Independence of IRS Appeals* 16 (Aug. 11, 2007) (ABA Survey) (reporting 25.1 percent of respondents). This survey was sent to members of the ABA's Section on Taxation.

and then by Revenue Procedure.[7] Although the public had the opportunity to comment on the original IRS Notice, Appeals plans to issue a new Revenue Procedure on *ex parte* rules.[8] Without a new opportunity for notice and comment, Appeals would create a new rule to protect taxpayer rights without allowing the taxpayer to weigh in on its content.

ANALYSIS OF PROBLEM

Background

The IRS generally supports administrative settlement over litigation when resolving tax disputes.[9] Accordingly, it is essential for the IRS to have an administrative appeals function that commands the confidence of taxpayers and provides them with an independent review of disputes.[10] The effectiveness of Appeals depends greatly on the trust the public has in its independence from the rest of the IRS.

The Historical Basis for the **Ex Parte** *Prohibition*

The rationale for having an independent administrative appeals function finds its roots in the Fifth Amendment of the United States Constitution. The "due process of law" clause to the Bill of Rights provides that "No person shall be … deprived of life, liberty, or property without due process of law."[11] This due process right extends to substantive laws as well as government procedures, such as reasonable notice and the right to be heard by an impartial arbiter.[12]

For this reason, the United States Government has maintained procedures for taxpayers to appeal proposed tax assessments since 1789.[13] This continued into the present income tax system when the Revenue Act of 1918 created the Advisory Tax Board within the IRS (still

7 Notice 99-50. 1999-2 C.B. 444 (Oct. 4, 1999); Rev. Proc. 2000-43, 2000-2 C.B. 404 (Oct. 23, 2000).

8 *Filing Season Return Preparer Visits Will Resume Despite Criticism, Fink Says*, 2010 TNT 201-4 (Oct. 19, 2010) ("IRS Office of Appeals Chief Diane Ryan announced that the agency is working to revise the existing *ex parte* rules as outlined in Rev. Proc. 2000-43, which generally prohibit IRS personnel from discussing the substance of a case with Appeals.").

9 *See, e.g.*, IRM 8.1.1.1(2) (Oct. 23, 2007); *see also* Donald C. Alexander & Brian S. Gleicher, 623-2nd T.M., *IRS Procedures: Examinations and Appeals* A-79 (Sept. 4, 2004) ("[Appeals'] purpose is to resolve as many issues as possible without trial ….").

10 Appeals Officers and Settlement Officers are Appeals employees who hear cases and recommend settlements. They serve in quasi-judicial capacities, although final settlement authority rests with their managers or team case leaders. They do not serve as administrative judges subject to the Administrative Procedures Act. See *Tucker v. Comm'r*, 135 T.C. 6 (2010), for a lengthy explanation of how Appeals Officers fit within our constitutional system of appointed officers and administrative law judges.

11 U.S. Const., amend V. The idea of "due process of law" pre-dates the U.S. Constitution and is originally expressed in the Magna Carta, cl. 39 (1215).

12 *See Goldberg v. Kelly,* 397 U.S. 254 (1970) holding that procedural due process includes a person's right to be adequately notified of proceedings, the opportunity to be heard at these proceedings, and that the person or panel making the final decision over the proceedings be impartial in regards to the matter before them. *Id*. at 267.

13 The Act of 1789 establishing the Treasury Department provided that any person dissatisfied with an audit could "within six months appeal to the Comptroller." The IRS memorialized this due process rationale in IRS Policy Statement 4-7: "An exaction by the United States Government, which is not based upon law, statutory or otherwise, is a taking of property without due process of law, in violation of the Fifth Amendment to the United States Constitution." IRS Policy Statement 4-7, *reprinted in* IRM 1.2.13.1.5 (Dec. 23, 1960).

referred to as the Bureau of Internal Revenue) to hear appeals of proposed deficiencies.[14] Later, Congress concluded that this appellate body should be outside of the IRS and created the U.S. Board of Tax Appeals (predecessor to the U.S. Tax Court) in 1924.[15] However, the workload for this new tribunal soon became unbearable, and the IRS realized the value of an internal administrative appeals function that could settle taxpayer disputes without formal litigation.[16]

As a result, the IRS established the current Office of Appeals in 1927. This new administrative appeals division was part of the Commissioner's office, independent of the organizational functions making the determinations that taxpayers appealed. The independent nature of Appeals was not only organizational in its separation from the other operating divisions. Appeals was also to have decisional independence, which means the individuals hearing the appeals were to be insulated from attempts by others to influence the outcomes of their individual cases.[17]

Congress codified Appeals' independence in 1998 by prohibiting *ex parte* communications that appear to compromise an Appeals employee's decisional independence.[18] Thus, the purpose of the *ex parte* prohibition is to maintain an independent appeals function, both real and perceived.

Ex parte compliance remains a major concern for Appeals executives.[19] Violations are also a concern for taxpayers and their representatives. A member survey conducted by the ABA concerning the independence of Appeals indicates that one out of every four attorney-practitioners who responded to the survey reported *ex parte* violations.[20] What is perhaps more telling is that almost half of the respondents were unable to answer whether *ex parte* violations had occurred.[21] One of the respondents to the ABA survey commented, "It would be helpful to get a sense of the magnitude of *ex parte* violations, which [seem] fairly common."[22] Appeals may have the same problem answering this question since it has no separate database for tracking *ex parte* violations, relying instead on its managers and internal quality measurement system to monitor and measure compliance.

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14 Revenue Act of 1918, § 1301(d), Ch. 18, 40 Stat. 1057, 1141 (Feb. 24, 1919). The Revenue Act of 1921, § 250(d), Ch. 136, 42 Stat. 227, 265, 266 (Nov. 23, 1921) provided that if a tax or deficiency in tax should be discovered, the taxpayer should be notified and given a period of not less than 30 days in which to file an appeal.

15 Revenue Act of 1924, § 900, Ch. 234, 43 Stat. 253, 336 *et seq.* (June 2, 1924).

16 By 1929, the Board of Tax Appeals was 20,000 cases in arrears. *The Cabinet: Since Hamilton*, Time (Feb. 4, 1929), *available at* http://www.time.com/time/magazine/article/0,9171,737244,00.html.

17 *See, e.g.*, Stephen H. Legomsky, *Deportation and the War on Independence*, 91 Cornell L. Rev. 369, 386 (2006) (discussing the need for decisional as well as organizational independence in administrative appellate tribunals).

18 *See* RRA 98 § 1001(a)(4); *Industrial Investors v. Comm'r*, T.C. Memo. 2007-93 ("Actual influence isn't required, only a reasonable possibility that the prohibited [*ex parte*] communication may have compromised the Appeals officer's impartiality.")

19 *See, e.g., IRS Appeals Office Strives for Independence, Says Official*, 2009 TNT 185-13 (Sept. 28, 2009). The then-Deputy Chief of Appeals stated, "[r]ules against *ex parte* communications and maintaining independence continue to be the top challenges for the IRS's Appeals function."

20 ABA Survey at 16 (reporting 25.1 percent of respondents).

21 *Id.* (reporting 47.4 percent of respondents).

22 ABA Survey at 40.

The National Taxpayer Advocate has repeatedly expressed her concern that taxpayers who perceive Appeals as not being independent will bypass the Appeals process altogether, thereby clogging up courts with unnecessary litigation.[23] Similar to that of the Taxpayer Advocate Service, part of Appeals' congressional mandate is to strike the "necessary balance between being independent and remaining part of the agency."[24]

Appeals must have a solid understanding of the problem's magnitude so it can act appropriately to address perception issues regarding this important taxpayer protection. Further, taxpayers need to see that Appeals is addressing the issue of *ex parte* compliance. As former Appeals Chief Sarah Hall Ingram once said of the *ex parte* issue, "To the extent that rumors continue floating around, it undermines credibility and damages Appeals."[25]

Taxpayer Satisfaction for Appeals' Independence Is Unacceptably Low

Only 65 percent of taxpayers surveyed for Appeals fiscal year (FY) 2009 customer satisfaction survey were satisfied with Appeals' independence.[26] Appeals notes that this is a two-point increase from FY 2008.[27] However, analysis of the customer satisfaction survey data shows that there has been no statistically significant change in satisfaction for independence since FY 2004. In other words, taxpayer satisfaction may not have improved at all over the past six years.

Recent data suggest that Appeals' perceived independence appears to have a parallel relationship with overall taxpayer satisfaction. This means taxpayers' perception of Appeals' independence could be a driver of their overall satisfaction.

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23 National Taxpayer Advocate 2009 Annual Report to Congress 70-84, 346-350, 418-429; National Taxpayer Advocate 2008 Annual Report to Congress 476-487; National Taxpayer Advocate 2007 Annual Report to Congress 569-581; National Taxpayer Advocate 2006 Annual Report to Congress 266-288; National Taxpayer Advocate 2005 Annual Report to Congress 136-161; National Taxpayer Advocate 2004 Annual Report to Congress 264-289, National Taxpayer Advocate 2006 Objectives Report to Congress App. VIII 20; National Taxpayer Advocate 2004 Objectives Report to Congress 13.

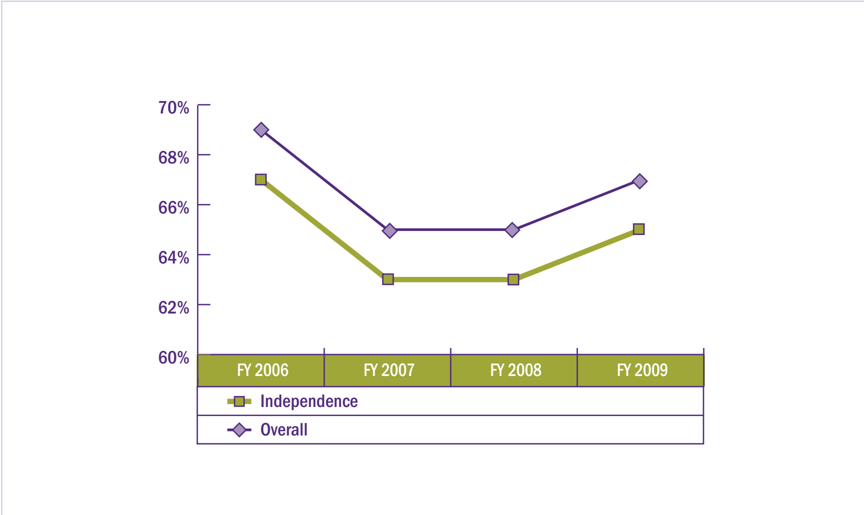
24 Nina E. Olson, *The Taxpayer Advocate Service: Independence Within the IRS*, 126 Tax Notes 1257 (Mar. 8, 2010); *see also* Bryan T. Camp, *What Good Is the National Taxpayer Advocate?*, 126 Tax Notes 1243 (Mar. 8, 2010).

25 *Appeals Chief, Practitioners Spar Over Ex Parte Rules*, 2008 TNT 221-3 (Nov. 13, 2008).

26 *Appeals Customer Satisfaction Survey FY 2009 Results* 29.

27 Appeals, *Business Performance Review – Q1* 4 (Feb. 23, 2010) ("[T]he majority of taxpayers continue to be satisfied with the degree of independence shown by Appeals, which grew two percent (to 65 percent).").

FIGURE 1.8.1, Taxpayer Satisfaction Scores for Appeals' Independence and Overall Satisfaction FY 2006 – FY 2009[28]



A 65 percent satisfaction rate means that only about two-thirds of taxpayers are satisfied with an attribute that is essential to the success of Appeals' mission and appears to be a strong driver of overall taxpayer satisfaction. Appeals has many opportunities to improve taxpayers' perception of its independence, which in turn should also increase taxpayers' overall satisfaction with the organization.

Court Cases and Practitioners Report Experiencing **Ex Parte** *Violations*

Recent U.S. Tax Court cases reveal that *ex parte* violations occur between the IRS and Appeals.[29] One case in particular, *Industrial Investors v. Commissioner*,[30] prompted a particularly strong rebuke from the court:

> This needs to stop. Congress wanted to give taxpayers an opportunity to appeal their case to an IRS employee who would take a fresh look at the facts. *Ex parte* contacts not only undermine the impartiality of the officer hearing the appeal, but are especially pernicious because they are so hard to detect.[31]

28 *Appeals Customer Satisfaction Survey FY 2009* 29; *Appeals Customer Satisfaction Trends FY 2003 – FY 2009*.

29 *See, e.g., Robert v. United States*, 364 F.3d 988 (8th Cir. 2004); *Drake v. Comm'r*, 125 T.C. 201 (2005); *Medical Practice Solutions, LLC v. Comm'r*, T.C. Memo. 2010-98; *Hotchkiss v. Comm'r*, T.C. Memo. 2010-32; *Industrial Investors v. Comm'r*, T.C. Memo. 2007-93; *Moore v. Comm'r*, T.C. Memo. 2006-171.

30 *Industrial Investors v. Comm'r*, T.C. Memo. 2007-93.

31 *Id.*

Taxpayers and practitioners have also reported *ex parte* violations that compromise Appeals' independence. The following is a partial list of narrative comments from recent surveys:[32]

- *"They should be independent. Their opinion should not be changed by the auditor."*[33]
- *"The prohibition against Appeals Officers having* ex parte *discussions with the examiner or collection officer is frequently ignored."*[34]
- *"There is often* ex parte *contact between examinations and Appeals that is not supposed to occur."*[35]

The customer satisfaction rating of 65 percent and these first-hand experiences indicate that a problem exists, at a minimum, with the public's perception of *ex parte* violations affecting Appeals' overall independence. The current lack of an *ex parte* database makes it difficult for Appeals to know what systemic problems exist and how to fix them.

Improved Measurements Would Help Appeals Determine to What Degree Ex Parte *Violations Are Real or Perceived*

Without accurate data on the number of *ex parte* violations, taxpayers are left to speculate as to what degree this is a problem and how seriously Appeals' overall independence is compromised. Rumors and negative anecdotes harm Appeals' perceived independence, while accurate data can determine if a problem truly exists and – most importantly – can suggest remedies. It would also be a clear indication that Appeals takes *ex parte* violations seriously. Even if taxpayers' perceptions of an independence problem differs from Appeals' perception, Appeals still needs to figure out why that difference exists, since it contributes to an unsatisfactory Appeals customer satisfaction rating.

Appeals Should Redesign Its Quality Measurement System to Separately Report *Ex Parte* Violations.

The only method of data collection Appeals has that touches upon *ex parte* compliance is Standard 1F of the Appeals Quality Measurement System (AQMS). A subset of one of the standards is a review for inappropriate *ex parte* communication. For FY 2009, Appeals' AQMS score for Standard 1F (the aggregate elements of "Privacy and Disclosure Provisions & *Ex Parte*") was 99.1 percent.[36] To arrive at this score, AQMS reviewers randomly select closed Appeals cases and evaluate them on multiple standards of quality. The reviewer can access only the information in the administrative case file. This means the reviewer cannot see any evidence of an *ex parte* communication unless the Appeals employee documents

32 For a complete list from the Appeals FY 2009 Survey and the ABA Survey, see *Appeals Customer Satisfaction Survey FY 2009 Results* 10, and ABA Survey at 40, 70, 82, 91, 93.

33 *Appeals Customer Satisfaction Survey FY 2009 Results* 10.

34 ABA Survey at 40.

35 *Id.*

36 Standard 1F covers whether Appeals properly processed power of attorney forms, if the Appeals employee allowed someone to represent the taxpayer who was not authorized to do so, and if third-party contact rules were followed. *See, e.g.*, Appeals, *AQMS Reviewer Non-Collection Checksheet* 3 (Rev. Oct. 1, 2009). These are unrelated to the *ex parte* prohibition in RRA 98.

it. Consequently, relying on the AQMS score to ascertain a systemic problem with *ex parte* violations would be misleading.

Given the disparity between the 99.1 percent internal quality score and the 65 percent satisfaction score for Appeals' independence in FY 2009, Appeals should not assume from its AQMS score that it excels in *ex parte* compliance and that taxpayer perception of its independence is simply mistaken. However, it appears as though Appeals does just that. Appeals' FY 2009 AQMS report states, "Appeals has consistently excelled over the past three years in … following Privacy, Disclosure and *Ex Parte* guidelines."[37] If Appeals is relying on the 99.1 percent quality score to conclude that *ex parte* violations are not occurring, it may be missing major opportunities to improve its *ex parte* compliance.

The National Taxpayer Advocate recommends that Appeals institute a formal system to document and track *ex parte* communications. Similar to its existing means of tracking expired statutes of limitation[38] and unauthorized access of taxpayer data,[39] the system would require Appeals employees to report all *ex parte* communications. Employees would submit these reports to their managers to determine if the incident rises to the level of an *ex parte* violation. The manager could then take the appropriate action to remedy the situation, including assigning a new Appeals employee to hear a specific case if the taxpayer so requests. The manager could also input the incident and his or her determination into a central database for systemic analysis by Appeals executives.

Appeals should also redesign its AQMS review standards to report *ex parte* violations separately from the general privacy and disclosure element. This way, Appeals and taxpayers will have a clearer understanding of how often *ex parte* violations occur.

The *Ex Parte* Prohibition Should Be Elevated to a Regulation.

Congress gave the Commissioner express authority to propose regulations on the independent organization of Appeals and *ex parte* prohibitions.[40] In response to the congressional directive in RRA 98 prohibiting *ex parte* communications, the Commissioner opted to publish Revenue Procedure 2000-43 rather than attempting to implement this mandate by Treasury Regulation.

There is an important distinction between Revenue Procedures and Treasury Regulations. Treasury Regulations must first be proposed and the public given the opportunity

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37 Appeals, *FY 2009 AQMS Results Report* 4 (Nov. 13, 2009).

38 *See* IRM 8.21.7, *et seq*. (Aug. 1, 2007).

39 *See* Taxpayer Browsing Protection Act, 105 Pub. L. No. 35, 111 Stat. 1104 (1997); *see also* Form 11377 (Rev. July 2008).

40 Congress explicitly left a gap for the IRS to fill by directing the Commissioner to "ensure an independent appeals function within the [IRS], including the prohibition … of *ex parte* communications between appeals officers and other [IRS] employees to the extent that such communications appear to compromise the independence of the appeals officers." RRA 98 § 1001(a)(4); *see also Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837, 843-44 (1984) ("If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation.").

to comment on them.[41] Revenue Procedures, on the other hand, are internal IRS pronouncements of procedure that generally are not subject to public notice and comment.[42] Although Appeals sought public comments in 1999 for the current Revenue Procedure, it is now looking to revise the *ex parte* Revenue Procedure.[43]

The National Taxpayer Advocate believes official rules regarding *ex parte* prohibitions should be elevated to a Treasury Regulation instead of relegated to a Revenue Procedure. This step will give taxpayers a fresh opportunity to comment on the proposed regulation.[44] It will also raise the importance of *ex parte* compliance for all IRS employees and afford the regulations greater judicial deference.[45] Since Appeals seeks to publish new *ex parte* guidance, this is the best opportunity to initiate the regulatory drafting process.

Appeals Should Lead the Initiative for Servicewide Training.

By definition, every potential *ex parte* violation involves Appeals. However, Appeals is not solely responsible for *ex parte* compliance, as everyone in the IRS shares this responsibility.[46]

Since Appeals is best suited to help the operating divisions train their employees on *ex parte* compliance, it should be the first to reach out to other functions and develop joint training and tracking programs so that all IRS employees can be mindful of prohibited communications that appear to compromise Appeals' independence.

CONCLUSION

The National Taxpayer Advocate recognizes that any disparity between alleged and actual *ex parte* violations might be a matter of perception. However, multiple court cases show that taxpayers and the IRS differ on what constitutes an *ex parte* violation.[47] Without a formal method of tracking such violations, Appeals will never know to what extent this problem is real or perceived, or how best to remedy the problem. In addition, formal regulations will increase public involvement in *ex parte* definition and enforcement, while

41 5 U.S.C. § 553; IRC § 7805.

42 *See* Treas. Reg. § 601.601(d)(2)(vi). The IRS has the authority to follow the notice-and-comment rules for Revenue Procedures if it chooses and has done so in the past. Treas. Reg. § 601.601(d)(2)(v)(f); *see e.g.*, Rev. Proc. 2005-31, 2005-1 C.B. 1374, finalizing rules proposed in Notice 2003-15, 2003-1 C.B. 540, pursuant to comments discussed in Announcement 2005-45, 2005-1 C.B. 1377.

43 *See* Notice 99-50. 1999-2 C.B. 444 (Oct. 4, 1999); *Filing Season Return Preparer Visits Will Resume Despite Criticism, Fink Says*, 2010 TNT 201-4 (Oct. 19, 2010).

44 *See Hoctor v. USDA*, 82 F.3d 165, 171 (7th Cir. 1986) (stating that the notice-and-comment rules are "the procedure by which the persons affected by legislative rules are enabled to communicate their concerns in a comprehensive and systematic fashion to the legislating agency."); Ronald A. Cass, *Models of Administrative Action*, 72 Va. L. Rev. 363, 364 (1986) (stating that the notice-and-comment requirement "loosely resembles the legislative process"). The IRS should take the necessary steps to ensure that the final regulations better serve and protect the right of taxpayers to a timely and independent review of their disputes.

45 In general, the courts afford greater deference to legislative regulations subject to the notice-and-comment procedure found in 5 U.S.C. § 553. *See* Steve R. Johnson, *Intermountain and the Importance of Administrative Law in Tax Law*, 128 Tax Notes, 837, 843 (Aug. 23, 2010).

46 Rev. Proc. 2000-43, 2000-2 C.B. 404, Q&A 29.

47 *See, e.g., Robert v. United States*, 364 F.3d 988 (8th Cir. 2004); *Drake v. Comm'r*, 125 T.C. 201 (2005); *Medical Practice Solutions, LLC v. Comm'r*, T.C. Memo. 2010-98; *Hotchkiss v. Comm'r*, T.C. Memo. 2010-32; *Industrial Investors v. Comm'r*, T.C. Memo. 2007-93; *Moore v. Comm'r*, T.C. Memo. 2006-171.

cross-functional training will better represent the fact that *ex parte* compliance is a service-wide responsibility.

In conclusion, the National Taxpayer Advocate makes the following preliminary recommendations to help minimize actual *ex parte* violations and improve taxpayers' perception of Appeals' independence:

1. Create a system to document *ex parte* communications in an effort to understand any difference between Appeals' actual compliance and public perception. The documentation system should be non-evaluative to encourage Appeals employees to report even suspected violations.
2. Track reported *ex parte* violations and the surrounding facts and circumstances to serve as the basis for improved policies and procedures to reduce actual *ex parte* violations.
3. Conduct focus group and survey research to determine how the public defines prohibited *ex parte* communications, and how it influences perceptions of independence and the public's willingness to utilize the Appeals process.
4. Develop a public information campaign based on the findings of the above research.
5. Re-design the AQMS review standards to separate *ex parte* violations from the privacy and disclosure elements.
6. Elevate the current *ex parte* guidance to a Treasury Regulation, ensuring that any new regulation uphold and protect taxpayers' rights.
7. Assist other IRS business units with *ex parte* compliance through joint training initiatives.

IRS COMMENTS

The National Taxpayer Advocate continues to express a concern about Appeals' independence under the congressional mandate established by RRA 98. The National Taxpayer Advocate's concerns focus on three areas:

1. Appeals' system of documenting and tracking *ex parte* violations;
2. The impact of perceived *ex parte* violations on Appeals' independence and a presumed correlation to overall customer satisfaction ratings; and
3. The lack of opportunity for public comment on *ex parte* procedures and the National Taxpayer Advocate's exception to the Commissioner's method of published guidance on prohibited *ex parte* communications.

Appeals is extremely proud of the service our employees provide to taxpayers and appreciates the National Taxpayer Advocate's recognition of the vital role we play in effective tax administration. Appeals values the National Taxpayer Advocate's support and feedback as we continually strive to improve our processes to meet the goals of our strategic plan and carry out our mission. In effecting that mission, independence continues to be one of Appeals' most important core values, and the RRA 98 statutory prohibition on *ex parte* communications is a significant component of Appeals' independence. Each Appeals employee is trained to understand and appreciate the seriousness of our commitment to these principles.

In the report, the National Taxpayer Advocate opines that a 2007 ABA Tax Section survey and Appeals customer satisfaction surveys reflecting "no statistically significant change in satisfaction for independence since FY 2004" support the concerns about Appeals. We respectfully disagree. Without diminishing its value as a tool to evaluate our operations, the 2007 ABA survey report [560 responses] is both limited in scope/currency and restricted in the number of participants.

However, in response to the National Taxpayer Advocate's 2004 Annual Report to Congress and the Most Serious Problem: *Independence of Appeals*,[48] a Treasury Inspector General for Tax Administration (TIGTA) audit was requested by Appeals. TIGTA's review, completed in 2005, was extensive. As part of its audit, TIGTA interviewed representatives from the ABA, the American Institute of Certified Public Accountants, the National Association of Enrolled Agents, and the National Society of Accountants. The report stated that those professional associations "believe the independence of Appeals is generally very high."[49] Interestingly, despite the fact that the National Taxpayer Advocate commended Appeals for requesting the TIGTA audit, this Most Serious Problem (MSP) 2010 neglects to cite either the audit or its strong conclusion that "The overall independence provided by Appeals' structure and processes appears to comply with the intent of the RRA 98."[50]

Procedural Updates

The National Taxpayer Advocate indicates that Appeals should seek input from external stakeholders. This implies that Appeals does not already do so, which is incorrect. The ABA survey and the National Taxpayer Advocate provide valuable information to incorporate into our planning and operations to improve overall tax administration, but cannot be evaluated in isolation from other feedback.

Appeals has made a number of procedural changes since the 2005 TIGTA audit, 2007 ABA survey, and ongoing National Taxpayer Advocate feedback. This included updates/clarifications to numerous IRM provisions, letters, publications, forms, and communications to ensure that we address internal and external stakeholder concerns on a continuing basis.

In FY 2010, Appeals participated in 250 outreach events reaching over 20,000 participants. Our participation at the IRS Nationwide Tax Forums was a particular success.

48 *See* National Taxpayer Advocate 2004 Annual Report to Congress 279.

49 TIGTA, Ref. No. 2005-10-141, *The Overall Independence of the Office of Appeals Appears to Be Sufficient* 1 (Sept. 9, 2005).

50 *Id.*

Appeals has delivered over 100 presentations to external stakeholders and IRS personnel outside of Appeals on the subjects of both Appeals independence and prohibited *ex parte* communications. As updates to the *Ex Parte* Revenue Procedure are effected, Appeals will be instrumental in developing and delivering servicewide training. We are pleased that the National Taxpayer Advocate is supportive of this cross-divisional endeavor.

Appeals devotes significant resources to ongoing *ex parte* training to its employees and the success of that effort is demonstrated in the decrease in post-FY 2006 prohibited *ex parte* violations as determined by the stringent review of AQMS reviews.

Documenting *Ex Parte* Communications

According to the National Taxpayer Advocate, reliance on AQMS reviewer scores to ascertain whether a systemic problem exists with prohibited *ex parte* communications is misleading in ascertaining whether a systemic problem exists because the reviewer only "touches upon" *ex parte* and is limited by the administrative file and Appeals Centralized Database System (ACDS).

The National Taxpayer Advocate states, "Recent U.S. Tax Court cases reveal that *ex parte* violations occur between the IRS and Appeals," and then cites six cases decided between 2004 and 2010. In two of the six cases cited, the courts, in fact, determined that **no** *ex parte* violations occurred.[51] In **each** case, the Appeals administrative case file fully documented contacts with and receipt of information from IRS Compliance employees. This clearly demonstrates the strength/reliability of the current system.

Appeals technical employees are required to use the Case Activity Reporting and Automated Timekeeping System (CARATS), a subsystem of ACDS, to "control their inventory, record case activities, record time spent, and establish follow-up actions, etc."[52] Employees are required to document their activities, inclusive of communications whether oral or written, with internal and external parties on a contemporaneous basis. Appeals managers are actively engaged conducting case, workload, and progress reviews all of which include reviewing communications.

IRM Part 8, *Appeals*, contains dozens of specific instructions for technical employees to "document" contacts, meetings, actions, events, verifications, receipts, plans, etc. While several of the IRM provisions address *ex parte* communications, Appeals does see an opportunity to improve upon our guidance to our technical employees and will include additional IRM guidance with respect to documenting *ex parte* communications in CARATS, as well as the importance of notifying their manager of potential or actual prohibited communications.

51 *Medical Practice Solutions, LLC v. Comm'r*, T.C. Memo. 2010-98; *Hotchkiss v. Comm'r*, T.C. Memo. 2010-32.

52 IRM 8.1.3.2.7.

Tracking *Ex Parte* Violations

The National Taxpayer Advocate states in the report that Appeals has no accurate data on the number of *ex parte* violations because it has no way of tracking such violations. This is simply not the case. *Ex parte* contacts, in conjunction with other quality data, are reviewed under the AQMS. The AQMS review team reviews over 1,000 cases annually. Each selected case goes through a lengthy and comprehensive quality review of every document in the case file (inclusive of emails, correspondence, notes, calculations, etc.), including the case activity record, culminating in a separate report for each case. Exclusive data on Appeals employees' compliance with *ex parte* communication are captured and tracked under Review Standard 1, Attribute F.

The following table reflects AQMS data over the past eight years for Review Standard 1, Attribute F, Reason Code 5 (where rating is "not met"):

TABLE 1.8.2, AQMS Reviews, Review Standard 1, Attribute F

Fiscal Year	Total 1.F.5 'Not Met' Ratings	Fiscal Year	Total 1.F.5 'Not Met' Ratings
2003	7	2007	1
2004	2	2008	0
2005	3	2009	0
2006	4	2010	0

Through Appeals' efforts at improving our compliance with the prohibited *ex parte* communication guidelines, the AQMS results clearly show significant improvement and have identified no violations since 2007.

As part of its overall responsibility, AQMS issues "quality alerts" to Appeals when they identify trends or issues of concern. The 2005 TIGTA report referenced such an alert issued by AQMS in 2003 relating to *ex parte* communication issues.[53] Based on the nature and extent of the AQMS review system, we believe we are adequately capturing prohibited *ex parte* communication data, and as the National Taxpayer Advocate recommended, in a non-evaluative manner.

Ex Parte Impact on Appeals' Independence and Overall Customer Satisfaction

Appeals conducts an annual Customer Satisfaction Survey, which includes an analysis of 17 individual attributes. However, the National Taxpayer Advocate attributes changes in Appeals' overall customer satisfaction score solely to a parallel relationship with a single survey item – satisfaction with Appeals' independence. Appeals' FY 2009 Overall

53 TIGTA, Ref. No. 2005-10-141, *The Overall Independence of the Office of Appeals Appears to Be Sufficient* (Sept. 9, 2005).

Satisfaction rate reflected its second highest result since the inception of the study, increasing two percentage points above FY 2008 satisfaction results and coming within two percent of the all-time Overall Satisfaction score. Appeals' overall dissatisfaction rate has improved significantly and is down to 17 percent. In merely four years since TIGTA performed its audit, Appeals has seen considerable improvement in both overall satisfaction as well as a sharp decline in the level of those dissatisfied.

TABLE 1.8.3, Appeals Satisfaction Rates, FY 2005-2009

Fiscal Year	Satisfied %	Neutral %	Dissatisfied %
2005[54]	56	18	26
2009[55]	67	17	17

Appeals takes very seriously the individual satisfaction scores on all 17 survey attributes, including Appeals' independence; however, there are no fewer than five other attributes that display a similar or nearly identical "parallel relationship" during that same time period.[56] Clearly, one cannot assume causation by observed correlation and the tracking of multiple factors with correlative attributes emphasizes the unreliability of such an approach.

The third-party vendor, however, identified seven attributes that were strong drivers of overall satisfaction during the FY 2009 survey, meaning they have the strongest impact on customers' perceptions of their experience. "Independence of Appeals" was listed as the lowest of the seven "high" attributes in 2009.

With respect to the ABA survey which specifically asks about *ex parte*, it is not clear from the reported results whether practitioners were applying a judicial ex parte rule as opposed to Rev. Proc. 2000-43, especially given the concerns espoused with respect to Fast Track Settlement/Fast Track Mediation communications, sharing of protests with Compliance for rebuttal and Appeals engagement on Issue Management Teams and Tax Shelter Settlement initiatives.

First and foremost, it should be clarified that while taxpayers' perceptions on whether Appeals engaged in an ex parte communication (whether through the lens of Revenue Procedure 2000-43, judicial rules or other vantages) can impact the rating attributable to Appeals independence, it is not necessarily considered by the respondent when assigning a rating to independence. There are likely other experiences (outcome, knowledge, views on law, understanding of settlement, etc.) that drive the taxpayers' rating of Appeals independence. Moreover, this cannot be equated with either *ex parte* concerns or satisfaction.

54 *Appeals Customer Satisfaction Survey for Fiscal Year 2005* 31.

55 *Appeals Customer Satisfaction Survey for Fiscal Year 2009* 30.

56 Explanation of Appeals Process; Listening to Your Concerns; Professionalism of Appeals Person; Degree of Respect Shown; Explanation of Payment Options; *Appeals Customer Satisfaction Surveys for Fiscal Years 2006 Through 2009*.

Consequently, Customer Satisfaction data cannot be used to support a view that an *ex parte* problem exists.

The National Taxpayer Advocate also continues to express the concern that taxpayers who perceive Appeals as not being independent will bypass the Appeals process altogether, thereby clogging the courts with unnecessary litigation. However, over the past several years Appeals receipts have grown by an average of nearly ten percent per annum. Clearly, taxpayers are not bypassing the Appeals process.

Elevating the *Ex Parte* Communication Rules to a Regulation and Opportunity for Public Comment

The National Taxpayer Advocate recommends that the *ex parte* communication rules be elevated to a regulation and states that Congress expressly gave the Commissioner the authority to issue regulations on the subject. There is no question that Treasury and the IRS have the authority to issue regulations addressing *ex parte* communications under their general rulemaking authority contained in IRC § 7805(a). However, RRA § 1001(a) does not mention regulations so there is clearly no requirement to implement the provision by issuing regulations. RRA § 1001(a) only required the Commissioner to develop and implement a "plan" to reorganize the IRS, which would include, among other things, an independent appeals function and "the prohibition in the plan of *ex parte* communications"… to the extent that such communications appear to compromise the independence of the appeals officers." Although Congress specified certain things that needed to be included in the plan, such as restrictions on *ex parte* communications, there is nothing that suggests that the plan had to take a particular form. At its core, RRA § 1001(a) is about the structure of the IRS and how its various functions interact with Appeals. Hence, the provision is essentially about the internal operations of the IRS, which do not need to be set forth in regulations. A revenue procedure is a more appropriate vehicle to set forth the *ex parte* communication rules.

Conclusion

At the heart of the National Taxpayer Advocate's Annual Report to Congress is the continuing strong support for the Appeals organization. The IRS agrees that the Appeals function is vital to sound tax administration. However, we believe that our system of documenting *ex parte* contacts is not only reliable but has provided us with the trend and training information crucial to insuring a strong and sustained commitment to our core value of Appeals independence. The depth of the 2005 TIGTA examination supports our confidence in the established safeguards for maintaining an independent administrative forum to resolve tax controversies.

Appeals values the input and insight of all stakeholders, whether through formal or informal means, and continually seeks to improve upon our policies, procedures, and processes to ensure that we provide the finest Appeals process. We appreciate and are grateful for National Taxpayer Advocate and Congress' support as we continue to be a world-class resolution forum for all taxpayers.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate reiterates her support for Appeals' vital role in effective tax administration. A key component of that role is Appeals' independence within the IRS and the public's perception that it complies with rules to safeguard that independence, such as the *ex parte* prohibitions of RRA 98. In its response, Appeals categorizes *ex parte* protections as being "essentially about the internal operations of the IRS." This statement demonstrates a profound misunderstanding of the importance of *ex parte* and the fundamental role it plays in assuring taxpayers that Appeals is, in fact, providing an impartial and independent review of the taxpayers' concerns.

In this Most Serious Problem, we identify a variety of facts that indicate there may be a problem with the public's perception of Appeals' *ex parte* compliance, and its independence as a whole. We recommend process improvements that would enable Appeals to know with greater certainty the extent to which these problems are real or perceived. If Appeals were to improve existing processes in making this distinction, it could take steps to improve *ex parte* compliance. It could also look for ways to improve the public's perception, even if no actual compliance problem exists. This is an important distinction, as any effective strategy to deal with an actual problem involving prohibited *ex parte* communications will differ significantly from one dealing only with the public's perception.

The 2007 ABA survey reported that 25 percent of tax practitioners experienced *ex parte* violations first hand.[57] In its response, Appeals eschews the ABA survey as "limited in scope/currency and restricted in the number of participants." Instead, Appeals presents TIGTA's 2005 audit of Appeals' independence as dispositive evidence of its compliance with the *ex parte* prohibition. The ABA survey reviewed responses from 560 tax practitioners, while the TIGTA audit reviewed 39 survey responses from taxpayers and their representatives.[58] Moreover, the 39 responses in the TIGTA audit were from taxpayers and representatives who participated in Appeals' Fast Track Settlement Program, a condition of which required taxpayers to *waive* the prohibition on *ex parte* communications. This means the population in the report that Appeals relies on to prove its *ex parte* compliance voluntarily gave up the protections the *ex parte* prohibition affords. If either report is "limited in scope/currency and restricted in the number of participants," based on these facts, it is the 2005 TIGTA audit and not the 2007 ABA survey.

The National Taxpayer Advocate finds Appeals' outreach efforts a good beginning and encourages Appeals to further pursue its outreach programs, which should include a *dialogue* with taxpayers and their representatives in addition to presentations. Presenting

57 Respondents were ABA tax section members.

58 TIGTA, Ref. No. 2005-10-141, *The Overall Independence of the Office of Appeals Appears to Be Sufficient* 10 (Sept. 9, 2005). Some representatives within large accounting and law firms are prohibited by their employers from participating in surveys on specific cases. *Id*. at 11 n.11. This could have made even those who elected to participate in the TIGTA surveys reluctant to be completely forthcoming about details of a specific case. On the other hand, the 560 respondents in the ABA survey were anonymous so there is a greater chance of candor in their responses.

information to taxpayers is one thing; directly soliciting their comments and opinions is another. It is in this spirit of outreach that we recommend Appeals seek more information from internal and external stakeholders in working to improve its *ex parte* compliance procedures.

The National Taxpayer Advocate acknowledges that Appeals trains its employees on *ex parte* compliance. However, she would constructively challenge Appeals to complement its training initiatives with procedures that will better guarantee the detection, documentation, reporting, and tracking of *ex parte* violations that occur.

Appeals points out that in two of the six cases cited, the court found no *ex parte* violations. This is true and in the interest of full disclosure we acknowledge that not every case taken before the U.S. Tax Court on an *ex parte* issue contains a violation. However, as Appeals points out, the court found *ex parte* violations in four of the six cases. The U.S. Tax Court in *Industrial Investors v. Commissioner* observed, "[*ex*] *parte* contacts not only undermine the impartiality of the officer hearing the appeal, *but are especially pernicious because they are so hard to detect*."[59] It is because *ex parte* violations are so hard to detect that the National Taxpayer Advocate recommends Appeals institute a formal documentation system that will allow Appeals employees to record suspected *ex parte* communications as they occur to determine whether Appeals has a systemic problem or one of perception only. This will also elevate *ex parte* above being considered merely an "internal operation of the IRS." Instead, it will be treated as an aspect of constitutional procedural due process in tax administration.

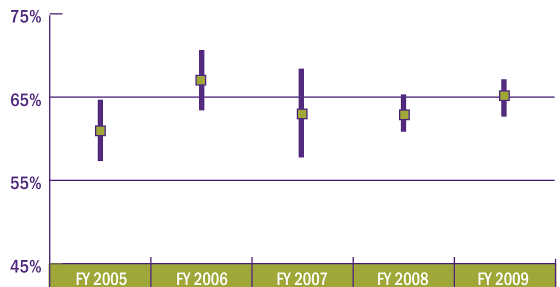
Appeals suggests that its current quality review system (AQMS) is sufficient for this purpose. However, AQMS reviewers look only at a sample of case files after the fact to find out if there is evidence of an *ex parte* violation. There is a significant difference between a system that diligently attempts to track each suspected violation and one that reviews a sample of files to see if a violation was recorded after it has already occurred. TIGTA recognized the same problem in its 2005 audit of Appeals independence when it wrote, "[i]t is also possible that inappropriate *ex parte* communications occurred that affected the outcome of cases for which there were no comments at all made in the case files, which would not have been identifiable by the AQMS process."[60]

Appeals' AQMS process yielded a 99.1 percent quality score for the attribute "Privacy and Disclosure Provisions & *Ex Parte*" for FY 2009. Yet its customer satisfaction score for independence for the same period was only 65 percent. While Appeals continues to present its independence score as a significant increase over previous years, an analysis of the survey data shows that there has been no statistically significant change in Appeals' customer satisfaction rates for independence since FY 2005, as shown in Figure 1.8.4.

59 *Industrial Investors v. Comm'r*, T.C. Memo. 2007-93 (emphasis added).

60 *See* TIGTA, Ref. No. 2005-10-141, *The Overall Independence of the Office of Appeals Appears to Be Sufficient* 4 (Sept. 9, 2005).

FIGURE 1.8.4, Appeals Independence Customer Satisfaction Scores, Percent of Customers Satisfied FY 2005 – FY 2009[61]



	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Range-Upper Bound	64.6%	70.6%	68.3%	65.1%	67.2%
Range-Lower Bound	57.4%	63.4%	57.7%	60.9%	62.8%
Midpoint	61.0%	67.0%	63.0%	63.0%	65.0%

Once again, given the disparity between the 99.1 percent internal quality score and the 65 percent satisfaction score for Appeals' independence in FY 2009, Appeals should make every effort – including modifying its tracking and quality review systems – to try to bridge the gap between its high internal quality score and its relatively low external rating.

The National Taxpayer Advocate does not predict which result reflects reality. She merely points out that a disparity exists, which could affect taxpayers' perceptions of an independence problem, and that Appeals should address. If taxpayers' perceptions differ from Appeals' perception, Appeals still needs to discover why that difference exists, since it contributes to an unsatisfactory Appeals customer satisfaction rating. The National Taxpayer Advocate believes better systems to track *ex parte* compliance are the first step in making that discovery.

Appeals responds to the National Taxpayer Advocate's recommendation to elevate *ex parte* rules to a regulation by stating, "RRA § 1001(a) does not mention regulations so there is clearly no requirement to implement the provision by issuing regulations." It goes further and summarily declares that a "revenue procedure is a more appropriate vehicle to set forth the *ex parte* communication rules." However, merely declaring that a revenue procedure is the appropriate form of guidance does not make it so. The National Taxpayer Advocate stands by her strong recommendation that *ex parte* rules be elevated to a regulation.

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61 TAS analysis of Appeals Customer Satisfaction Survey data from FY 2005 to FY 2009. When considering confidence intervals and comparing one year to the next, there have been no statistically significant improvements from year to year (if there is any overlap in the range in the years being compared, there is no statistically significant difference). Using FY 2005 as a baseline, as Appeals does in its response, there were no statistically significant improvements through FY 2009.

When implementing RRA 98, Appeals should ask, "Who is the beneficiary of §1001(a)?" It is not the IRS, nor is it Appeals. Congress passed the law for the direct benefit of the taxpayer. To claim, "the provision is essentially about the internal operations of the IRS, which do not need to be set forth in regulations" misses the point. Congress did not seek to restructure the IRS in a vacuum. It sought to do so in an effort to provide increased taxpayer protections. The *ex parte* prohibition and its rules should not be divorced from the effects such rules would have on the beneficiaries of RRA 98 § 1001(a). Therefore, the National Taxpayer Advocate maintains her position that a regulation subject to notice and comment from the very taxpayers Appeals must protect is appropriate.

Recommendations

The National Taxpayer Advocate offers the following recommendations:

1. Create a system to document *ex parte* communications in an effort to understand any difference between Appeals' actual compliance and public perception. The documentation system should be non-evaluative to encourage Appeals employees to report even suspected violations.
2. Track reported *ex parte* violations and the surrounding facts and circumstances to serve as the basis for improved policies and procedures to reduce actual *ex parte* violations.
3. Conduct focus group and survey research to determine how the public defines prohibited *ex parte* communications, and how it influences perceptions of independence and the public's willingness to utilize the Appeals process.
4. Develop a public information campaign based on the findings of the above research.
5. Re-design the AQMS review standards to separate *ex parte* violations from the privacy and disclosure elements.
6. Elevate the current *ex parte* guidance to a Treasury Regulation, ensuring that any new regulation uphold and protect taxpayers' rights.
7. Assist other IRS business units with *ex parte* compliance through joint training initiatives.

MSP #9 The IRS's Failure to Provide Timely and Adequate Collection Due Process Hearings May Deprive Taxpayers of an Opportunity to Have Their Cases Fully Considered

RESPONSIBLE OFFICIALS

Diane Ryan, Chief, Appeals
Chris Wagner, Commissioner, Small Business/Self-Employed Division
Richard E. Byrd Jr., Commissioner, Wage & Investment Division

DEFINITION OF PROBLEM

The IRS Restructuring and Reform Act of 1998 (RRA 98) requires the IRS to give taxpayers notice and the opportunity to be heard by an independent Office of Appeals (Appeals) in a Collection Due Process (CDP) hearing to review IRS collection activity.[1] In CDP hearings, impartial Appeals officers must determine "whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive then necessary."[2] The National Taxpayer Advocate is concerned that IRS actions and Appeals' handling of CDP hearings may deprive taxpayers of meaningful hearings. These problems include:

- In fiscal year (FY) 2009, the IRS issued approximately 36 percent of CDP notices before the Collection function could verify the tax liabilities or adequately analyze the taxpayers' ability to pay.[3]
- Appeals' CDP quality score in FY 2009 was 57 percent for documenting whether applicable law and administrative procedures were met, indicating that Appeals may not be receiving proper verification from the IRS.[4]
- IRS Automated Collection System (ACS) employees routinely ask taxpayers to withdraw their CDP hearing requests upon reaching a resolution of their cases. These

1 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, §§ 1001(a) & 3401, 112 Stat. 685 (1998).

2 Internal Revenue Code (IRC) §§ 6330(b)(3) & (c)(3). IRC §§ 6330(c), (d) (other than paragraph (2)(B)), & (e) apply to Collection Due Process (CDP) actions brought after the filing of a Notice of Federal Tax Lien (NFTL). IRC § 6320(c).

3 The IRS generally issues Letter 1058, *Final Notice of Intent to Levy and Notice of Your Right to a Hearing* (rev. Oct. 2008), for proposed levy actions or a Letter 3172, *Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320* (rev. Mar. 2009), after it files a Notice of Federal Tax Lien (NFTL) to provide taxpayers an opportunity for a CDP hearing. Internal Revenue Manual (IRM) 5.19.8.3 (Aug. 27, 2010). IRS, CDW, Integrated Data Retrieval System (IDRS), analysis of IDRS transaction code (TC) 971, action codes (ACS) 69 (for levy CDP notices) and 252 (for lien CDP notices) for status 22, Automated Collection System (ACS), and status 26, Collection Field function (CFf), cases for fiscal year (FY) 2009. The IRS issued 36 percent of CDP notices at the same time as or just before the tax module was assigned to the ACS or CFf.

4 At the hearing, Appeals must obtain verification from the IRS that the requirements of any applicable law or administrative procedure have been met. IRC § 6330(c)(1). Appeals, Appeals Quality Measurement System (AQMS), *All Areas Results Report for FY 2009* 11 (Nov. 13, 2009). IRC § 6330(c)(1). The AQMS provides overall case quality data from the review of a statistically valid sample of closed cases. National Taxpayer Advocate 2009 Annual Report to Congress 75.

requests create pressure on taxpayers and may cause them to lose judicial review rights if their cases are not completely resolved.[5]

- In FY 2010, ACS held unresolved hearing requests for an average of 93 days before transferring them to Appeals. This period represents almost 33 percent of total CDP cycle time, *i.e.*, the number of days from the date of the hearing request to the issuance of a determination.[6]

Untimely and inadequate hearings harm taxpayers who qualify for a collection alternative or can receive a partial abatement of their tax liability, because additional interest and penalties accrue on the correct amount owed, and the statutory period for collection is suspended.[7] Yet the IRS has no measures to determine whether delays or inadequate CDP hearings increase downstream costs of collecting taxes or impair future compliance.

ANALYSIS OF PROBLEM

Background

Congress established the CDP process to provide taxpayers an opportunity for an independent review of a tax lien filing or a proposed levy action.[8] CDP hearings are held by an impartial officer from Appeals,[9] are informal, and can be conducted face-to-face, by teleconference, or by correspondence.[10] The process generally begins when the IRS sends the taxpayer a certified letter giving notice of the filed lien or proposed levy action.[11] To schedule a hearing and to preserve their right to a judicial appeal of the determination, taxpayers must return a signed written request for a hearing within 30 days of the date of the CDP notice.[12]

At the CDP hearing, the taxpayer has the statutory right to raise any relevant issues related to the unpaid tax, lien, or proposed levy, including the appropriateness of collection action,

5 IRS procedures require a taxpayer to file a request for a CDP hearing with the office initiating the action, not Appeals. IRM 5.19.8.4.2(6) (Aug. 27, 2010). Through the first half of FY 2010, ACS generated 73 percent of Appeals CDP receipts. Appeals, *Business Performance Review* 5 (May 20, 2010). Only the first CDP notice properly sent to the taxpayer confers a right to request a CDP hearing for the tax period listed on the notice. Treas. Reg. §§ 301.6320-1(a)(3) A-A9, A-A10, -1(b)(2) A-B4 & 301.6330-1(a)(3) A-A9, A-A10, -1(b)(2) A-B4. Upon withdrawal of the CDP hearing request, a taxpayer is not entitled to a Notice of Determination. Treas. Reg. § 301.6320-1(e)(3) A-E8(ii); Treas. Reg. § 301.6330-1(e)(3) A-E8(ii). The Notice of Determination is the taxpayer's "ticket" to the Tax Court. *Weber v. Comm'r*, 122 T.C. 258, 263 (2004). Thus, a taxpayer may not seek another CDP hearing or Tax Court review upon withdrawal of his or her CDP hearing request for a tax period.

6 Appeals, CDP P1 *Measures* (Sept. 2010); Appeals, *Commissioner's Monthly Report* (Sept. 2010) (Appeals CDP cycle time for FY 2010 averaged 191 days). ACS held unresolved CDP hearing requests 48 days longer than is permitted under its procedures. IRM 5.19.8.4.7.5(14) (Aug. 27, 2010).

7 *See* IRC § 6601(a) (interest on underpayments continues until the liability is paid); IRC § 6651(a)(2) (penalty for failure to pay continues for up to 50 months); and IRC § 6330(e) (suspension of statutory period of limitations during the CDP hearing and any appeals of CDP determinations to Tax Court).

8 RRA 98, Pub. L. No. 105-206, Section 3401. IRC § 6323(h)(5).

9 IRC §§ 6330(b)(1) and 6330(b)(3).

10 Treas. Reg. § 301.6330-1(d)(2) Q & A-D7.

11 IRC §§ 6320(a)(2) and 6330(a)(2). The notice is given in person, left at the dwelling or usual place of business of the taxpayer, or sent by certified or registered mail, returned receipt requested, to the taxpayer's last known address. After the NFTL is filed, the notice regarding the lien must be sent not more than five business days after the day of the filing. The notice regarding a levy is generally sent prior to the levy action and must be sent not less than 30 days before the day of the first levy.

12 Treas. Reg. § 301.6330-1(c)(2), Q&A-C1,C3.

collection alternatives, spousal defenses, and in certain circumstances the underlying tax liability.[13] Taxpayers have the right to judicial review of Appeals' determinations provided they timely request the CDP hearing and petition the court.[14] Taxpayers who file an untimely request for a CDP hearing may be eligible for an equivalent hearing, which is similar to the CDP hearing but without court review, if requested within one year of the CDP notice.[15] Generally, the IRS suspends collection action during the hearing and any judicial review that may follow.[16]

The IRS significantly increased enforcement actions in FY 2009 by issuing 965,618 NFTLs and 3,478,181 levies, a 26 percent and 32 percent increase over FY 2008, respectively.[17]

The following table shows the number of levies and liens filed, CDP hearing requests received each year (by Collection and Appeals), and Tax Court CDP petitions filed since FY 2007.[18]

TABLE 1.9.1, Levies, Liens, and CDP Hearing Requests

Fiscal Year	2007	2008	2009
Levies[19]	3,757,190	2,631,038	3,478,181
Liens[20]	683,659	768,168	965,618
CDP Hearing Requests (received by ACS & CFf)[21]	41,862	47,866	60,556
CDP Hearing Requests (received by Appeals)[22]	30,938	35,760	42,447
Tax Court Petitions Filed[23]	1,527	1,463	1,629

The IRS generates a vast majority of these levies and liens through the ACS due to its high-volume operation, which handles over 90 percent of IRS collection inventory.[24] One of

13 IRC § 6330(c)(2). The taxpayer may raise the underlying liability in a CDP hearing for any tax period if he or she did not receive a statutory notice of deficiency for such liability or did not otherwise have an opportunity to dispute the liability. IRC § 6330(c)(2)(B).

14 IRC § 6330(d).

15 Treas. Reg. §§ 301.6320-1(i)(1) & 301.6330-1(i)(1).

16 IRC § 6330(e).

17 IRS Data Book SOI Tax Stats 2009; Delinquent Collection Activities Table 16. The trend in increased collection actions has continued in FY 2010, in which the IRS issued 1,096,376 liens and 3,606,818 levies, an increase of 13 percent and 3 percent, respectively, over FY 2009. IRS, *FY 2010 Enforcement Results, available at* http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf (last visited Dec. 16, 2010).

18 The table starts with FY 2007 because effective for determinations after August 17, 2006, Congress mandated the Tax Court have sole jurisdiction with respect to judicial review of CDP determinations. Pub. L. No. 109-280, Title VIII, Section 855(a), 120 Stat. 1019.

19 IRS, Collection Activity Report NO-5000-C23, *Collection Workload Indicators Reports* (FY 2007, FY 2008 and FY 2009).

20 *Id.*

21 SB/SE response to TAS research request (July 7, 2010).

22 Appeals, Commissioner's Monthly Report September (FY 2009). Appeals reviews all late-filed CDP hearing requests in a CDP timeliness determination (CDPTD). IRM 8.22.1.1.1.2.2.1 (Apr. 7, 2009). Appeals receipt data does not include CDPTD receipts. Appeals received 4,534 and 5,124 CDPTD cases in FY 2008 and FY 2009, respectively. Appeals, *Business Performance Review* 10 (Nov. 17, 2009).

23 IRS Chief Counsel, Counsel Automated Tracking System, PPL3254 (Jan. 22, 2010).

24 At the end of FY 2010, there were 3,057,827 taxpayer cases in the ACS ending inventory and 207,810 in the CFf. During FY 2010, ACS received 3,748,410 taxpayer cases and CFf received 364,723. IRS, Collection Activity Report NO-5000-2, *Taxpayer Delinquent Account Cumulative Report for FY 2010* (Oct. 4, 2010); IRS, Collection Activity Report NO-5000-2, *Taxpayer Delinquent Account Cumulative Report for FY 2009* (Aug. 11, 2010).

the downstream consequences of the increased IRS enforcement activity is an increase in Appeals' CDP cases. In FY 2009, Appeals CDP receipts increased 19 percent over FY 2008.

IRS Early Issuance of CDP Notices May Deprive Taxpayers of Due Process Review of Collection Actions.

Congress intended § 3401 of RRA 98 to provide formal procedures to ensure due process where the IRS seeks to collect taxes by levy or after filing the NFTL.[25] Although not required to itemize property subject to collection, the IRS is required to verify that all statutory, regulatory, and administrative requirements for the proposed collection action have been met, including verification of the taxpayer's liability and thorough consideration of the facts of the case.[26] Further, § 3421 of RRA 98 requires the IRS to implement an approval process under which any lien, levy, or seizure would, where appropriate, be approved by a supervisor who, in addition to other analysis, may certify that the employee has reviewed the taxpayer's information, verified the balance due, and affirmed that the action proposed is appropriate, considering the amount due and the value of the property.[27] Review, verification, and consideration of the facts of the case are necessary to develop an adequate record before sending a CDP notice.

The IRS routinely files an NFTL or issues a notice of intent to levy before it determines a taxpayer's ability to pay or economic hardship through an initial telephone or in-person contact. In FY 2009, the IRS issued CDP notices on the same day or before a case was assigned to ACS in 45 percent of ACS cases and to CFf in almost two percent of CFf cases. Further, the IRS issued CDP notices and did not assign the case to ACS or CFf in 24 percent of lien cases and almost ten percent of levy cases.[28]

Inadequate case development by IRS Collection can cause Appeals to take more time to resolve cases or deprive taxpayers of the opportunity to discuss and develop their issues with the IRS.[29] By foregoing case review and managerial approval before issuing CDP notices, Collection is leaving Appeals with the difficult task of holding a hearing on a case where the proposed collection action may not be in the government's or the taxpayer's best interest. Taxpayer satisfaction scores reflect the challenges Appeals faces when conducting CDP hearings. In FY 2009, taxpayer satisfaction scores for CDP hearings were 56 percent

25 RRA 98, § 3401, Pub. L. No. 105-206, 112 Stat. 758 (1998). H.R. Rep. No. 105-599, at 263, 265 (1998) (Conf. Rep.).

26 H.R. Rep. No. 105-599, at 264-265 (1998) (Conf. Rep.).

27 RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 758 (1998). *See* S. Rep. No. 105-174, at 78 (1998). The provision will preclude the IRS from "abusively us[ing] its liens-and-seizure authority." Unanimous Consent Request - H.R. 2676, 143 Cong. Rec. S12230-02, at S12231 (Statement of Sen. Roth). *See* National Taxpayer Advocate 2009 Annual Report to Congress 33, 38 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*).

28 IRS CDW, analysis of IDRS TC 971, ACs 69 (for levy CDP notices) and 252 (for lien CDP notices) for status 22 (ACS) and status 26 (CFf) cases for FY 2009.

29 For example, the IRS has not verified delivery of a deficiency notice to a taxpayer, or receipt of a waiver of a notice of deficiency from taxpayers. *See Hoyle v. Comm'r*, 131 T.C. 197 (2008); *Marlow v. Comm'r*, T.C. Memo. 2010-113.

and 54 percent for the adequacy of resources applied by Appeals, and the length of the appeals process, respectively.[30]

The IRS Is Harming Taxpayers by Asking Taxpayers to Withdraw Their CDP Cases.

The ACS Support (ACSS) function is responsible for supporting ACS call sites.[31] Among other things, its duties include perfecting lien requests and levies; processing paper levy responses, ACS undelivered mail, and delinquent returns; performing account actions from correspondence; processing TAS cases; and resolving CDP cases.[32] Once a case is assigned to ACSS, an employee will attempt to make one phone contact within five days and, if no response is received, send a letter asking the taxpayer to respond within 15 days to resolve the case with ACSS. If the taxpayer makes contact and is satisfied with the resolution reached with ACSS, the ACSS employee will ask the taxpayer to withdraw his or her request.[33] In FY 2009, ACSS received 46,082 CDP cases and processed 2,127 withdrawals.[34] Premature withdrawals deprive taxpayers of meaningful CDP hearings and judicial review of IRS actions. For example, ACSS employees are not responsible for discussing liability issues with the taxpayer.[35] The National Taxpayer Advocate believes the IRS should cease this practice immediately. Taxpayers may feel pressured by withdrawal requests from Collection personnel to give up their due process rights in exchange for achieving a resolution – a resolution that in no way guarantees a taxpayer will not need those due process rights again.

In cases where the IRS issues a CDP notice before contacting the taxpayer or the taxpayer indicates a willingness to resolve the case at the Collection level, the IRS could suspend the hearing for a short interval.[36] This approach would provide for future consideration by Appeals if a dispute should arise over the resolution (*e.g.*, the termination or default of an installment agreement).[37] However, the IRS does not record the nature of the resolutions reached or their success rate after taxpayers withdraw their CDP hearing requests.[38]

30 IRS, *Appeals Customer Satisfaction Survey, National Report FY 2009* 79 (Apr. 2010). Only the satisfaction score for time to hear from appeals was lower (52 percent) than these two attributes for FY 2009.

31 Four ACS Support sites receive and prepare ACS CDP cases. The SB/SE sites are in Philadelphia and Cincinnati. The Wage and Investment division (W&I) sites are in Kansas City and Fresno. IRM 5.19.8.4.2 (Aug. 27, 2010).

32 IRM 5.19.6.1(5) (July 8, 2008).

33 IRM 5.19.8.4.7.5(7) (Aug. 27, 2010) (cross-referencing IRM 5.19.8.4.8 (Oct. 23, 2008)).

34 SB/SE response to TAS research request (July 7, 2010). The CFf reported 933 withdrawals for FY 2009.

35 IRM 5.19.8.4.7.5(5) (Aug. 27, 2010).

36 Alternatively, the IRS might rescind the notice to preserve the taxpayer's CDP rights. Collection forwards cases to Appeals when the taxpayer indicates he or she only wants to work with Appeals, when a resolution is reached and the taxpayer will not withdraw his or her hearing request, or whenever discussions with the taxpayer reach an impasse. IRM 5.19.8.4.7.5 (Aug. 27, 2010).

37 This would be consistent with Appeals' retained jurisdiction of CDP hearings after a determination has been made under IRC § 6330(d)(2).

38 SB/SE response to TAS research request (July 7, 2010).

Appeals and ACSS Inaction May Cause Delays and Errors that Impact Taxpayer Rights.

Upon receipt of a processable request for a CDP hearing, ACSS employees update the CDP Tracking System (CDPTS), review the request, contact the taxpayer for clarification or missing information, and gather documents.[39] An ACSS employee must document the file if the taxpayer is willing to work on a case resolution beyond 45 days, and if not, the case must be transferred to Appeals.[40] In FY 2010, ACSS held Appeals' unresolved CDP hearing requests for an average of 93 days before transferring them to Appeals, which is almost 33 percent of the average length of CDP hearings.[41] In the ACSS customer satisfaction survey for the period ending in December 2009, one in four respondents was dissatisfied with the length of resolution, and 38 percent of those who provided comments stated "it took too long" or "I haven't still been notified."[42] However, ACSS does not keep customer satisfaction data specifically for CDP cases. ACSS should redouble its efforts to meet the 45-day deadline for processing cases, and gather its customer satisfaction data by function to better serve taxpayers and improve timeliness.

Appeals' gaps in activity and its untimely case actions may be causing further taxpayer dissatisfaction. For FY 2009, taxpayers had some of the highest rates of dissatisfaction, 22 and 21 percent respectively, concerning the time it takes to hear from Appeals and the length of Appeals procedures.[43] Appeals Quality Measurement System (AQMS) reports do not track timely actions for CDP alone, but for collection cases the reports indicate that timely case actions were rated 75 percent in FY 2009, which is an eight percent decrease from FY 2008.[44] Half of the negative ratings were attributed to delays in initial conference activity, which may have caused gaps in activity from six weeks to just over a year.[45]

ACSS and Appeals may be harming taxpayers by failing to update or incorrectly updating the CDPTS. An ACSS employee posts a collection statute suspension code to a taxpayer's master file transcript when the taxpayer makes a timely CDP hearing request.[46] The Treasury Inspector General for Tax Administration (TIGTA) estimates that almost 13 percent of CDP cases closed in FY 2009 have an incorrect collection statute expiration date

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39 IRM 5.19.8.4.7.5 (Aug. 27, 2010).

40 IRM 5.19.8.4.7.5(14) (Aug. 27, 2010).

41 Appeals, CDP P1 *Measures* (Sept. 2010); Appeals, *Commissioner's Monthly Report* (Sept. 2010) (Appeals CDP cycle time for FY 2010 averaged 191 days). The 93 days in which the unresolved hearing request was held by ACS is not part of the average days a CDP case was pending in Appeals.

42 IRS, *ACS Correspondence Support Customer Satisfaction Survey National Report, October – December 2009* 13, 23 (Mar. 2010).

43 IRS, *Appeals Customer Satisfaction Survey, National Report FY 2009* 79 (Apr. 2010).

44 Appeals, AQMS, *All Areas Results Report for FY 2009* 10 (Nov. 13, 2009). AQMS compiles some data attributes specifically for CDP, such as attribute 1G for CDP substantive contacts, some attributes under standard 6 for CDP procedural requirements, and some attributes under standard 8 for CDP processing. However, standard 5 for time span and time applied is only reviewed from a sample of collection and non-collection cases closed. In FY 2009, 72 percent of the 56,365 Appeals' collection cases closed were attributable to CDP cases (35,509) and CDP timeliness determinations (5,016). Appeals, Commissioner's Monthly Report September (FY 2009). Appeals, *Business Performance Review* 10 (Nov. 17, 2009).

45 Appeals, AQMS, *All Areas Results Report for FY 2009* 10 (Nov. 13, 2009).

46 ACSS employees will post a TC 520 on the IDRS for any module with a timely CDP hearing request to suspend collection action and the statutory period for collection, but not for an equivalent hearing, which will not suspend collection action or the statutory period. IRM 5.19.3.6.1 (Nov. 28, 2008); IRM 5.19.8.4.10 (Nov. 1, 2007); IRM 5.19.8.4.3 (Nov. 1, 2007).

(CSED), and that ACSS inappropriately suspended the CSED in one percent of equivalent hearing cases.[47] Moreover, Appeals' AQMS quality score is 75 percent for timely verifying collection statutes for FY 2009 cases.[48] Incorrect CSEDs harm taxpayers when the CSED is extended, but the government's interest is harmed when the CSED is shortened. The National Taxpayer Advocate is concerned that the IRS is not addressing the CSED problem.[49]

Appeals Processes, Forms, and Letters Provide Limited Opportunities for Taxpayers to Choose a Preferred Hearing Location.

Congress intended CDP to provide taxpayers with an opportunity for a "meaningful hearing" and "that following procedures designed to afford taxpayers due process in collections would increase fairness to taxpayers."[50] The IRS provides face-to-face CDP hearings at the Appeals office closest to the taxpayer's business or residence for taxpayers who raise relevant, non-frivolous issues.[51] When the IRS intends to levy or has filed an NFTL, the IRS sends the taxpayer a CDP notice including a Form 12153, *Request for a Collection Due Process or Equivalent Hearing*. However, this form does not prompt the taxpayer to choose the type of hearing or explain the circumstances under which he or she may want or need a local hearing or a face-to-face hearing with Appeals.[52]

Appeals maintains that telephone or correspondence hearings are the preferred choice of taxpayers.[53] Yet Appeals' most recent customer satisfaction survey indicates that 73 percent of taxpayers who receive field CDP hearings prefer them, compared to 62 percent of taxpayers who receive IRS campus hearings.[54] Appeals should ask taxpayers which type of hearing they want and where it should take place. Further, Appeals should track the effectiveness of field and campus hearings by tracking sustention and default rates, and other indicators of long-term compliance, after determinations are made.[55]

The National Taxpayer Advocate supports teleconferencing and correspondence hearings with taxpayers who prefer them. However, the National Taxpayer Advocate also believes that taxpayers, especially unrepresented ones, should be able to meet face-to-face or have telephonic or correspondence hearings with local appeals or settlement officers,

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47 TIGTA, Ref. No. 2010-10-075, *The Office of Appeals Has Improved Compliance Within Its Collection Due Process Program; However, Some Improvement Is Still Needed* 6-7 (July 15, 2010).

48 Appeals, AQMS, *All Areas Results Report for FY 2009* 11-12 (Nov. 13, 2009).

49 For a further discussion of CSED issues, see Status Update: *The IRS's Handling of Collection Statute Expiration Dates Continues to Adversely Affect Taxpayers, infra.*

50 Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 1998* 81-2 (Nov. 24, 1998).

51 Treas. Reg. §§ 301.6320-1(d)(2) A-D7 & 301.6330-1(d)(2) A-D7.

52 Form 12153, *Request for a Collection Due Process or Equivalent Hearing* (Nov. 2006).

53 Appeals, *Strategic Plan FY 2009-2013* 4.

54 IRS, *Appeals Customer Satisfaction Survey, National Report FY 2009* 67 (Apr. 2010).

55 *See* Appeals response to TAS research request (July 21, 2010). "Appeals does not track or report sustention data; information on docketed resolutions, or 'informal remands' is likewise not available."

because knowledge of local economic conditions or issues may be key to a successful case resolution. Otherwise, these taxpayers may not be able to receive a meaningful hearing.

Appeals Fails to Effectively Communicate and Document Case Information or Explain Resolutions to Taxpayers.

Appeals FY 2009 AQMS reports show that the organization is having difficulty communicating with taxpayers, contacting taxpayers, and documenting case actions. Appeals received a quality score of 57 percent for its documentation that applicable law and administrative procedures were met in CDP cases, which has been reflected in recent Tax Court cases.[56] In FY 2009, Appeals received scores of 63 and 71 percent, respectively, for its communication of case status and substantive contacts in CDP cases, and a rating of 71 percent on whether the case narrative included in its determination was adequate for collection cases.[57] Failure to effectively contact taxpayers and communicate case status and determinations leads to dissatisfaction and misunderstanding, as well as missed educational opportunities, and may lead taxpayers to seek Tax Court review.

CONCLUSION

The National Taxpayer Advocate is concerned that certain IRS procedures undermine the adequacy and effectiveness of CDP hearings, and that the IRS pressures taxpayers to withdraw CDP hearing requests and unnecessarily delays processing these requests. The National Taxpayer Advocate offers the following preliminary recommendations to improve the adequacy and timing of CDP hearings:

1. The IRS should require substantial efforts at telephone or in-person contacts before proposing levies or filing liens, to identify taxpayers who are able to pay;
2. ACSS should suspend and not withdraw CDP hearing requests when taxpayers are willing to work with ACSS to attempt resolution, in order to preserve the taxpayer's CDP judicial review rights;
3. ACSS should revise its customer satisfaction survey to gather data by function;
4. Appeals should revise its notices and procedures to clearly inform taxpayers about the types and alternative location of hearings, including Form 12153, *Request for a Collection Due Process or Equivalent Hearing*, to allow taxpayers to select their preferred type of hearing; and
5. Appeals should track field and campus CDP sustention and taxpayer default rates following CDP determinations.

56 Appeals, AQMS, *All Areas Results Report for FY 2009* 11 (Nov. 13, 2009). IRC § 6330(c)(1); *see also Marlow v. Commissioner*, T.C. Memo. 2110-113, at 23-33; *Hoyle v. Commissioner*, 131 T.C. 197, 203-06 (2008).

57 Appeals, AQMS, *All Areas Results Report for FY 2009* 4, 9 (Nov. 13, 2009).

IRS COMMENTS

The National Taxpayer Advocate expresses concern over whether taxpayers are receiving timely and adequate service when requesting a CDP hearing. The stated concerns focus on four key issues:

1. Early issuance of CDP notices by the IRS may deprive taxpayers of due process review of collection actions;
2. Taxpayers are harmed when asked to withdraw their CDP hearing requests;
3. Appeals' communication problems and activity gaps are harming taxpayers; and
4. Taxpayers have limited opportunities to choose their preferred hearing.

Early Issuance of CDP Notices

The IRS recognizes the need to ensure collection actions are taken based on the most accurate information known at the time of the action. The amount owed, and all other pertinent information available at the time, are considered part of the determination to either issue a notice of levy or file an NFTL. Additionally, in those situations when it is appropriate, managerial approval is required prior to issuing a levy or filing a lien. In RRA 98, Congress directed IRS to develop and implement procedures for supervisory review and approval, where appropriate, of liens, levies, and seizures. The conference agreement from RRA 98 § 3421 states as follows:

> The conference agreement follows the Senate amendment. The conferees *intend that the Commissioner have discretion* in promulgating the procedures required by this provision to determine the circumstances under which supervisory review of liens or levies issued by the automated collection system is or is not appropriate.[58]

In accordance with § 3421, the IRS has used discretion to ensure that authorities are based on the training and experience of the employee and the type of case at issue, not the pay grade of the employee.

The IRS attempts to contact each taxpayer through various methods to resolve balance due accounts so that individual circumstances can be considered. Several recent reviews by TIGTA have found that the IRS consistently protects taxpayer rights in both lien and levy contexts.

The IRM addresses lien determinations and requires prior written notice of possible lien filing.[59] When accounts are issued to Collection Field function (CFf), typically after process-

58 RRA 98, Pub. L. No. 105-206, § 3401, 112 Stat. 685 (1998); H.R. Rep. No. 105-599, at 278 (1998) (Conf. Rep.) (emphasis added).

59 IRM 5.19.4.5.1. "Be sure a written warning of lien filing is evident on each module to be included on the NFTL."

ing in the Automated Collection System (ACS), the IRM states that the lien determination will generally be made in conjunction with the initial contact.[60]

Both ACS and CFf have received guidance on situations in which lien filing may be deferred or delayed based on taxpayer circumstances. Most taxpayers in the collection process have received at least two notices of the balance due and have failed or refused to make arrangements to resolve the liability. The IRS stands ready to assist any taxpayer responding to notices of liability (whether in writing or otherwise).

TIGTA found, for the sixth year in a row, in its FY 2010 annual audit regarding IRS compliance with legal guidelines when issuing levies, "The IRS is protecting taxpayers' rights when issuing systemically generated and manually prepared levies."[61] TIGTA noted that the IRS has strong controls on systemic levy that "prevent a levy from being generated if there are fewer than 30 calendar days between the date the taxpayer was notified of the pending levy and the date requested for actual issuance of the levy."

IRS policies and procedures provide further guidance regarding the use of enforcement action. CFf employees are instructed to make prompt contact on all taxpayer cases. During these contacts, the employees attempt to secure all the necessary information and address the unique facts and circumstances of each case to resolve the balance due. IRS guidance requires that enforcement action take place only after the taxpayer is given an opportunity to resolve their tax liability but fails to do so.

In addition, the IRM allows for discretion during the initial contact with taxpayers in issuing CDP notices to consider the circumstances of the case and the compliance history of the taxpayer.[62]

Taxpayers Harmed When Asked to Withdraw Request for CDP Hearing

We respectfully disagree with the National Taxpayer Advocate in her assertion that taxpayers are being harmed when they reach a mutually agreed upon resolution to their tax matters and withdraw their CDP hearing requests.

When a taxpayer requests a CDP hearing, the taxpayer may present new information or may request a collection alternative not previously considered by the IRS. In appropriate cases, and if the taxpayer is willing, the Collection employee works with the taxpayer to see

60 IRM 5.12.2.3(2). "While the notices sent in the notice stream are sufficient for filing a NFTL, generally when a NFTL has not been previously filed the revenue officer's determination with respect to the filing of the NFTL will be done in conjunction with the initial actual contact or initial attempted contact. Contact (request for full payment) may be made by: a. field contact (preferably). b. telephone. c. mailing a notice or letter to the last known address (when appropriate). See IRM 5.11.1.2.1.1 for 'last known address' description."

61 TIGTA, Ref. No. 2010-30-068, *Fiscal Year 2010 Statutory Review of Compliance with Legal Guidelines When Issuing Levies* (June 15, 2010).

62 IRM 5.11.1.2.2 (4). "Use discretion when issuing the L1058 on initial contact with an IMF only balance due taxpayer. Consider the circumstances of the case and the compliance history of the taxpayer in determining whether to issue the L1058."

if the issue can be resolved. If the issue can be resolved prior to Appeals consideration, it expedites the process for the taxpayer.[63]

Many taxpayers clearly state on their CDP hearing request the resolution they are seeking, *e.g.*, an installment agreement. When issues raised are unambiguous and routine, Collection employees can explain the requirements to the taxpayer and address such issues more quickly than if the taxpayers are required to go through the formal appeals process only to end up with the same result.

By retaining the case in Collection after a CDP hearing request is received and continuing to work with the taxpayer in reaching a mutually agreeable resolution, we are also following the CDP regulations:[64]

> Q-C9. Can taxpayers attempt to resolve the matter of the proposed levy with an officer or employee of the IRS office collecting the tax liability stated on the CDP Notice either before or after requesting a CDP hearing?
>
> A-C9. Yes. Taxpayers are encouraged to discuss their concerns with the IRS office collecting the tax, either before or after they request a CDP hearing. If such a discussion occurs before a request is made for a CDP hearing, the matter may be resolved without the need for Appeals consideration. However, these discussions do not suspend the running of the 30-day period within which the taxpayer is required to request a CDP hearing, nor do they extend that 30-day period. *If discussions occur after the request for a CDP hearing is filed and the taxpayer resolves the matter with the IRS office collecting the tax, the taxpayer may withdraw in writing the request that a CDP hearing be conducted by Appeals.*

When a mutually agreed upon resolution of the issue is reached, we advise the taxpayer of the option to voluntarily withdraw the CDP hearing request and explain the effect of the withdrawal.[65] If the issue is satisfactorily resolved, the taxpayer often no longer wants a hearing with Appeals. The taxpayer's right to withdraw the hearing allows the taxpayer to waive the hearing with Appeals. If the taxpayer does not withdraw the hearing request, the request is sent to Appeals for the hearing.[66]

The withdrawal of the CDP hearing request must be in writing. Form 12256, *Withdrawal of Request for Collection Due Process or Equivalent Hearing*, is provided to the taxpayer to

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63 IRM 5.1.9.3.3(3). "If the taxpayer presents new information or requests collection alternatives not previously considered and if the taxpayer is willing, the RO should work with the taxpayer to see if the issue can be resolved. If the case can be resolved prior to Appeals consideration, it expedites the process for the taxpayer."

64 Treas. Reg. § 301.6330-1(c)(2) Q & A-C9.

65 IRM 5.1.9.3.3.1(1). "A taxpayer that reaches a satisfactory resolution with Collection after filing a request for a CDP hearing can withdraw the request for a CDP hearing. When resolution is reached, explain to the taxpayer the option to withdraw the request for a CDP hearing and the effect of doing so, *i.e.*, the taxpayer will lose CDP rights with respect to the CDP tax periods and proposed collection action, including the right to judicial review. The decision to withdraw belongs to the taxpayer. A taxpayer can also withdraw the request for hearing with Appeals."

66 IRM 5.1.9.3.3.1(2). "If a withdrawal is not secured, the timely CDP hearing request must be sent to Appeals even if the account is otherwise resolved."

use to withdraw the hearing request.[67] This form clearly explains to the taxpayer the effect of the withdrawal. It states that by withdrawing the hearing request, the taxpayer gives up the right to a hearing with Appeals and gives up the right to judicial review of the Appeals determination. It also specifies that the taxpayer does not give up other appeal rights such as the right to appeal the proposed termination or default of an installment agreement under the Collection Appeal Program or the right to an equivalent hearing.

This process was created cross-functionally by Appeals, Chief Counsel, SB/SE (Collection) and Wage and Investment, in an effort to allow taxpayers to resolve collection disputes at the earliest possible level and at the lowest cost to both the taxpayer and the government. If at any time the taxpayer expresses a desire to end its negotiations with Collection and go straight to Appeals, Collection expeditiously transfers the case to Appeals.[68]

Resolving the case at the earliest possible level directly benefits the taxpayer whose tax matter is resolved more expeditiously. Taxpayer withdrawals of CDP hearing requests in appropriate, mutually agreeable situations also benefit other taxpayers by freeing Appeals employees to work on truly unresolved cases.

Appeals' Communication and Activity Gap Issues

Appeals continues to experience record receipts with over 49,000 CDP cases received in FY 2010.[69] This is a 16 percent increase over FY 2009 receipts and a 37 percent increase over FY 2008 totals.[70]

To meet the challenges associated with dramatic increases in receipts, Appeals did undertake additional hiring, bringing on approximately 200 new settlement officers over the last two years. This represents roughly 35 percent of all settlement officers. Appeals has been ensuring the new workforce receives the required training and transition to the organization, which also requires a significant resource investment from the experienced settlement officers.

The overall workforce investment will position Appeals to handle the increases in case receipts and provide improved customer service. In fact, we believe we're already seeing some positive trends. While our CDP receipts and inventory increased in FY 2010, average hours per resolution decreased, and closed non-docketed cycle time improved.

The FY 2009 AQMS and customer satisfaction scores reflect the:

- Dramatic increase in Collection-sourced receipts;

67 IRM 5.1.9.3.3.1(2). "Form 12256, *Withdrawal of Request for Collection Due Process or Equivalent Hearing, Under Section 6320 and/or 6330* is available to taxpayers to use for withdrawing the CDP hearing request."

68 IRM 5.1.9.3.3.

69 IRS Data Book FY 2010.

70 IRS Data Book – 2009 49; IRS Data Book – 2008 49.

- Significant number of new settlement officers hired to address the receipts; and
- Training and orientation investment by many experienced Appeals employees.

Appeals agrees there are improvement opportunities in key AQMS and customer satisfaction survey elements. For example, the IRM requirement to document in the case activity record that applicable laws and administrative procedures were met in CDP cases is relatively new[71] and reinforces the longstanding requirement to document the same in the Appeals Case Memorandum,[72] for which AQMS score were 99 percent in FY 2009 and 95.4 percent in FY 2010.[73]

Appeals continues to monitor workload levels to ensure taxpayers are provided the opportunity to have a fair and timely hearing in Appeals.

Opportunities to Choose Preferred Hearing

The National Taxpayer Advocate states that Appeals provides taxpayers with "limited opportunities" to choose the type of hearing they prefer and cites FY 2009 customer satisfaction survey scores to conclude "taxpayers who receive field CDP hearings prefer them" over CDP hearings heard by campus Appeals employees. This statement is misleading because the percentages cited were for overall customer satisfaction and not about whether the taxpayers responding to the survey preferred a field settlement officer over a campus settlement officer.

Meeting the needs of taxpayers is something Appeals takes very seriously and we respectfully disagree with the National Taxpayer Advocate about funneling taxpayers into any type of hearing they do not want. Appeals transfers several thousand CDP cases annually for a variety of reasons rooted in providing the best service possible and this most definitely includes honoring requests or needs for face-to-face hearings. TIGTA included the following statement in its latest report: "Due to our prior recommendation and Appeals management's corrective actions, these taxpayers' right of requesting a face-to-face hearing was protected."[74]

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71 The requirement to document in the case activity record verification that all applicable laws and administrative procedures were followed first appeared in the October 2007 revision of IRM 8.22.2.2.4.7. The AQMS score for FY 2008 (first year) was 35.3 percent, so although 57.1 percent is low, it nonetheless represents a significant increase that is expected to improve again in FY 2010.

72 Original guidance was placed in IRM 8.7.2 in November of 2001 and later moved in October of 2007 to IRM 8.22.2. The Nov. 2001 revision of IRM 8.7.2.3 (15) and all subsequent revisions read: The Appeals employee must consider in the hearing and address in the determination letter/Appeals Case Memorandum (ACM) the following "Big Three" areas:

1. Verification from the Service that the requirements of any applicable law or administrative procedure have been met.

73 *AQMS Reviewer Collection Check Sheet*, Reason Code 4.C.4 requires the Appeals Case Memorandum to address "the three required elements of IRC 6330(c)(3)."
IRC § 6330(c)(1) REQUIREMENT OF INVESTIGATION– The appeals officer shall at the hearing obtain verification from the Secretary that the requirements of any applicable law or administrative procedures have been met.
IRC § 6330(c)(3) BASIS FOR DETERMINATION–The determination by an appeals officer under this subsection shall take into consideration–
(A) the verification presented under paragraph (1).

74 TIGTA, Ref. No. 2010-10-021, *Appeals Has Made Considerable Progress in Its Campus Centralization Efforts, but Some Opportunities Exist for Improvement* (Feb. 19, 2010).

The Appeals Team Manager issues a letter to the taxpayer acknowledging receipt of their request for a CDP hearing.[75] The letter includes the following statement regarding the hearing:

> If…you would prefer your conference to be held by face-to face conference at the Appeals office closest to your current residence, the school you attend or your place of employment or if you are a business, your business address, or by correspondence, please let me know within fourteen (14) days from the date of this letter. I will discuss with you if there are any offices that may be more convenient for you (e.g., Appeals office nearest place of employment or school) when you contact me.

In most cases, the settlement officer assigned to the case then issues a second "substantive contact" letter[76] to the taxpayer that includes the same language identified above.

Appeals also recently revised its guidance on circuit riding to make access to face-to-face hearings more convenient for more taxpayers.[77] This includes circuit riding "at least quarterly to meet the needs of each and every taxpayer."

In the report of the National Taxpayer Advocate there are five recommendations. We are taking or have taken the following actions with respect to these issues:

Personal contact is an important tool for helping taxpayers return to compliance. In striving to contact the greatest number of taxpayers as early as possible in the collection process, we consider the entire collection system, including our notice process and our campus operations. We have designed our treatments to direct as many taxpayers as possible to the least invasive and least burdensome option possible. We believe that a balance between prompt attention and appropriate treatment streams will ultimately secure payment of as much of the delinquent tax as possible.

The IRS uses several resources to ensure our records reflect a taxpayer's most current address.[78] In any instance, the IRS issues a final notice of intent to levy and notice of a right to a CDP hearing before taking enforcement action. The notice must be given to the taxpayer, left at the residence or place of business, or sent by certified mail. Further, annual TIGTA reviews have consistently verified IRS compliance with lien notice requirements. Therefore, we believe existing IRS policy and guidance properly address the need to ensure contact with a taxpayer has been attempted prior to filing an NFTL or issuing a levy.

When a taxpayer is willing to work with ACS Support (ACSS), and ultimately agrees to a resolution that is satisfactory to him or her, only then will ACSS ask if they wish to

75 IRM 1.4.28.3.1.

76 IRM 8.22.2.2.6.

77 IRM 8.6.1.3.1.1 (June 8, 2010).

78 We utilize National Change of Address files from the United States Postal Service; the Address Research system; additional locator services or phone calls when notices are returned as undeliverable.

withdraw their CDP hearing request. ACSS does not withdraw CDP hearing requests on its own without the formal written request of the taxpayer. The taxpayer submits a Form 12256 to accomplish this. By submitting this form, the taxpayer is explicitly stating that a satisfactory resolution has been reached and understands the implications of the withdrawal. The taxpayer does not have to submit the withdrawal and they often do not. In these instances, the resolved case is forwarded by ACSS to Appeals. This process encourages the quickest resolution of taxpayers' problems at the lowest level. However, we will revise the ACSS CDP IRM 5.19.8.4.7.5(12), and any related correspondence, to clarify that the withdrawal is not required for the offer in compromise request or Innocent Spouse (IS) claim to go forward.

The ACS customer satisfaction survey is designed to be conducted for ACS call sites during phone calls. Before a phone conversation ends, randomly selected taxpayers are asked if they would like to take the survey. If they agree, they are transferred to an IRS Quality Unit that collects data then to a vendor system that administers the survey questions. This is all handled electronically through the call site telephone system.

ACS Support is an operation that supports the ACS call sites by processing paper documents generated as a consequence of an action by the call site, or responding to correspondence from taxpayers prompted as a result of contact with an ACS call site. The two operations are linked closely and most taxpayers may not know that they are dealing with ACS Support as opposed to an ACS call site. The distinction between the two functions is not to such an extent that a taxpayer would be able to complete a survey regarding ACS Support as a distinct function; therefore, there is no separate survey for ACS Support.

We will look for other ways to gather information that may reflect or impact satisfaction of the taxpayers that directly interact with ACS Support such as determining if additional data can be extracted from our quality systems and monitoring the results of local site CDP quality reviews.

Appeals offers taxpayers multiple opportunities to select their preferred type of hearing. Acknowledgement and substantive contact letters both specifically offer taxpayers the opportunity for a face-to-face hearing and administrative procedures applicable to both campus and field personnel are already in place to ensure taxpayers receive meaningful hearings in whatever manner the taxpayer chooses.

Appeals ensures the IRS has complied with all legal and administrative procedures and has documented such in its formal case memorandums at a rate of 99 percent in two of the past three fiscal years. Appeals employees are now also documenting this in their case activity records to comply with more recent IRM requirements.

Conclusion

We appreciate the feedback from the National Taxpayer Advocate on this important collection process just as we do from all stakeholders. The IRS remains committed to providing America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all. This includes enforcing the law to ensure everyone meets their obligation to pay their taxes. For taxpayers who have balance due accounts, IRS works directly with the taxpayer towards a mutually agreeable resolution which takes into consideration the taxpayers' facts and circumstances. We work hard to incorporate taxpayer perspective, expedite resolution of taxpayer issues and provide timely guidance to help all taxpayers pay their fair share of taxes. We are equally dedicated to ensuring that our employees receive the best training and technology to meet those needs. We continually strive to maintain the fairest and most effective system of voluntary compliance in the world.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate agrees that the IRS should use its discretion and take collection actions based on the most accurate information available. However, the National Taxpayer Advocate finds it deeply ironic that the IRS justifies its decision to allow taxpayers to bargain away their CDP hearing rights on the grounds that it leads to early case resolution, even as Appeals complains of its dramatically increasing CDP caseload – which arises from the IRS's failure to make early meaningful contact (and resolution) with the taxpayer before issuing the CDP notice. The IRS's inability to see the connection between these two conditions – and Appeals' acquiescence – is at the heart of all that is wrong with the IRS's administration of CDP hearings.

The IRS's Reliance on Its Systems to Issue CDP Notices Without Discretion or Adequate Information Harms and Frustrates Taxpayers Willing to Work with the IRS.

The National Taxpayer Advocate acknowledges that Collection employees receive training and the IRS has procedures to determine whether to take specific collection actions. However, she questions whether these procedures can be followed when the IRS generates CDP notices and NFTLs by computer before the case reaches a Collection employee (*i.e.*, has anyone made an outbound call to the taxpayer? Who makes the lien determination? Who determines the levy source? Who determines if the taxpayer can pay?). TAS reviewed FY 2009 cases and found the IRS issued proposed levy or lien filing notices on 11 percent of taxpayers' tax year modules before their cases were ever assigned to Collection.[79]

The IRS cites a TIGTA report to support its efforts to protect taxpayer rights. However, the report measures only whether the IRS complied with the minimum required actions – *i.e.*, providing CDP rights to taxpayers at least 30 days before the IRS levied.[80] TIGTA did not evaluate whether the IRS used its discretion properly or whether issuing a CDP notice to an economically-disadvantaged taxpayer increased compliance. Further, in a later report, TIGTA found the IRS did not update its records when CDP lien notices were returned undeliverable, and that in 84 percent of these cases the IRS did not follow procedures to research where to send a returned notice.[81] The National Taxpayer Advocate urges the IRS to change its practices by requiring telephone or in-person contact and having employees review taxpayers' accounts before filing NFTLs or proposing levies in every case.[82]

79 See Most Serious Problem: *IRS Policy Implementation Through Systems Programming Lacks Transparency and Precludes Adequate Review, supra*. IRS, CDW, Integrated Data Retrieval System (IDRS), analysis of IDRS transaction code (TC) 971, action codes (ACs) 69 (for levy Collection Due Process (CDP) notices) and 252 (for lien CDP notices) for status 22, ACS, and status 26, CFf, cases for FY 2009. Further, 24 percent of the modules were not in Collection before issuance of CDP lien notices, and almost ten percent of the modules were not in Collection before the issuance of a CDP levy notice. Of those modules not in Collection, 28 percent of modules were in the queue on or before a CDP levy notice was issued and 47 percent of modules were in the queue on or before a CDP lien notice was issued.

80 TIGTA, Ref. No. 2010-30-068, *Fiscal Year 2010 Statutory Review of Compliance with Legal Guidelines When Issuing Levies* (June 15, 2010).

81 TIGTA, Ref. No. 2010-30-072, *Actions Are Needed to Protect Taxpayers' Rights During the Lien Due Process* 7, 9 (July 9, 2010). Additionally, TIGTA found the IRS did not notify taxpayers' representatives of taxpayers' CDP lien appeal rights in 26 percent of the cases it reviewed. *Id*. at 6. *See* Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers, infra*.

82 *See The IRS Collection Strategy Is Failing to Meet Key Objectives of the IRS Mission*, vol. 2, *infra*.

The IRS Requires Taxpayers to Waive Their CDP Rights to Quickly Resolve Their Accounts.

The National Taxpayer Advocate is pleased that ACS will revise its procedures to clarify that withdrawal of a CDP request will not be required when taxpayers are seeking relief in the form of an offer in compromise or innocent spouse relief. However, she disagrees with ACS's overall policy of soliciting withdrawals of CDP requests despite reaching resolutions with taxpayers.[83] Taxpayers may not understand the significance of waiving their hearing rights and may feel pressure from ACS employees to withdraw.

The CDP hearing process not only provides due process protections to individual taxpayers but also ensures that Collection as a whole functions appropriately. CDP accomplishes this goal by, among other things, requiring settlement officers to verify that the requirements of any applicable law or administrative procedures have been met, to consider the issues raised by taxpayers, and most importantly, to balance the need for the efficient collection of taxes with the legitimate concern of the taxpayer that any collection action be no more intrusive than necessary.[84] In conducting this review, Appeals serves as a check on potential excesses by the Collection function. Therefore, Appeals should fulfill these statutory requirements in every CDP hearing, regardless of the administrative level at which an agreement regarding collection was reached.

The National Taxpayer Advocate acknowledges that reliance on IRS Collection to receive and work CDP requests was necessary when RRA 98 created CDP, because Appeals' workload at that time primarily concerned audit issues. However, now that Appeals has had an opportunity to handle thousands of collection cases, the IRS should redesign the process to deliver CDP requests directly to Appeals and provide one-stop service for taxpayers. Where IRS Collection does not have the opportunity to speak with a taxpayer, Appeals can "send" the case back to Collection. Once it reaches a resolution with the taxpayer, the IRS would send the case back to Appeals, which would review the proposed resolution in light of the statutory balancing test and determine whether the IRS had followed all applicable laws and procedures. Appeals would then issue a determination.[85] However, if a taxpayer raises liability issues, before addressing collection alternatives Appeals should decide whether to suspend the case and send the issue to audit reconsideration (or for amended return processing), or retain the case because liability may be considered during the CDP process, or possibly for Tax Court review.[86] The National Taxpayer Advocate recommends that the IRS revise the CDP process to eliminate the need for withdrawals and provide one-stop service to taxpayers.

83 In its response, the IRS acknowledges that TAS – the statutory voice of the taxpayer inside the IRS – was absent from the discussion leading to the policy of CDP withdrawals.

84 IRC §§ 6330(c)(1), (c)(2), and (c)(3).

85 Appeals issues Form 12257, *Summary Notice of Determination, Waiver of Right to Judicial Review of a Collection Due Process Determination, and Waiver of Suspension of Levy Action*, to close agreed cases.

86 IRC § 6330(c)(2)(B); Treas. Reg. §§ 301.6320-1(e)(3) Q&A-E11 & 301.6330-1(e)(3) Q&A-E11.

Appeals Favors Form Over Substance When Documenting Whether Applicable Law and Procedures Are Followed in CDP Cases.

Appeals claims its quality rating for verification that applicable law and procedures are being followed was 99 percent in FY 2009 and 95.4 percent in FY 2010. However, TAS has reviewed the AQMS reviewer's guide and determined that Appeals is referring to an attribute concerning whether the Appeals Case Memorandum (ACM) "discusses" whether the requirements of any applicable law or administrative procedure were met.[87] The rating for whether hearing officers appropriately documented their review of whether these requirements were met was 57.1 percent in FY 2009 and 66.9 percent in FY 2010.[88] The National Taxpayer Advocate agrees that there are improvement opportunities in the AQMS, but believes Appeals should start by acknowledging that the documentation of its reviews in CDP cases may be insufficient.

Appeals Is Reluctant to Study Taxpayer Satisfaction to Determine if Taxpayers Prefer Local or Face-to-Face Hearings.

The National Taxpayer Advocate disagrees that the statement regarding the customer satisfaction survey results of campus and field Appeals is misleading. Of the taxpayers taking the survey, 73 percent of those who received a field appeal were satisfied; 62 percent of those who received a campus appeal were satisfied. A reasonable inference from this significant difference is that the location of the hearing has a major impact on taxpayers' satisfaction. The National Taxpayer Advocate recommends that Appeals just ask taxpayers what type of hearings they want, and whether they prefer campus or field appeals, in the

87 Appeals, AQMS, *Reviewer's Guide for Collection Cases* 71 (Dec. 31, 2008). Reason Code 4.C.4 applies to CDP cases in which one or more of the required elements of IRC § 6330(c)(3) were not "discussed" in the ACM. Discussion typically involves a statement that the requirements of applicable law and procedure were met in the case. The overall scores for Reason Code 4.C. (ACM narrative adequate) were 70.9 percent for FY 2009 and 68.2 percent for FY 2010. Appeals, AQMS, *All Areas Results Report for FY 2010* 8 (Nov. 17, 2010).

88 Appeals, AQMS, *All Areas Results Report for FY 2010* 10 (Nov. 17, 2010). "Even if the Collection Specialist previously reviewed and documented verification of legal and administrative requirements; the hearing officer must document their review independent of the Collection Specialist." Appeals, AQMS, *Reviewer's Guide for Collection Cases* 125-26 (Dec. 31, 2008).

hearing request.[89] Further, Appeals should track CDP sustention rates and default rates for campus and field CDP hearings. The National Taxpayer Advocate believes this information will help Appeals make an informed decision about staffing and handling of CDP cases.

ACS Support Can Track Taxpayer Satisfaction for CDP Cases it Handles.

The National Taxpayer Advocate is disappointed that ACS is unable to separate its customer satisfaction survey results for the CDP cases it handles.[90] She recommends that the IRS and Appeals address ACSS handling of CDP cases in the Appeals customer satisfaction survey.

89 Evidence of the negative impact Appeals' dogged refusal to offer face-to-face hearings can have on taxpayer satisfaction recently surfaced on the American Bar Association's (ABA's) Low Income Taxpayer Clinic (LITC) listserv:

> I just finished a very frustrating phone call with appeals. In the past, when we have requested a face-to-face CDP hearing, we have had to insist very strongly on a face-to-face hearing. The IRS does not like to grant these requests, even though CFR 301.6330 provides for face-to-face hearings. They have given me all kinds of reasons to try to schedule telephone hearings. However, I have never had them outright refuse to give me a face-to-face hearing or to require prerequisites.
>
> Appeals told me today that they are not allowed, under any circumstances, to forward a CDP case that involves collection alternatives for a face-to-face hearing without having all relevant information about the collection alternative in hand (in my case, an OIC). They told me they are not allowed to give me more than 10 days (!) to get them a 433-A, 656, and all supporting documentation information for an OIC. The appeals officer and manager I spoke to referenced this memo when pressed for a policy number:
>
> http://www.irs.gov/pub/irs-utl/ap-08-1010-06.pdf
>
> It outlines a policy with a lot of loopholes:
>
> Background: Appeals ordinarily grants a request for a face-to-face CDP conference if the taxpayer wishes to discuss any relevant, nonfrivolous issue. Except in certain circumstances, Appeals may require a Collection Information Statement as a condition to granting a face-to-face conference if the sole purpose of the conference is to discuss a collection alternative which requires a Collection Information Statement. The Collection Information Statement needs to be completed in sufficient detail to enable Appeals to productively discuss the viability of the proposed collection alternative. Appeals must consider a number of factors before denying a face-to-face conference.
>
> In my case, an OIC is not the sole purpose of the hearing. However, appeals said that it did not matter- this is their policy in all collection alternative cases. They disregarded the language in the memo.
>
> In the past, when an OIC was involved, we presented the OIC at the hearing. My understanding is that the appeals officer then makes a preliminary determination and the OIC goes to the OIC unit mainly for that unit to verify asset and income information. It then comes back to appeals and the hearing officer makes a final determination.
>
> Now, the officer and manager I talked to told me that they are sending everything to the OIC unit first. When that unit is done with a case, they will issue a preliminary determination. The case will then go to local appeals. If any new information is presented at the face-to-face hearing, the case has to go back to the OIC unit, then back to local appeals. It sounds like this will take forever.
>
> I don't think this particular office's interpretation of the IRS memo is correct. Is this a rogue office or are other people seeing this?

In response to this posting, another LITC Director posted the following:

> Yes this is their new posture and I believe it is contrary to the regulation or at least overreaching. If I were you and you cannot get a Form 433-A prepared in time, write a detailed letter explaining why so you have it in the record, then appeal the notice of determination for abuse of discretion.

E-mail posting to the ABA's LITC listserv, Dec. 20, 2010 (on file with National Taxpayer Advocate).

90 The IRS response states that the distinction between the ACS and the ACSS functions "is not to such an extent that a taxpayer would be able to complete a survey regarding ACS Support as a distinct function; therefore, there is no separate survey for ACS Support." However, W&I already completed a survey for its ACSS functions at the Fresno and Kansas City campuses. *See* IRS, ACS *Correspondence Support Customer Satisfaction Survey National Report, October – December 2009* 4 (Mar. 2010). While SB/SE may not complete a survey for its ACSS function, the National Taxpayer Advocate believes SB/SE and W&I should work with Appeals to obtain survey data from a pool of taxpayers after ACSS transfers its CDP cases to Appeals.

Recommendations

The National Taxpayer Advocate recommends that the IRS take the following specific actions:

1. The IRS should require substantial efforts at telephone or in-person contacts before proposing levies or filing liens, to identify taxpayers who are able to pay;
2. Appeals should be the point of contact for all CDP hearing requests, should route cases to IRS Collection when necessary to attempt resolution, and should issue agreed decisions or determinations, rather than obtain withdrawals, to preserve taxpayers' rights to review of collection actions and the balancing provided under the law;
3. ACSS should obtain customer satisfaction survey data for the CDP cases it works by partnering with Appeals to add questions regarding ACSS services to the Appeals customer satisfaction survey;
4. Appeals should revise its notices and procedures to clearly inform taxpayers about the types and alternative location of hearings, including Form 12153, *Request for a Collection Due Process or Equivalent Hearing*, to allow taxpayers to select their preferred type of hearing; and
5. Appeals should track field and campus CDP sustention and taxpayer default rates following CDP determinations.

MSP #10

Third-Party Reporting of Cancellation-of-Debt Events is Not Always Accurate, and the IRS's Reliance on Such Reporting May Burden Taxpayers

RESPONSIBLE OFFICIALS

Richard E. Byrd Jr., Commissioner, Wage and Investment Division
Chris Wagner, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

A taxpayer whose debt is canceled must generally include the amount canceled in his or her income when filing a tax return, while a creditor that cancels a debt is generally required to report that amount to the IRS on Form 1099-C, *Cancellation of Debt*.[1] Creditors issued Forms 1099-C to approximately two million taxpayers for 2008, almost half of whom were low income.[2] The canceled debt was more likely to be credit card debt than any other kind, and was usually for less than $10,000.[3]

The IRS uses the information on Form 1099-C to determine whether a debtor had cancellation of debt income, but Form 1099-C differs from other types of third-party reporting in ways that make it unreliable by comparison. For example:

- Because creditors may issue a Form 1099-C independently of whether they are cancelling a debt, creditors may continue to collect the debt from the taxpayer even as the IRS is collecting tax from the taxpayer for cancellation of that debt.
- Creditors may threaten to "sic the U.S. government" on a debtor by issuing a Form 1099-C as a means of pressuring a debtor to pay.
- Creditors often make errors in preparing Forms 1099-C, and debtors are rarely able to obtain a correction.
- IRS automated systems do not identify taxpayers who receive a Form 1099-C but do not owe additional tax because they are insolvent. Taxpayers are burdened by IRS contact, and they may also unnecessarily lose significant earned income tax credits.

These problems are impacting significantly more taxpayers as a result of current economic conditions. Creditors went from writing off four percent of the dollars they loaned for

1 Internal Revenue Code (IRC) §§ 61(a)(12), 6050P(a). Treas. Reg. §1.6050P-1(a) requires creditors that discharge an indebtedness of at least $600 during any calendar year to file a Form 1099-C information return with the IRS. The National Taxpayer Advocate twice identified cancellation of debt as a serious problem faced by taxpayers (National Taxpayer Advocate 2007 Annual Report to Congress 13; National Taxpayer Advocate 2008 Annual Report to Congress 39), and recommended simplifying the tax treatment of cancellation of debt income (National Taxpayer Advocate 2008 Annual Report to Congress 391).

2 Creditors issued Forms 1099-C to 1,938,520 taxpayers for tax year 2008. IRS Compliance Data Warehouse, *Individual Returns Master File* (Tax Year 2008); out of 380 taxpayers in a TAS sample, 180 taxpayers, or 47 percent, were low income. *See* analysis of TAS Form 1099-C sample, discussed *infra* note 23.

3 Analysis of TAS Form 1099-C sample, discussed *infra*; IRS Compliance Data Warehouse, *Individual Returns Master File* (Tax year 2008).

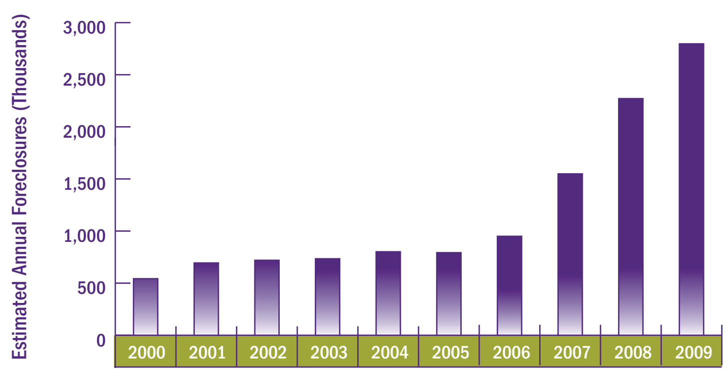
credit card debt in the first quarter of 2007 to nearly 11 percent in the second quarter of 2010.[4]

ANALYSIS OF PROBLEM

Background

According to the Federal Deposit Insurance Corporation (FDIC), home foreclosures soared from 780,000 in 2005 to about three million in 2009.[5] Figure 1.10.1 depicts the trend in foreclosures over the past ten years.

FIGURE 1.10.1, Estimated Home Foreclosures, 2000 - 2009[6]



Source: FDIC estimates based on Mortgage Bankers Association data.

As Figure 1.10.2 (below) shows, the rate of credit card write-offs, historically already larger than home mortgage loan write-offs, rose even more precipitously than mortgage write-offs in 2009 and continued at historic levels in 2010.

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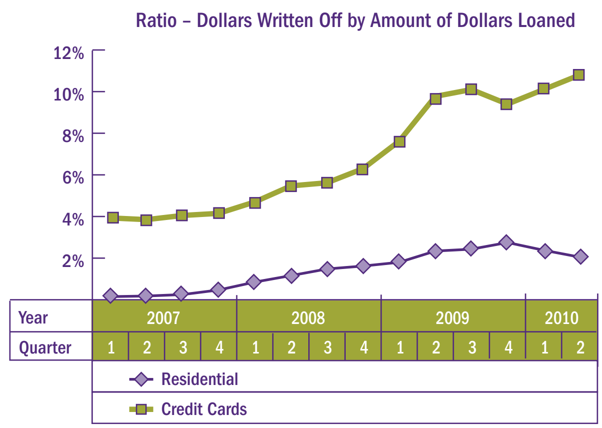
4 Federal Reserve Statistical Release, *Charge-off Rates on Loans and Leases at Commercial Banks* (Not Seasonally Adjusted), *available at* http://www.federalreserve.gov/releases/chargeoff/chgallnsa.htm (last visited Oct. 7, 2010).

5 FDIC, *Measuring Progress in U.S. Housing and Mortgage Markets, available at* http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_1/latest.html.

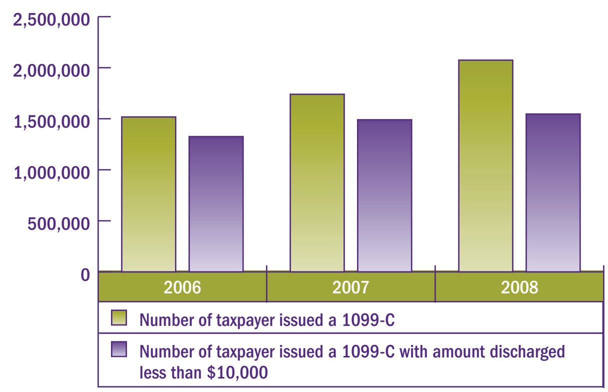
6 *Id.* at Table 9.

FIGURE 1.10.2, Proportion of Residential Real Estate and Consumer Loans Written Off[7]



To report debtors' potential income from cancellation of debt, creditors issued Forms 1099-C to a record number of taxpayers for 2008. As Figure 1.10.3 illustrates, most taxpayers' debts were less than $10,000.

FIGURE 1.10.3, Taxpayers Issued Form 1099-C[8]



Note: A small minority of taxpayers (4 percent in 2006, 5 percent in 2007, and 7 percent in 2008) are counted twice because they were issued more than one 1099-C with differences in the amount discharged greater than $10,000.

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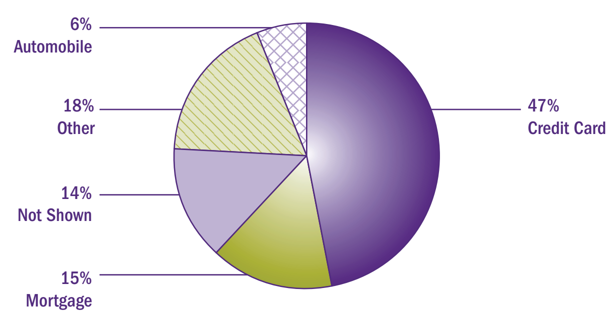
7 Federal Reserve Statistical Release, *Charge-off Rates on Loans and Leases at Commercial Banks* (Not Seasonally Adjusted), *available at* http://www.federalreserve.gov/releases/chargeoff/chgallnsa.htm (last visited June 18, 2010). Credit cards are consumer loans. Creditors write off loans (*i.e.*, treat them as an expense in their accounting records) because they do not expect to collect them.

8 IRS Compliance Data Warehouse, *Individual Returns Master File* (Tax years 2006, 2007, and 2008).

Of the nearly two million Forms 1099-C issued for 2008, TAS analyzed a random sample of 424 forms issued to 380 taxpayers (the TAS Form 1099-C sample). As Figure 1.10.4 shows, more Forms 1099-C were issued for credit card debt than for any other category.

FIGURE 1.10.4, 2008 Forms 1099-C Sources of Debt[9]



A Creditor that Issues a Form 1099-C Is Not Necessarily Canceling a Debt, Yet the IRS Assumes that Form 1099-C Reflects Taxable Income to the Debtor.

Although Box 2 of Form 1099-C is captioned "Amount of Debt Canceled," Treasury regulations require creditors to issue a Form 1099-C upon the occurrence of an "identifiable event" as defined in the regulation, "whether or not an actual discharge of indebtedness has occurred."[10] Of the eight identifiable events, seven describe circumstances in which the creditor cannot, or clearly intends not to, collect the debt.[11] However, the simple passage of time (generally 36 months) with no payment from the debtor may also be an identifiable event that triggers the creditor's reporting obligation.[12]

9 TAS Research, Form 1099-C sample. Credit card (95 percent confidence = 0.42 - 0.52); Other (95 percent confidence = 0.14 - 0.22); Mortgage (95 percent confidence = 0.12 - 0.18); Not shown (95 percent confidence = 0.11 - 0.17); Automobile (95 percent confidence = 0.04 - 0.08).

10 Treas. Reg. § 1.6050P-1(a)(1).

11 These seven identifiable events are: (1) a discharge in bankruptcy; (2) cancellation in the context of asset transfers in corporate reorganizations pursuant to bankruptcy; (3) expiration of the statute of limitations if the debtor's affirmative statute of limitations defense is upheld in a final judgment or decision of a judicial proceeding, and the period for appealing the judgment or decision has expired; (4) cancellation pursuant to an election of foreclosure remedies that statutorily extinguishes or bars the creditor's right to pursue collection of the indebtedness; (5) cancellation that renders a debt unenforceable pursuant to a probate or similar proceeding; (6) discharge pursuant to an agreement between the creditor and the debtor; or (7) discharge pursuant to a decision by the creditor, or the application of a defined policy of the creditor, to discontinue collection activity and discharge the debt. Treas. Reg. § 1.6050P-1(b)(2)(i)(A)-(G).

12 Treas. Reg. § 1.6050P-1(b)(2)(i)(H). Treas. Reg. § 1.6050P-1(b)(2)(iv) defines a "testing period," generally 36 months, and provides that if the testing period expires without payment by the debtor, a presumption arises that an identifiable event has occurred. The presumption may be rebutted *by the creditor* as described in the regulation (*i.e.*, a creditor that does *not* issue a Form 1099-C may rebut the presumption that an identifiable event occurred, thereby justifying the failure to report). *See* Legislative Recommendation: *Remove the 36-Month "Testing Period" Reporting*, *infra*.

The IRS can recognize from Form 1099-C neither the identifiable event that triggered its issuance, nor whether the creditor is actually canceling a debt. Nevertheless, if the taxpayer does not report the canceled debt on a return, he or she may receive a Notice CP 2000, *Notice Proposing Adjustments to Income, Payments, or Credits,* which is the IRS's first step toward assessing the tax.[13] Moreover, because Form 1099-C is issued independently of whether a debt has actually been discharged, *a creditor may attempt to collect a debt even after issuing a Form 1099-C.* This may place the taxpayer in the position of being told by the creditor to pay the debt while simultaneously being told by the IRS to pay tax on the income from cancellation of the debt. Worse still, a creditor may threaten to issue Form 1099-C as a means of coercing a debtor to pay, because "there's no better dog to sic on a debtor than the U.S. government."[14]

Creditors Often Prepare Form 1099-C Improperly, and It Is Difficult for Taxpayers to Correct.

Form 1099-C contains a field for the creditor to report the "fair market value of property," which is particularly relevant in real estate foreclosures.[15] The amount of canceled debt, which the debtor is expected to report as income, should be reduced by the fair market value of the property taken (*i.e.*, the amount of debt canceled is the amount owed less the fair market value of property applied toward satisfaction of the debt). More than 20 percent of the 2008 Forms 1099-C in the TAS Form 1099-C sample were issued for real estate or automobile debt, so we would expect to see a fair market value reported for this underlying property.[16] However, creditors almost always report the fair market value of property as zero.[17]

Another difficulty taxpayers encounter is that they may never receive the Form 1099-C because the address on the form is no longer current. In the TAS Form 1099-C sample, more than 40 percent of 2008 forms showed an address for the debtor different from the one on the debtor's 2008 tax return.[18]

13 See National Taxpayer Advocate 2008 Annual Report to Congress 47 for a description of the IRS's Automated Underreporter (AUR) program, which matches a Form 1099-C against the taxpayer's return. *See also* IRM 4.19.3.7.19.1 (Oct. 15, 2008).

14 Jacob Barron, *Leveraging Uncle Sam, Getting the Threat of the IRS Behind Your Collection Effort*, National Association of Credit Management, *Business Credit*, June 2008. For consumer views pertaining to unfair debt collection practices involving Form 1099-C, see Debt Consolidation Care Forum, *available at* http://www.debtconsolidationcare.com/collection-agencies/latest-scam-2.html. *McCormick v. Comm'r*, T.C. Memo. 2009-239, illustrates another incorrect use of Form 1099-C. In *McCormick*, there was no discharge of indebtedness at all, but rather settlement of a disputed amount. However, the creditor issued a Form 1099-C, and on that basis alone the IRS asserted that the taxpayer had cancellation of debt income and determined a deficiency. The taxpayer ultimately prevailed.

15 See *Instructions to Form 1099-C*, which reference "gross foreclosure bid price" or "appraised value" in cases of abandonment or "conveyance to the lender in lieu of foreclosure."

16 As shown in Figure xx.xx.xx, *supra*, 15 percent of the Forms 1099-C were for mortgage debt and six percent were for automobile loans. Moreover, as Figure xx.xx.xx, *supra*, indicates, in 2008, between one and two percent of every dollar loaned for residential real estate loans was written off.

17 Of the 1,938,520 taxpayers that were issued a Form 1099-C in 2008, 1,752,170, or 90 percent, were issued a Form 1099-C showing zero fair market value of the property. IRS Compliance Data Warehouse, *Individual Returns Master File* (Tax Year 2008). Similarly, in the TAS Form 1099-C sample, of the 380 taxpayers issued a Form 1099-C, 351, or 92 percent were issued a Form 1099-C showing zero for fair market value of the property. (95 percent confidence = 0.89 - 0.95).

18 In the sample, the "mismatch" occurred in 183 out of 424 Forms 1099-C, for a rate of 43 percent (95 percent confidence = 0.38 - 0.48).

When taxpayers receive a Form 1099-C that contains an error, they may attempt to obtain a corrected form from the creditor. The National Taxpayer Advocate recommended in her 2007 Annual Report to Congress, and the IRS agreed, to revise Form 1099-C to include issuers' phone numbers (in addition to their addresses) to make it easier for the taxpayer to contact the issuer. However, in the TAS 1099-C sample, approximately 13 percent of the Forms 1099-C were issued by creditors that appear to no longer exist.[19]

Taxpayers who are issued an inaccurate Form 1099-C may not receive it, may not attempt to ask for a correction, or may not succeed in obtaining a correction. In any event, of the nearly two million Forms 1099-C the IRS received for 2008, only 315 indicated that they were corrected.[20]

IRS Automated Systems Do Not Recognize when Form 1099-C Does Not Signal Additional Taxable Income Due to Taxpayer Insolvency.

Pursuant to IRC § 108(a)(1)(B), a taxpayer may exclude canceled debt from income if the taxpayer is insolvent when the debt is canceled. The term "insolvent" means the excess of liabilities over the fair market value of assets.[21] The IRS does not routinely capture information about the level of taxpayers' assets and liabilities, but information reported on taxpayers' returns may signal insolvency. For example, a taxpayer who has income of less than 250 percent of the federal poverty guidelines may also be insolvent.[22] In the TAS Form 1099-C sample, 47 percent of taxpayers had adjusted gross income of less than 250 percent of federal poverty guidelines.[23]

A taxpayer who does not report cancellation of debt income as shown on the Form 1099-C may receive a Notice CP 2000, the first step toward assessment of the tax.[24] The IRS issued 214,858 such notices in 2007 and TAS analyzed a random sample of 316 taxpayers

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19 Issuers of 54 out of the 424 Forms 1099-C in the TAS Form 1099-C sample either did not file separate (unconsolidated) business returns (*i.e.*, income tax returns or employment tax returns) after Dec. 31, 2008, or the employer identification number on the Form 1099-C does not correspond to any entity in IRS records. This yields a rate of 13 percent (95 percent confidence = 0.10 - 0.16).

20 IRS Compliance Data Warehouse, *Individual Returns Master File* (Tax Year 2008).

21 IRC § 108(a)(1)(d). The IRS, in collaboration with TAS, developed additional language for inclusion in paragraph 72 of the Notice CP 2000 advising taxpayers of this exclusion. *See* IRM Exhibit 4.19.3-12 (Sept. 1, 2010).

22 The Department of Health and Human Services issues poverty guidelines each year that are used to determine financial eligibility for certain federal programs, including the low income taxpayer clinic (LITC) program. *See* Dept. of Health and Human Services, Annual Update of the Poverty Guidelines, 73 Fed. Reg. 4199 (Jan. 23, 2009), *available at* http://aspe.hhs.gov/poverty/09fedreg.shtml (extended until at least May 31, 2010). Under the guidelines, the 2009 poverty level for a single person is $10,830. Pursuant to IRC § 7526(b)(1)(B), taxpayers with income of less than 250 percent of the poverty level are low income taxpayers for purposes of qualifying for LITC assistance. Taxpayers with household income between 100 percent and 400 percent of the poverty line will qualify for tax credits pursuant to the Patient Protection and Affordable Care Act, Pub. L. No. 111-148, §1401, 124 Stat. 119, 213 (Mar. 23, 2010).

23 In the TAS Form 1099-C sample, 180 out of 380 taxpayers had adjusted gross income less than 250 percent of the federal poverty level, for a rate of 47 percent (95 percent confidence = 0.42 - 0.52). An additional 94 of the 380 taxpayers, or 25 percent, had adjusted gross income of less than 400 percent of federal poverty guidelines. This makes a total of 180 + 94 = 274 taxpayers out of 380, or 72 percent, who had adjusted gross income below 400 percent of federal poverty level (95 percent confidence = 0.67 - 0.77).

24 A Notice CP 2000 may also result where there is a mismatch between amounts shown on a taxpayer's return and information on other types of third-party reports (*e.g.*, a Form W-2 reporting wage income, a Form 1099-Div reporting dividend income, and Form 1099-Int reporting interest income). *See* IRM 4.19.3.1(4), (5), and (11) (Sept. 1, 2010).

to whom they were issued (TAS Notice CP 2000 sample).[25] The Notice CP 2000 was issued *solely* on the basis of a Form 1099-C to 71 taxpayers in the Notice CP 2000 sample. Almost all of these 71 taxpayers claimed the Earned Income Tax Credit (EITC)[26] and had adjusted gross income of less than 250 percent of federal poverty guidelines.[27] However, close to half of the 71 taxpayers did not respond to the Notice CP 2000 or to the ensuing statutory notice of deficiency and additional tax was assessed by default.[28] Almost as many of the 71 taxpayers responded by agreeing with the Notice CP 2000 or with a statutory notice of deficiency.[29] Both of these measures suggest that taxpayers may not understand that they are not required to include canceled debt in income if they were insolvent when the debt was canceled. IRS initiatives to identify insolvency would benefit these taxpayers, especially because the cancellation of debt income, in addition to increasing adjusted gross income, reduced or eliminated the earned income tax credit that most of these taxpayers claimed. The average amount of lost EITC was $893 for the 71 taxpayers that were issued a Notice CP 2000 solely because they reportedly had cancellation of debt income.[30]

CONCLUSION

In conclusion, the National Taxpayer Advocate offers these preliminary recommendations:

1. The IRS should revise the IRC § 6050P regulations to better align the Form 1099-C reporting requirements with actual cancellation of debt.
2. The IRS should revise Form 1099-C to require the creditor to specify the identifiable event that triggered issuance of the form, to specify the type of debt it was issued for (*e.g.*, real estate, automobile, credit card, or other debt), and to affirmatively state whether a debt was actually canceled.
3. The IRS should adjust its document-matching program (Automated Underreporter) to identify taxpayers who are not required to include in income amounts shown on a Form 1099-C because they are insolvent.

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25 The IRS issued 225,189 Notices CP 2000 in 2006, 214,858 in 2007, and 253,095 in 2008. IRS response to TAS research request (June 7, 2010).

26 The EITC is a refundable federal income tax credit for low to moderate income working individuals and families. *See* IRC § 32. Increases in income, such as from cancellation of debt, decrease the amount of credit allowed. Out of 316 taxpayers in the sample, 282 claimed the EITC for a rate of 89 percent (95 percent confidence = 0.86 - 0.92). Of the 71 taxpayers issued a Notice CP 2000 solely on the basis of the Form 1099-C, 66 taxpayers, or 93 percent (95 percent confidence = 0.87 - 0.99), claimed the EITC and 67 taxpayers had income less than 250 percent of federal poverty guidelines. The average EITC claimed was $2,490 (95 percent confidence level = $1,914 - $2,490).

27 Out of 316 taxpayers in the sample, 290 had gross income of less than 250 percent of federal poverty guidelines for a rate of 92 percent with a confidence level of 95 percent and a margin of three percent.

28 Of the 71 taxpayers, 33, or 46 percent (95 percent confidence = 0.34 - 0.58), were assessed deficiencies by default. Out of 316 taxpayers in the sample, 164 were assessed deficiencies by default, for a rate of 52 percent (95 percent confidence = 0.46 - 0.58).

29 Of the 71 taxpayers, 32, or 45 percent (95 percent confidence = 0.33 - 0.57), agreed with the CP 2000 or the statutory notice of deficiency. Out of 316 taxpayers in the sample, 109 agreed with the CP 2000 or the statutory notice of deficiency, for a rate of 34 percent (95 percent confidence = 0.29 - 0.39).

30 95 percent confidence level = $797 - $989.

IRS COMMENTS

The IRS recognizes the burden placed on taxpayers when the Form 1099-C is not adequately completed and reported by third party sources. The IRS has taken several steps to reduce unnecessary taxpayer contact by reviewing case selection criteria of underreported cancellation of debt, providing training and IRM instructions for determining when to pursue COD, and updating our notices to provide additional instructions to taxpayers.

The National Taxpayer Advocate's research findings show that taxpayer insolvency is not recognized in the AUR program. AUR resolves discrepancies between income or credits reported on filed income tax returns and information reported by third parties on information returns. The IRS cannot determine a taxpayer's insolvency during case selection based on the data currently available to the IRS. However, the IRS does look at several factors prior to issuing a CP 2000 notice. For example, employees are instructed to compare Fair Market Value to the amount of the cancelled debt as reported on Form 1099-C to establish the COD taxable amount. Employees also look for evidence of a bankruptcy.

The IRS, in collaboration with the Office of the Taxpayer Advocate, created a clarifying paragraph in the CP 2000 notice that instructs taxpayers that under certain conditions, canceled or forgiven debt should be included on the return as income. This paragraph also states if the taxpayer claims insolvency, they should provide a breakdown of total assets and liabilities immediately before the cancellation of debt.

The National Taxpayer Advocate makes three specific recommendations in the report to improve the COD processes and procedures. The IRS is taking or has taken the following actions with respect to these recommendations:

The IRS agrees with the National Taxpayer Advocate's recommendation that IRC § 6050P regulations should better align the Form 1099-C reporting requirements with actual cancellation of debt. In 2009, the regulations were amended, narrowing the scope of the 36-month rule, so it only applies to the entities originally subject to IRC § 6050P, such as banks and credit unions. We will continue to assess whether additional changes are appropriate.

The regulations expressly state that discharged indebtedness must be reported regardless of whether the debtor is subject to tax on the discharged debt under IRC §§ 61 and 108 or otherwise by applicable law. The instructions for the debtor on the Form 1099-C also state that some canceled debts may not be included in income. We believe this makes it clear to the creditor, debtor, and the IRS, that receipt of a 1099-C does not necessarily translate into a receipt of income.

The IRS agrees to take into consideration the recommendation to revise Form 1099-C to require the creditor to specify the type of debt for which it was issued. The AUR program currently utilizes the information provided on box 4 (Debt Description) of the Form 1099-C to determine the type of debt the creditor considers canceled. Note that while a more specific description of the debt may be useful, it will not allow the IRS to determine insolvency.

We currently disagree with the second half of the recommendation to revise Form 1099-C to require the issuer to affirmatively state whether a debt was actually cancelled. Regulations specifically state that a discharge is deemed to have occurred if an identifiable event has taken place. Any statement on Form 1099-C that the debt has not actually been cancelled would be contrary to this position and would require a regulatory change. We will forward this recommendation to the Office of Chief Counsel for further consideration.

Finally, the National Taxpayer Advocate recommends the IRS adjust its AUR document-matching program to identify taxpayers who are not required to include income amounts shown on a Form 1099-C because they are insolvent. At this time, data available to AUR do not allow the IRS to determine insolvency and using income alone as an exclusion criterion is not a valid indicator of taxpayers' assets and liabilities. We will continue to explore opportunities to assist us in determining insolvency.

The IRS has taken a number of steps to improve AUR case selection of underreported cancellation of debt since the National Taxpayer Advocate first addressed this in the 2007 Annual Report to Congress. Several of those recommendations have been implemented. For example, we worked in close coordination with the National Taxpayer Advocate to develop Publication 4681, *Canceled Debts, Foreclosures, Repossessions and Abandonments.* This publication provides guidance to taxpayers to determine the extent of their insolvency by completing a worksheet to compute total assets and liabilities. In addition, the IRS revised the AUR CP 2000 notice with language provided by the Office of the Taxpayer Advocate to help taxpayers better understand if they are impacted by cancelled debt.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate acknowledges and appreciates the IRS's past collaboration with TAS in easing some cancellation of debt reporting burdens. We are pleased the IRS recognizes that taxpayers continue to be burdened by incorrectly prepared Forms 1099-C, and that the regulations under IRC § 6050P should be revised to better align the Form 1099-C reporting requirements with actual cancellation of debt. We look forward to working with the IRS to improve the reporting requirements, particularly in revising Form 1099-C.

As the IRS acknowledges, every *identifiable* event triggers the obligation to issue a Form 1099-C, but not every Form 1099-C signifies that a *taxable* event occurred. The IRS previously revised the form to accommodate this reporting regime, specifically with regard to nonrecourse debt, so it is unclear why the IRS hesitates to adopt our recommendations this year. As we explained in the 2007 Annual Report to Congress, cancellation of nonrecourse debt is an identifiable event that requires issuance of a Form 1099-C, yet is generally not included in the debtor's income.[31] Noting that there was no difference in the way canceled recourse debts and canceled nonrecourse debts were reported on Form 1099-C, the National Taxpayer Advocate recommended, and the IRS agreed, to revise Form 1099-C to show whether the canceled debt was recourse or nonrecourse.[32] Requiring a creditor to state whether a debt was actually canceled is no different than requiring an indication as to whether the debt was nonrecourse. Providing the information would not contradict the regulations but would simply allow the IRS to differentiate between a report of a *taxable* event and a report of an *identifiable* event. Thus, Form 1099-C should be revised to require the creditor to state whether a debt was actually discharged, independently of whether the regulations are revised.

The National Taxpayer Advocate is pleased that the IRS is willing to explore opportunities to assist in determining insolvency. An immediate step the IRS could take would be to include the insolvency worksheet that appears in Publication 4681 when it sends taxpayers a Notice CP 2000 based on a Form 1099-C. In addition, TAS's analysis of income data is consistent with the hypothesis that many taxpayers who receive a Notice CP 2000 on the basis of a Form 1099-C are insolvent. The IRS should test this hypothesis by analyzing a sample of these taxpayers and determining how often their liabilities exceed their assets, and then adjusting its document-matching program accordingly.[33] TAS is willing to work with the IRS on this project.

31 *See* Treas. Reg. § 1.1001-2(a)(1) & (c), Example (7). However, any reduction in the principal balance of a nonrecourse debt that occurs outside the context of a foreclosure or other disposition of the property (*e.g.*, as part of a loan modification, or "workout") generally gives rise to taxable cancellation of indebtedness income. Rev. Rul. 91-31, 1991-1 C.B. 19.

32 *See* National Taxpayer Advocate 2007 Annual Report to Congress 18, 27. The 2008 Form 1099-C was revised to include the question "Was borrower personally liable for repayment of the debt?"

33 As the IRS notes, requiring a specific description of the debt on Form 1099-C will not allow the IRS to determine insolvency. However, a description of the debt will allow the IRS to detect some patent errors on a Form 1099-C (*e.g.*, fair market value of property shown as zero where the debt is mortgage or automobile debt). In any event, it does not appear that the IRS objects to including this additional information on the form.

Recommendations

In summary, the National Taxpayer Advocate recommends that the IRS:

1. Revise the IRC § 6050P regulations to better align the Form 1099-C reporting requirements with actual cancellation of debt.
2. Revise Form 1099-C to require the creditor to specify the identifiable event that triggered issuance of the form, to specify the type of debt it was issued for (*e.g.*, real estate, automobile, credit card, or other debt), and to affirmatively state whether a debt was actually canceled.
3. Include the insolvency worksheet that appears in Publication 4681 when it sends taxpayers a Notice CP 2000 based on a Form 1099-C.
4. Analyze, in collaboration with TAS if preferred, a sample of taxpayers who were issued a Notice CP 2000 on the basis of a Form 1099-C. To the extent there is a correlation between income and insolvency for that population, adjust the document-matching program (Automated Underreporter) to identify taxpayers who insolvent and are therefore not required to include in income amounts shown on a Form 1099-C.

MSP #11

The IRS's Failure to Track and Analyze the Outcomes of Audit Reconsiderations and Inconsistent Guidance Increase Taxpayer Burden and Inflate IRS Audit Results and Cost Effectiveness Measures

RESPONSIBLE OFFICIALS

Richard E. Byrd Jr., Commissioner, Wage and Investment Division
Chris Wagner, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

The IRS uses the audit reconsideration process to reevaluate the results of previous audits where additional tax was assessed and remains unpaid or a tax credit was reversed.[1] In recent years, the number of audit reconsiderations has increased about 190 percent, from nearly 164,000 cases in fiscal year (FY) 2006 to over 474,000 in FY 2009.[2] Audit reconsiderations now comprise about ten percent of the IRS's total examination inventory.[3] Tax abatements, which are one possible result of an audit reconsideration, have increased 315 percent during the same period, from $1.2 billion in FY 2006 to $5.1 billion in FY 2009.[4]

In the absence of effective measures and clear guidance, audit reconsiderations remain burdensome for taxpayers and ineffective from a tax administration standpoint.[5] The National Taxpayer Advocate has identified the following problems with IRS processes and procedures:

- The IRS's inability to measure the impact of the growing number of audit reconsiderations and use the outcomes to improve procedures for original audits;
- The omission of abatements and rework data that inflates audit results and cost effectiveness measures;

1 Internal Revenue Manual (IRM) 4.13.1.2 (Oct. 1, 2006). The IRS also uses the audit reconsideration process when a taxpayer disputes a Substitute for Return (SFR) assessment by filing an original delinquent return.

2 IRS, Enforcement Revenue Information Systems (ERIS) SBD 721 Database (July 27 & 28, 2010). All years are presented as of tax cycle 201026. ERIS is a cross-functional database administered by the Office of Revenue Analysis. It tracks the amount and timing of revenue from all IRS enforcement actions.

3 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2009-40-099, *The Discretionary Examination Program Performance Results Are Incomplete; Therefore, Some Measures Are Overstated and Inaccurate* 4, 23 (Aug. 6, 2009). Discretionary examinations are correspondence examinations.

4 IRS, ERIS SBD 721 Database (July 27 & 28, 2010). All years are presented as of tax cycle 201026. Calculations include Earned Income Tax Credit (EITC) assessments, and abatements. *See also* TIGTA, Ref. No. 2001-40-053, *Audit Reconsideration Cases Create Unnecessary Burden on Taxpayers and the Internal Revenue Service* 6 (Mar. 2001); National Taxpayer Advocate 2007 Annual Report to Congress 287.

5 The National Taxpayer Advocate, TIGTA, and the Government Accountability Office (GAO) have found the process is ineffective and burdensome to taxpayers and IRS employees. *See, e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 287; TIGTA, Ref. No. 2009-40-099, *The Discretionary Examination Program Performance Results Are Incomplete; Therefore, Some Measures Are Overstated and Inaccurate* 6 (Aug. 6, 2009); TIGTA, Ref. No. 2004-40-028, *The Wage and Investment Division Does Not Have a Reliable System for Identifying Trends Related to Automated Underreporter Reconsideration Cases* 6-7, 21 (Dec. 2003); TIGTA, Ref. No. 2001-40-053, *Audit Reconsideration Cases Create Unnecessary Burden and the Internal Revenue Service* 4-5 (Mar. 2001); GAO, GAO-01-328, *IRS Can Help Taxpayers Reduce the Need for Tax Abatement* 2, 7 (Mar. 2001).

- Automated processes with less human interaction and mail handling delays that burden taxpayers and increase the likelihood that they will seek audit reconsiderations; and
- Inconsistent, ambiguous, and often contradictory forms and publications, and confusing IRM provisions that create a potential for error and excessive taxpayer burden.

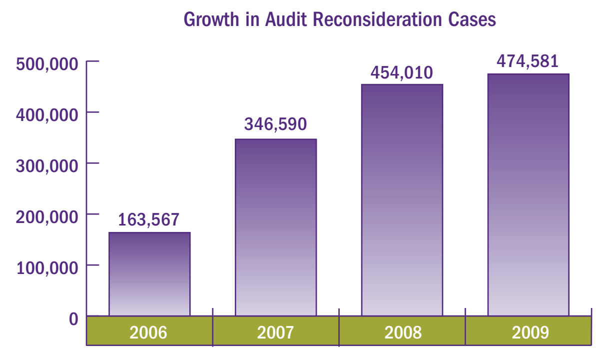
ANALYSIS OF PROBLEM

Background

Taxpayers who disagree with the outcome of an audit may ask the IRS to reconsider the examiner's determination if they have information that was not considered during the initial audit.[6] This includes situations in which taxpayers missed their opportunity to request an appeal or seek relief in the U.S. Tax Court.[7] For these taxpayers, the reconsideration process represents a final opportunity to dispute the outcome of an audit without having to pay the tax and file a formal claim for refund.[8]

Audit reconsideration cases have increased about 190 percent, from 163,567 in FY 2006 to 474,581 in FY 2009, as illustrated in Chart 1.11.1 below.[9]

FIGURE 1.11.1, Audit Reconsiderations in FY 2006 - FY 2009[10]



6 *See generally* Internal Revenue Code (IRC) § 7605(b); Treas. Reg. § 1.7605-1(h).

7 IRC § 6404(a) gives the IRS discretionary authority to abate any unpaid tax it determines to be excessive, upon reconsideration. *See also* IRM 1.2.12.1.15, *IRS Policy Statement P-2-89* (Sept. 20, 1999).

8 IRC § 6511(a). *See also* IRM 4.13.4.4(1) (Oct. 1, 2006).

9 IRS, ERIS SBD 721 SBD 721 Database (July 27 & 28, 2010). All years are presented as of cycle 201026.

10 *Id.* All years are presented as of cycle 201026.

During this period, the Taxpayer Advocate Service's (TAS) audit reconsideration inventory has ranged from about 22,000 to about 27,000 cases or about ten percent of overall TAS inventory.[11] It has been in the top ten TAS case receipts since at least FY 2003.[12]

The IRS does not measure or analyze the growing number of audit reconsiderations or use the outcomes to improve processes for original audits.

Because audit reconsiderations constitute rework, the dramatic growth in these cases calls into question the effectiveness of IRS policies, procedures, and processes that gave rise to the original audit assessments. However, the IRS does not analyze the reasons why these assessments increasingly result in reconsiderations.

The IRS controls all initial examinations on the Automated Information Management System (AIMS). It uses AIMS to assign returns, track audit results, cycle time, case dispositions, and generate management reports.[13] However, the IRS does not use AIMS for managing audit reconsiderations, which originate from many assessment sources.[14] Instead, it generally controls them on the Correspondence Examination Automation Support (CEAS) system,[15] which reports inventory counts but cannot track audit results, cycle time, and overage cases.[16]

The CEAS system cannot produce accurate reports showing the total volume of cases, original audit assessments, and tax abatement results.[17] In 2009, the Treasury Inspector General for Tax Administration (TIGTA) noted that these limitations distort the data used to develop the IRS's annual Examination work plan and lead to the omission of audit reconsideration results and cycle time from operational reports furnished to the IRS Oversight Board.[18] As a result, these reports overstate total assessments and program yield (*i.e.*,

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11 *See* IRM 4.13.1.5 (June 14, 2010); TAMIS research request (June 3, 2010). TAS audit reconsideration case receipts were 21,753 in FY 2006, 26,279 in FY 2007, 26,881 in FY 2008, and 22,286 in FY 2009. Total TAS receipts were 242,173 in FY 2006, 247,839 in FY 2007, 274,051 in FY 2008, and 272,404 in FY 2009. TAS cases were extracted from the Taxpayer Advocate Management Information System (TAMIS) database using issue codes (IC) IC 620, audit reconsideration receipts; IC 639, EITC audit reconsideration receipts; IC 670 AUR audit reconsideration receipts; and IC 680 OIC doubt-as-to-liability audit reconsideration receipts.

12 National Taxpayer Advocate 2009 Annual Report to Congress 499; National Taxpayer Advocate 2008 Annual Report to Congress 546; National Taxpayer Advocate 2007 Annual Report to Congress 642; National Taxpayer Advocate 2006 Annual Report to Congress 636; National Taxpayer Advocate 2005 Annual Report to Congress 549; National Taxpayer Advocate 2004 Annual Report to Congress 573; National Taxpayer Advocate 2003 Annual Report to Congress 424.

13 IRM 4.4.1.2 (May 19, 2009). AIMS is a computer system used by Examination and Appeals to control returns, input assessments and adjustments to the Master File, and generate management reports.

14 Examples of assessment sources include Automated Substitute for Return (ASFR), Automated Underreporter (AUR), EITC, and Correspondence Examination. An exception exists for audit reconsiderations transferred to the field, which the IRS controls on AIMS using Source Code 73, Aging Reason Code 53.

15 CEAS is a suite of web-based applications developed to enhance the campus examination process.

16 Teleconference with Small Business/Self-Employed (SB/SE) and Wage and Investment (W&I) division staff (June 14, 2010). The IRS did not establish program goals for audit reconsiderations by work stream for FY 2007 through FY 2009. SB/SE, *Business Performance Review* 11-17 (Aug. 12, 2008).

17 TIGTA, Ref. No. 2009-40-099, *The Discretionary Examination Program Performance Results Are Incomplete; Therefore, Some Measures Are Overstated and Inaccurate* 8 (Aug. 6, 2009); TIGTA, Ref. No. 2001-40-053, *Audit Reconsideration Cases Create Unnecessary Burden on Taxpayers and the Internal Revenue Service* ii-iii, 4-5 (Mar. 2001).

18 TIGTA, Ref. No. 2009-40-099, *The Discretionary Examination Program Performance Results Are Incomplete; Therefore, Some Measures Are Overstated and Inaccurate* 2, 4, 9, 16 (Aug. 6, 2009). TIGTA based its findings on a statistical sample with a 95 percent confidence level, (+/-) six percent precision, and eight percent expected error rate.

assessments per case), and understate cycle time on case closures.[19] These limitations also impede the IRS's ability to determine why so many taxpayers requested reconsideration and to lessen taxpayer burden by reducing inappropriate audit assessments and future reconsiderations.[20]

The IRS disagreed with TIGTA's recommendation to modify its operational reports to include reconsideration cycle time in the closure results, citing cost-prohibitive programming.[21] The National Taxpayer Advocate believes the IRS should accurately assess the costs associated with the programming changes needed for AIMS, which is technically capable of tracking audit results and cycle time, and generating management reports.[22] The failure to track this information perpetuates the depletion of audit resources the IRS could redirect to productive compliance work. It also causes TAS employees to devote considerable time and effort to assisting taxpayers in audit reconsideration cases.[23]

Automated processes and mail handling delays burden taxpayers and increase the likelihood of taxpayers seeking audit reconsiderations.

The IRS's Wage and Investment (W&I) Division recently enhanced the Automated Underreporter (AUR) program, a computerized document-matching system, with automatic purging and batch processing capabilities.[24] Batch processing moves cases through the examination process automatically. If a taxpayer fails to respond precisely within the prescribed period, the case moves to the next phase in the process.[25]

The Small Business/Self-Employed (SB/SE) Division also announced plans to use batch processing in audits.[26] Its Campus Compliance Services Initiative is designed to automate processing of the initial contact letters sent to taxpayers in examination cases, requesting

19 TIGTA, Ref. No. 2009-40-099, *The Discretionary Examination Program Performance Results Are Incomplete; Therefore, Some Measures Are Overstated and Inaccurate* 2, 4, 9, 16 (Aug. 6, 2009). TIGTA based its findings on a statistical sample with a 95 percent confidence level, (+/-) six percent precision, and eight percent expected error rate.

20 *Id.* at 12. *See also* TIGTA, Ref. No. 2001-40-053, *Audit Reconsideration Cases Create Unnecessary Burden on Taxpayers and the Internal Revenue Service* 4-5 (Mar. 2001).

21 TIGTA, Ref. No. 2009-40-099, *The Discretionary Examination Program Performance Results Are Incomplete; Therefore, Some Measures Are Overstated and Inaccurate* 2, 4, 9, 16 (Aug. 6, 2009).

22 For example, audit reconsiderations may be tracked on AIMS as a reopening of the case – reversing the AIMS status code from status 90 (closed), to an open examination status (*e.g.*, status 12 or one uniquely created specifically for audit reconsiderations). Currently some audit reconsiderations are reassigned from the Central Reconsideration Unit to campuses and field offices because of complexity using AIMS source code 73, with an aging reason code 53 (reason codes are used for tracking purposes).

23 TIGTA, Ref. No. 2001-40-053, *Audit Reconsideration Cases Create Unnecessary Burden on Taxpayers and the Internal Revenue Service* 4-5 (Mar. 2001); TAMIS research request (June 3, 2010). TAS audit reconsideration case receipts were 26,279 in FY 2007, 26,881 in FY 2008, and 22,286 in FY 2009.

24 Auto-purging accommodates "virtual" cases and significantly reduces case handling. It eliminates delays in case movement by aging and batching them for the next phase in processing. Each step in the process has a pre-established period programmed into the system. Auto-batching applies to processing of approximately 2.5 million electronic returns. W&I, *Compliance FY 2010 Program Letter* 1 (Oct. 18, 2010); IRM 4.19.13.6 (Jan. 24, 2006). *See also* National Taxpayer 2008 Advocate Annual Report to Congress 248.

25 IRM 4.19.2.2.25 (Sept. 1, 2010) lists the established suspense times for notices and letters in the batch processing system. The AUR generates a "Suspense Aged Batch Report" that shows which suspense batches have met the appropriate suspense times during the previous week. The system checks for the required conditions, such as foreign address, disaster end dates, and new transactions, and allows the appropriate suspense time.

26 *See* SB/SE, *FY 2008-2009 Plan* 33, 35, 36, 39, 44, 55, 61 (Oct. 2007).

information and responses.[27] The CEAS Project is designed to implement unattended case processing for discretionary inventories, workload resolution, issue documentation, and inventory management.[28] These processes focus on greater automation and less human interaction and could increase the likelihood of taxpayers seeking audit reconsideration.

In addition, mail processing delays impede taxpayers' ability to timely respond to automated IRS correspondence and hinder IRS employees who try to help the taxpayers.[29] Both taxpayers and IRS employees have voiced concerns about the IRS's mail handling problems, as the following remarks illustrate:

- "Send the documents in, they don't get it, so I had to send again. I mailed and faxed them."[30]
- "The mail process does not work, it takes three weeks to receive correspondence from the mailroom or a fax from the clerical group."[31]

The National Taxpayer Advocate remains concerned that "efficiency-driven" initiatives that accelerate the audit process and reduce human contact, coupled with the IRS's mail handling problems, burden taxpayers and fuel the growth of audit reconsiderations.[32]

Inconsistent, ambiguous, and often contradictory forms and publications, and confusing IRM provisions create a potential for error and excessive taxpayer burden.

The IRS requires taxpayers to request audit reconsiderations in writing.[33] However, although the IRS has a form for almost everything imaginable, it does not have one designed specifically for taxpayers requesting audit reconsideration. Taxpayers can seek reconsideration by letter, original return (Form 1040, *U.S. Individual Income Tax Return*), amended return (Form 1040X, *Amended U.S. Individual Income Tax Return*), or by filing a claim for refund and request for abatement (Form 843, *Claim for Refund and Request for Abatement*). In addition, IRS employees can initiate requests for audit reconsideration using Form 3870,

27 The CCS Initiative is designed to automate the CP 2501, *Initial Contact to Resolve Discrepancy Between Income, Credits, and/or Deductions Claimed on Return and Those Reported by Payer*, purge process and expand auto-batching processes. *See* IRM 21.3.1.4.63 (Aug. 17, 2010).

28 *See* SB/SE, *FY 2008-2009 Plan* 33, 35, 36, 39, 44, 55, 61 (Oct. 2007).

29 *See* Most Serious Problem: *The IRS Does Not Process Vital Taxpayer Responses Timely*, and Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail to Taxpayers, infra/supra*. *See also* TIGTA, Ref. No. 2009-40-099, *The Discretionary Examination Program Performance Results Are Incomplete; Therefore, Some Measures Are Overstated and Inaccurate* 6 (Aug. 6, 2009). TIGTA found that mail handling delays contributed to the average 159 days examiners took to close audit reconsideration cases in FY 2007. IRS, *Lean Six Sigma Exam Mail Project Oversight Board Briefing* 3 (Mar. 24, 2010). The IRS has acknowledged there are many inconsistencies among its campuses in handling aged mail, and is working to expedite mail handling.

30 IRS, *Lean Six Sigma Exam Mail Project Oversight Board Briefing* 3 (Mar. 24, 2010) (quoting taxpayer from phone focus groups).

31 *Id*.

32 *See, e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 287; TIGTA, Ref. No. 2001-40-053, *Audit Reconsideration Cases Create Unnecessary Burden on Taxpayers and the Internal Revenue Service* 1-3 (Mar. 2001); IRS, *Lean Six Sigma Exam Mail Project Oversight Board Briefing* 2, 5 (Mar. 24, 2010).

33 IRS, Pub 3598, *What You Should Know About the Audit Reconsideration Process* (Aug. 2008); IRM 4.13.2.3 (Dec. 31, 2009); IRM 5.1.15.6 (Oct. 3, 2006).

Request for Adjustment. The numerous ways to open an audit reconsideration make the process overly complicated and cumbersome for both taxpayers and IRS employees.

IRS Publication 3598, *What You Should Know About the Audit Reconsideration Process*, recommends (but does not require) that taxpayers submit copies of their examination reports (Form 4549, *Income Tax Examination Changes*) with requests for audit reconsideration. The mailing instructions, however, direct taxpayers to send requests to the IRS campuses shown on the reports. As a result, taxpayers who have lost or misplaced the reports may have difficulty in determining where to mail their requests.

Instructions for appealing an audit reconsideration are disjointed, circular, and difficult to follow.

Taxpayers who disagree with the outcome of an audit reconsideration may appeal the decision. Examiners are required to provide Publication 3598, *What You Should Know About the Audit Reconsideration Process*, and Publication 5, *Your Appeal Rights and How to Prepare a Protest If You Don't Agree*.[34] Publication 3598 instructs taxpayers to file a written "small case request" or a "written protest" and directs them to the section of Publication 5 entitled "Protests." However, Publication 5 makes no actual mention of the audit reconsideration process. It further implies that taxpayers may have recourse in the courts if they disagree with the IRS Appeals function, and directs them to follow the instructions in the audit reconsideration denial letters they received from the IRS – which direct taxpayers back to Publication 5. This roundabout flow of information fails to provide taxpayers with any additional guidance for requesting an appeal.[35]

IRM guidance on audit reconsiderations may confuse IRS employees and taxpayers, and cause excessive taxpayer burden.

Audit reconsiderations differ from claims for refunds in that they generally do not result in refunds.[36] However, IRM guidance explaining audit reconsiderations may be confusing to taxpayers and IRS employees as demonstrated by some excerpts below:

- "An informal claim known as an Audit Reconsideration."[37]

34 IRM 4.13.4.4(2) (Oct. 1, 2006); IRM 4.13.6 (Dec. 31, 2009); IRM 4.13.3.16 (Oct. 1, 2006); IRM 4.13.4.4 (Oct. 1, 2006); IRS, Publication 5, *Your Appeal Rights and How to Prepare a Protest If You Don't Agree* (Jan. 1999).

35 IRS Letter 3340C, *Audit Reconsideration Denial Letter* (Sept. 6, 2005); Letter 2726 (DO), *Audit Reconsideration Denial Letter* (Sept. 2000); Letter 2737 (DO), *Audit Reconsideration Partial Disallowance Letter* (Sept. 2000). *See also* National Taxpayer Advocate 2004 Report to Congress vol. 2, 19 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*) (stating that many EITC taxpayers cannot understand the IRS letters they receive).

36 To file a claim, a taxpayer must pay the tax and request a refund, not merely request an abatement of an unpaid tax as with an audit reconsideration. However, the reconsideration of audit deficiencies involving the disallowance of refundable tax credits, such as the EITC or the Additional Child Tax Credit (ATC), can result in refunds. Audit reconsiderations also can generate refunds if taxpayers have paid down their liabilities, *e.g.*, through installment payments or refund offset.

37 IRM 4.2.6.4(1) (June 1, 2007). In response to an inquiry by TAS and the Special Counsel to the National Taxpayer Advocate, the IRS has agreed to correct the inaccurate language in this provision.

- "An informal claim is one that is submitted by the taxpayer either on a non-standard form (written request) or by some other means...."[38]
- "A claim for abatement is NOT an informal claim."[39]
- "Audit reconsiderations are not formal claims since the tax liability in dispute has not been paid."[40]

Guidance for employees is also confusing regarding the suspension of collection activity when taxpayers request audit reconsideration. For example, an IRS Memorandum of Understanding states that SB/SE campus and area office employees must take the appropriate action to suspend collection while taxpayers prepare their requests for reconsideration.[41] However, IRM guidance instructs these same employees not to suspend collection action until taxpayers provide documentation to support their requests.[42] At the same time, the general guidance for SB/SE field collection employees (*i.e.*, revenue officers) requires them to suspend collection, but only on amounts they are considering for adjustment.[43] The National Taxpayer Advocate is concerned that these disparities may result in inconsistent treatment of similarly situated taxpayers, causing significant taxpayer burden.

CONCLUSION

In conclusion, the National Taxpayer Advocate offers these preliminary recommendations for improving the audit reconsideration processes and procedures:

1. Reprogram AIMS to control and track audit reconsideration results from all assessment sources;
2. Standardize and consolidate IRM procedures to provide for consistent and uniform treatment of audit reconsiderations;
3. Create a separate form and instructions for taxpayers requesting audit reconsideration;
4. Revise Publication 5 and Publication 3598 as well as Letters 3340C, 2626 (DO), and 2738 (DO), to provide clear, non-circular instructions for appealing an audit reconsideration denial and a mailing address to submit requests for audit reconsideration and appeal; and
5. Clarify guidance regarding collection holds during an audit reconsideration.

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38 IRM 4.10.8.9 (Aug. 11, 2006).

39 *Id*.

40 IRM 8.7.7.13.1 (Oct. 26, 2007).

41 Conference call with SB/SE (May 27, 2010); IRS, *Memorandum of Understanding Between Small Business/Self-Employed Division and Area Office Examination Concerning Area Office Audit Reconsideration Cases* 1 (July 27, 2008).

42 IRM 4.13.1.4 (Oct. 1, 2006) and 4.13.2.3 (Dec. 31, 2009).

43 IRM 5.1.15.3.1 (Apr. 16, 2010).

IRS COMMENTS

The IRS acknowledges an increase in the number of correspondence examination audit reconsiderations, and continues to analyze ways to improve the initial correspondence examination process to reduce reconsiderations. Reducing taxpayer burden is an essential part of providing top quality customer service to the public. This goal, as well as increasing the effectiveness of voluntary compliance, is always on the forefront of IRS programs. Each year, new initiatives are established to refine the correspondence examination process to improve effectiveness and meet taxpayer needs. For example, we have actively worked with the Office of Taxpayer Correspondence (OTC) to improve the language and content of our letters and look forward to implementation of these improvements once system issues are resolved.

During the reconsideration process, taxpayers are given a second opportunity to reduce their tax obligations by providing information needed to address the additional tax liability assessed. This information is considered, along with previously submitted documentation, and is another way the IRS ensures all taxpayers pay the correct tax due. This process is considerably less time consuming than the correspondence exam audit process, which also provides the taxpayer several opportunities to reply.

The National Taxpayer Advocate's report makes five specific recommendations to improve the audit reconsideration processes and procedures. The IRS is taking, or has taken, the following actions with respect to these recommendations:

The IRS requested programming changes to enhance the current CEAS reconsideration reports to reduce current system limitations.[44] Campus Examination elected to utilize CEAS for all reconsideration cases since cycle time, as well as the time to resolve the issues, is reduced. Using AIMS would require additional time for the AIMS record to be created, or AIMS extractions to be completed, before any subsequent adjustments can post to close the case. By eliminating this step, case resolution time is reduced.

However, due to the small volume of audit reconsideration cases transferred to Field Examination, they are controlled on AIMS. While AIMS is utilized for tracking the Field cases, the Field cycle time is very different than the cycle time on Correspondence Examination cases and the impact to the Field cases is minimal. CEAS reports are not available to Field Examination to effectively track cases using this method.

While the IRS agrees reprogramming AIMS may be the optimal method to track reconsideration case measures, because of current budget constraints, doing so is not a viable solution at this time. The IRS is exploring other options, such as the use of the Enforcement Revenue Information System. The IRS is currently communicating with ERIS programmers and determining requirements for testing. In the interim, the IRS is

44 FY 2011 Report Generating Software, Unified Work Request, WEX100028OTH.

utilizing RGS/CEAS reports for volume of cases, original audit assessments, and tax abatement results to monitor the Audit Reconsideration program. In addition, the IRS considers feedback received from taxpayers and/or their representatives from multiple sources such as Tax Forums and customer satisfaction surveys, to improve programs and procedures making voluntary compliance easier.

The IRS strives for consistency in IRM procedures and uniform treatment of audit reconsiderations. In doing so, IRMs are reviewed and updated annually. Feedback from all sources, including IRM users, is taken into consideration by the IRM authors and used in determining IRM areas needing further clarification or correction. The areas for possible improvement noted in the National Taxpayer Advocate's report have been elevated to the appropriate IRM authors for consideration during the next IRM update.

In an effort to make the audit reconsideration process as easy as possible for taxpayers, the IRS does not require taxpayers to submit a standardized form. However, Form 12661, *Disputed Issue Verification*, is currently available for use as part of the reconsideration process. This form is designed to allow taxpayers to identify the issue(s) in dispute, provide reason for disagreement, and identify the amount per the return and the amount allowed during the audit process.

The IRS continually strives to ensure guidance is clear, providing taxpayers with the information they require. Publication 5, Y*our Appeal Rights and How to Prepare a Protest If You Don't Agree*, clearly defines the process to request an appeal of a decision made by the IRS. It further defines the process to file a claim for refund in District Court of Federal Claims. Publication 3598, *What You Should Know About the Audit Reconsideration Process*, contains the mailing addresses for the ten IRS campuses. If a request for reconsideration is mailed to an incorrect address, the request will be routed to the correct area.[45] Letter 3340C explains the taxpayer's right to appeal the decision made on his/her reconsideration within 30 days of the date of the letter. While we believe these documents provide taxpayer's understandable instructions, we will continue to review and revise our taxpayer correspondence and publications and make revisions where necessary.

The IRS believes that guidance regarding collection holds is clearly defined in the Reconsideration and Collection IRMs.[46] When reconsiderations are received in Examination, collection activities are suspended until an examiner reviews the case to determine if the taxpayer has provided the additional documentation for all issues requiring reconsideration. Upon completion of the review of the reconsideration request, the collection activity suspense is reviewed to determine subsequent actions.

45 IRM 4.13.3.4 (Oct. 1, 2006).

46 IRM 4.13.1.4 (Oct. 1, 2006); IRM 5.1.15 (Apr. 16, 2010).

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased with the IRS's commitment and increased focus on reducing taxpayer burden and providing top quality customer service to taxpayers during audit reconsiderations. Despite the efforts of the IRS to stem the number of audit reconsiderations by working to improve correspondence examination letters and processes, audit reconsiderations have reached an all time high and continue to grow. The audit reconsideration process remains confusing and overly burdensome to the ever-growing number of taxpayers and the IRS employees working to assist them.

The IRS contends that the audit reconsideration process affords taxpayers a second chance to reduce their liabilities and is considerably less time-consuming than the correspondence examination process. While we agree that audit reconsiderations do allow taxpayers a second chance to present arguments that may reduce their liabilities, such a process comes at a significant cost. Audit reconsiderations constitute rework that IRS employees must perform after conducting and closing original examinations. Reconsiderations are time-consuming, costly, and prevent the IRS from directing resources to other productive compliance work.[47]

The National Taxpayer Advocate is pleased that the IRS recognizes the need to track audit reconsideration case measures. She also acknowledges that budget constraints must be considered in system reprogramming requests. However, while the IRS acknowledges reprogramming AIMS is the optimal method to track reconsiderations, it has opted to pursue other methods such as programming modifications to CEAS and retooling ERIS without offering any analysis of the cost-effectiveness of these system enhancements compared to the costs associated with reprogramming AIMS. It is also unclear whether the suggested programming changes would enable RGS/CEAS or ERIS to measure audit reconsideration cycle time and closure results.[48] The National Taxpayer Advocate would support any cost-effective alternative method of measuring audit reconsideration closure results and cycle time, and offers TAS's assistance in developing such a method. To improve the effectiveness of correspondence examinations, the IRS should routinely pull a representative sample of audit reconsiderations from CEAS to analyze the outcomes and direct appropriate policy changes for original audits.

The National Taxpayer Advocate appreciates the IRS's willingness to clarify IRM provisions regarding audit reconsiderations and looks forward to reviewing the changes. However, she remains concerned that the IRS perceives the absence of a standardized form, designed specifically for taxpayers requesting audit reconsideration, as making the process "as easy as possible" for taxpayers. The variety of methods for requesting an audit reconsideration

47 TIGTA, Ref. No. 2009-40-099, *at* 4, 6, 23.

48 The IRS disagreed with TIGTA's recommendation that operational reports should be modified to include audit reconsideration cycle time, citing cost prohibitive programming changes. *See* TIGTA, Ref. No. 2009-40-099, *at* 9-10, 23.

can confuse taxpayers. For example, in its comments the IRS points to Form 12661 (9-2000), *Disputed Issue Verification Resolution*, as yet another way taxpayers can initiate an audit reconsideration. The form allows taxpayers to state why they disagree with the IRS's decisions in an audit. It has entries for the disputed item, why the item is in dispute, and a comparison of the amount claimed on a return versus the amount allowed on the audit report. However, the IRS does not describe the form in Publication 3598, *What You Should Know About the Audit Reconsideration Process*, nor does it mention it in the associated IRM provisions that address audit reconsiderations. Creating a separate, standardized form for audit reconsideration, or at least identifying Form 12661 as a method of requesting audit reconsideration, and revising taxpayer correspondence and publications to provide clear, non-circular instructions that refer to such a form, will alleviate taxpayer burden and improve the audit reconsideration process.

Finally, the National Taxpayer Advocate believes the IRM guidance regarding the suspension of collection activity in reconsideration cases can be improved to address the mechanical aspects of collection holds in these cases. The IRS should revise and consolidate this guidance to cross-reference specific collection hold instructions to employees in different functions.

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Develop a method to control and track audit reconsideration results including the cycle time from all assessment sources.
2. Institute a program of reviewing representative samples of audit reconsiderations from CEAS to analyze the reasons for and the outcomes of audit reconsiderations and identify program and policy changes for underlying correspondence examination procedures.
3. Clarify guidance in publications and instructions that taxpayers can use Form 12661, *Disputed Issue Verification Resolution*, to request audit reconsideration in writing.
4. Revise Publications 5 and 3598 as well as Letters 3340C, 2626 (DO), and 2738 (DO), to provide clear, non-circular instructions for appealing an audit reconsideration denial and a mailing address to submit requests for audit reconsideration and appeal.
5. Clarify guidance regarding collection holds during an audit reconsideration.

MSP #12 Persistent Breakdowns in Power of Attorney Processes Undermine Fundamental Taxpayer Rights

RESPONSIBLE OFFICIALS

Richard E. Byrd Jr., Commissioner, Wage and Investment Division
Chris Wagner, Commissioner, Small Business/Self-Employed Division
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DEFINITION OF PROBLEM

The Internal Revenue Code (IRC) sets forth a basic taxpayer right to representation before the IRS.[1] Yet IRS processes and systems designed to recognize and record power of attorney (POA) information continue to frustrate taxpayers and their representatives attempting to comply with filing and payment responsibilities. For example, in early 2010 the IRS's Centralized Authorization File (CAF) unit, which is responsible for processing POA requests, experienced significant delays.[2] In April 2010, the delays became so overwhelming that the IRS suspended normal processing timeframes (two to three days for faxed receipts) and extended processing timeframes to 15 days upon receipt, even for Taxpayer Advocate Service (TAS) priority cases.[3]

Between 2004 and 2009, the number of POA forms filed by individual taxpayers jumped from nearly one million to 1.8 million, an increase of 83 percent.[4] While the IRS has not identified the cause of this increase, staffing dedicated to POA processing has declined by nearly 20 percent since 2004.[5] The Treasury Inspector General for Tax Administration (TIGTA) recently estimated that 60,675 taxpayer representatives may not have been provided lien notices between June 30, 2008 and June 30, 2009, potentially violating the taxpayers' right to have their representatives notified of a lien filing.

When the IRS fails to timely or properly record a valid POA request on its CAF, or link common databases such as the Automated Lien System (ALS) to the CAF, taxpayers may experience difficulties including:[6]

- Lack of or impaired representation;
- Adverse IRS action, such as unnecessary liens and levies;

1 IRC § 7521(c) provides that taxpayers have the right to be represented in their tax matters.

2 The CAF assigns unique identifiers to authorized representatives (Form 2848) and appointees (Form 8821) and maintains the data with linkages to the appropriate taxpayer accounts and tax modules. This system is part of the Integrated Data Retrieval System (IDRS).

3 Internal Revenue Manual (IRM) 21.3.7.1.7 (Oct. 26, 2009); Servicewide Electronic Research Program (SERP) Alert 100232 (Apr. 27, 2010).

4 IRS, Compliance Data Warehouse (CDW) Individual Master File (IMF) Transaction File, Processing Years 2004-2009 (Aug. 2010).

5 IRS, Wage and Investment (W&I) division response to TAS questions (Oct. 19, 2010). In fiscal year (FY) 2004, the CAF unit had a total of 252 employees and in FY 2009 the number had declined to a total of 206 CAF Unit employees. W&I stated that all CAF sites have trained additional staff to assist when inventory spikes.

6 The ALS generates Notices of Federal Tax Lien (NFTL) and releases of liens, and maintains a database of all pertinent lien information.

- Lengthy delays in processing of tax returns and associated refunds; and
- Inadvertent disclosure of personal tax information.

Additionally, POA processing delays and systemic setbacks also hamper the ability of Low Income Taxpayer Clinics (LITCs) to represent taxpayers before the IRS.[7] Because many LITCs rely on student assistance, delays in POA processing affect staff levels and limit the effectiveness of LITC representation.

ANALYSIS OF PROBLEM

Background

A taxpayer must file a Form 2848, *Power of Attorney and Declaration of Representative*, or Form 8821, *Tax Information Authorization*, with the CAF to appoint a third party to represent him or her in dealings with the IRS.[8] The unit assigns a unique identifier to the authorized representative (Form 2848) or appointee (Form 8821), and maintains the data with links to the appropriate taxpayer accounts and tax modules that make up the Integrated Data Retrieval System (IDRS).[9]

During the past six years, the number of POA forms filed by individual taxpayers grew 83 percent as shown in Chart 1.12.1 below.[10]

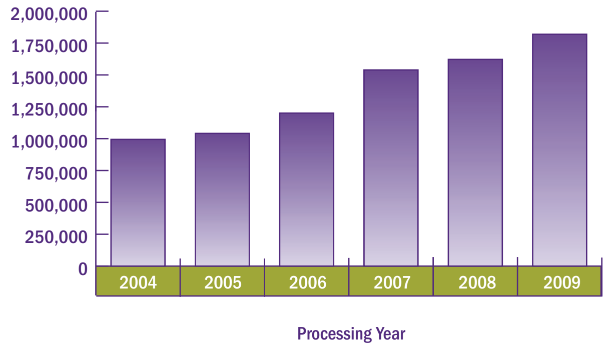
7 *See generally* IRC § 7526. The LITC program serves individuals whose income is below a certain level and require assistance with the IRS. LITCs are independent from the IRS and most LITCs can provide representation before the IRS or in court on audits, tax collection disputes, and other issues for free or for a nominal fee.

8 *See generally* IRM 21.3.7 (Apr. 17, 2009).

9 IDRS consists of databases and operating programs that support IRS employees working active tax cases within each business unit. This system manages data retrieved from the Master File, allowing employees to take actions on account issues, track status, and post updates back to the Master File.

10 IRS, CDW IMF Transaction File, Processing Years 2004-2009 (Aug. 2010).

FIGURE 1.12.1, Volume of Power of Attorney Filings[11]



CAF Unit Delays and Unlinked Databases Harm Taxpayers

IRS Databases are not Linked

When the IRS has a valid POA on file, it is required to send all original correspondence to the taxpayer and provide a copy to the representative unless the taxpayer has indicated otherwise on Form 2848.[12] However, two key IRS databases – the Automated Offer in Compromise (AOIC)[13] system and the ALS – are not linked to the CAF, and therefore do not systemically copy IRS correspondence to taxpayers' representatives.[14]

In her 2009 Annual Report to Congress, the National Taxpayer Advocate expressed concern about the impact of systemic POA processing errors on a POA's ability to effectively represent his or her client.[15] These consequences range from taxpayers missing important deadlines, such as filing for a Collection Due Process (CDP) hearing, to small businesses going out of business because of a lien or levy.[16] A recent TIGTA report states that while the IRS error rate for notices of federal tax lien has declined from 76 percent in FY 2006 to 26 percent in FY 2010, the potential for violations still exists in approximately one out of every four cases requiring taxpayer representative notification.[17]

11 This chart includes individual taxpayer POAs filed with either Form 2848 or Form 8821.

12 Treas. Reg. § 601.506; IRM 13.1.10.3.1 (Oct. 31, 2004).

13 The AOIC application tracks and controls almost all IRS offer in compromise activity.

14 TIGTA, Ref. No. 2010-30-072, *Additional Actions Are Needed to Protect Taxpayers' Rights During the Lien Due Process* (July 9, 2010). IRC § 6320 requires the IRS to notify taxpayers in writing, at their last known address, about filings of a NFTL within five business days of the lien filings.

15 National Taxpayer Advocate 2009 Annual Report to Congress 256-271.

16 The filing of an NFTL negatively affects taxpayer credit and may preclude access to business financing. IRM 5.1.9.3.1 (Nov. 28, 2008).

17 TIGTA, Ref. No. 2010-30-072, *Additional Actions Are Needed to Protect Taxpayers' Rights During the Lien Due Process* (July 9, 2010).

As a result of TAS and TIGTA recommendations, the IRS changed its programming to improve the rate at which representatives receive required tax lien notices. The corrective actions, which affect the Integrated Automation Technologies (IAT) tool used by IRS employees,[18] will allow for a systemic upload of representative information directly from the CAF to the ALS and will submit taxpayer representative notifications to ALS for each lien when the IRS requests multiple liens. Although the IAT tool will not interface with AOIC, procedures are in place to ensure that a representative will receive a copy of the offer in compromise (OIC) correspondence when authorized by the taxpayer.[19] The National Taxpayer Advocate applauds the IRS for committing to these changes but remains concerned about the timelines for entering POAs onto the CAF system.

CAF Unit Experiences Significant Delays, Impeding Practitioners Ability to Represent Their Clients

In 2009, the IRS's Wage and Investment division stated that its Correspondence Imaging System (CIS), a paperless fax system, would be implemented in 2010.[20] When the system did not materialize as promised, the IRS informed TAS that budgetary constraints were preventing implementation. Yet as necessary technological upgrades are put on hold, so is vital service to taxpayers.

For example, between January and June 2010, the normal three-day CAF processing timeframe for faxed receipts extended to a month or longer.[21] In addition to the numerous concerns discussed with the National Taxpayer Advocate during practitioner meetings throughout the country, unresolved and ongoing delays have generated more than 100 POA related submissions through TAS's Systemic Advocacy Management System (SAMS) since 2001.[22]

When the CAF unit does not acknowledge that it received fax submissions, practitioners may send duplicates, which exacerbates the backlog problem. Use of the CIS would enhance efficiency in the CAF unit by timely and accurately processing POA submissions via electronic inventory management. An electronic system also would eliminate inefficiency associated with fax breakdowns and lost or misplaced paper submissions. Along with providing immediate acknowledgements, such a system would allow the IRS to reduce the large backlogs and avoid costly rework and potential adverse actions for taxpayers.

18 Formerly known as the IDRS Decision Assisting Program (IDAP), IAT supplies automated tools to IRS employees to simplify research, reduce keystrokes, and increase the accuracy of regular work processes.

19 New POA information that is received with the offer but not on IDRS is forwarded to the CAF unit and loaded on AOIC. Once authorized representative information is loaded on AOIC, all correspondence generated by the system will include a copy for the POA.

20 W&I response to TAS questions (June 22, 2009). The Correspondence Imaging System (CIS) captures images of letters, returned notices and standard forms, which are scanned and electronically routed to employees.

21 TAS LITC Academic Clinic Conference Call discussion on May 2, 2010, and Sept. 30, 2010 ("Actual CAF processing delays were a month or longer during the CAF backlog timeframe January through June 2010.").

22 SAMS is a TAS application and acts as the primary method of receiving and prioritizing systemic issues and problems submitted by IRS employees and the general public.

To illustrate how processing delays can cause taxpayer and practitioner harm and frustration during a time sensitive tax crisis, consider the following example:

> **Example:** A taxpayer receives a Notice of Intent to Levy requiring a response in 30 days. The taxpayer seeks professional help from an attorney, who immediately files a Form 2848 with the IRS. The attorney attempts to respond to the IRS using the number provided on the levy notice, and calls the Automated Collection System (ACS). However, there is no record of the POA form on the CAF system so the ACS employee advises the tax practitioner that she cannot talk to him. A copy of the Form 2848 is then faxed to the ACS site (per IRM 21.1.3.3 guidance) but the employee still refuses to discuss the tax matter until the POA form shows up on the CAF. The practitioner then waits for the POA form to be processed, which takes over a month. In the meantime, the IRS levies upon the taxpayer's bank account. The attorney's POA form is ultimately processed, and the IRS returns the levied proceeds. The IRS's untimely POA processing along with confusion over internal procedures impedes the attorney's ability to provide effective representation and creates rework for the IRS.[23]

These types of problems became critical in April 2010 when a processing backlog required the IRS to tell its employees that normal POA processing timeframes would be suspended. These timeframes applied to both the Practitioner Priority Service (PPS) and TAS,[24] were far outside normal processing guidelines, and severely affected practitioners' ability to represent their clients.[25]

TAS urged the IRS to revise its guidance to employees to include an exception to the 15-day timeframe for PPS and TAS priority cases, thereby permitting the IRS to expedite the processing of time-critical tax issues where potential adverse actions existed. The National Taxpayer Advocate is pleased that the IRS issued revised guidance for TAS requests.[26]

Taxpayers Are Harmed When Low Income Taxpayer Clinics Are Unable to Provide Timely Service.

The National Taxpayer Advocate is pleased with the recent dialogue established between TAS and W&I about LITC POA issues, but remains concerned by the IRS's stance regarding this vital program's representation of low income taxpayers. LITC directors have the primary responsibility to monitor their student POAs, and a duty to their clients and the IRS according to Circular 230.[27] Students derive their authority through the LITC director (a Circular 230 representative) and must be cleared by the IRS Office of Professional Responsibility (OPR)

23 Although the IRS states that this example "ignores the reality of how the majority of POAs interact with the Service," TAS's experience suggests otherwise. TAS has cases in its inventory, a SAMS submission on the issue, and regularly hears complaints from practitioners that when it has not processed POA forms, the IRS sometimes refuses to deal with the attorney and the taxpayer essentially must proceed unrepresented until the IRS processes the form.

24 IRS, SERP Alert 100232 (Apr. 27, 2010).

25 IRM 21.3.7.1.7 (Oct. 26, 2009). Receipts received in the CAF are processed in 24 hours from receipt for priority faxes originating from Practitioner Priority Services , TAS, and large corporations, and two business days from receipt in the CAF function for all other fax receipts.

26 SERP Alert 100232 Revision (July 2, 2010).

27 Treas. Dept. Cir. No. 230, 31 CFR, Subt. A, Pt. 10.

before being added to a POA form.[28] Moreover, the LITCs operate under the scrutiny of TAS, the Government Accountability Office (GAO), and TIGTA, and all clinic grantees are required to attend an annual week-long conference conducted by the IRS.[29]

For all of these reasons, LITCs with student representatives require special rules to protect taxpayers without placing additional burden on taxpayers, clinics, and the CAF unit. If the taxpayer authorizes the clinic director to substitute a student as a POA, the director must submit a second Form 2848, with a copy of the initial Form 2848 signed by the taxpayer, *for each student representative.*[30] Once the second Form 2848 has been processed, the student's POA status will remain valid for only 130 days from the time it is received in the CAF unit.[31] When this period expires, the clinic must resubmit the form. The student's POA status often expires at the end of the semester. However, some clinics' semesters go beyond the 130 days, paralyzing the student's ability to work cases.

Requiring clinics to repeatedly resubmit forms is burdensome and time-consuming, and exacerbates the tax problems facing low income clients.[32] The IRS should revise Form 2848 (or create a POA form specifically for LITCs) to allow the LITC director, as a primary representative, to substitute student POAs at the end of an academic term with new students without submitting a second form should the student's term end before the taxpayer's problem is fully resolved. LITC directors should have authority to simply submit a letter (or a simplified POA form) with attached new OPR special orders to a designated CAF unit employee for substitution of these student POAs or delegation of authority to new student POAs.[33] By adopting this proposal, the IRS would improve clinics' service to their low income clients and save scarce resources that the clinics could then use to help the clients.[34] This would solve a problem that has frustrated student tax clinics and LITC services for decades.

28 IRS, Publication 4134 (Mar. 2010). There are currently 160 LITCs. A copy of the OPR special order authorizing practice before the IRS must be attached to the power of attorney form (Form 2848) and submitted to the CAF unit. IRM 21.3.7.9.6 (Oct. 26, 2009); IRM 5.1.10.5.2 (Aug. 21, 2006). Some non-academic clinics also utilize student interns under arrangements with law or business schools.

29 IRS, Publication 3319, *Low-Income Taxpayer Clinics Grant Application Package Book* (May 2010). TAS oversight includes six-month and annual reviews, and site visits at least once every three years. All clinics grantees are required to attend an annual weeklong conference conducted by the IRS.

30 Form 2848, *Power of Attorney and Declaration of Representation* (June 2008). Under current procedures, the taxpayer may authorize his or her representative (including LITC directors) to substitute or delegate authority to another representative by adding this authority in the space provided on line 5 of Form 2848, however, entering information on Line 5 constitutes a modification that will prevent the representative from using e-services.

31 IRM 13.2.2.6.1 (July 16, 2009).

32 National Taxpayer Advocate 2009 Annual Report to Congress 260-262 (see specifically recommendation 3 on page 262).

33 LITCs are required to enter into "*Pro Bono* Representation Agreements" with all clients, setting out the terms of representation (including naming the issue(s) and that indicating that there is no or nominal fee). Therefore, the clinics could be required to add a line to the *pro bono* representation agreement informing the taxpayer that at the end of the semester another student may be substituted, the taxpayer has the right to request another student, and the clinic director or other faculty member remains the primary representative.

34 IRM 21.3.7.9.6 (Oct. 26, 2009); IRM 5.1.10.5.2 (Aug. 21, 2006).

IRS Employees Often Do Not Adhere to Taxpayer Representative Designations, Thus Violating the Direct Contact Provisions of IRC § 7521.

The Code generally prohibits disclosure of tax return information to third parties unless the taxpayer has given the IRS consent to disclose this information to a designated representative.[35] The Code's direct contact provisions specifically require IRS employees to:

- Stop a taxpayer interview whenever a taxpayer asks to consult with a representative; and
- Obtain their immediate supervisor's approval to contact the taxpayer instead of the representative if the representative is unreasonably delaying the completion of an examination or investigation.[36]

Between October 2008 and September 2009, TIGTA reported four instances in which employees improperly bypassed taxpayer representatives.[37] However – for the 12th consecutive year – TIGTA said it could not give an opinion on how well the IRS is complying with IRC restrictions on direct contact because of limitations within the IRS's management information systems. In considering the significance of this limitation, TIGTA reported, "it is important to recognize that the evidence obtained and evaluated over the years suggests potential direct contact violations are very small considering that thousands of IRS enforcement personnel routinely interact with millions of taxpayers and their representatives each year."[38] However, there was no evidence that a representative or taxpayer complaint was ever filed in the four instances where TIGTA confirmed that IRS personnel improperly bypassed taxpayer representatives.

Practitioners from the LITC program and the American Institute of Certified Public Accountants (AICPA) have raised concerns that IRS employees in various functions have bypassed representatives without reason and without regard for the bypass procedures.[39] In an informal review cited in the 2009 Annual Report, the National Taxpayer Advocate found eight potential POA bypass violations, of which only one was elevated to TIGTA for investigation.[40]

Between FY 2009 and FY 2010, the IRS hired nearly 1,200 compliance employees.[41] While the IRS recently revised its new hire training curriculum to include more emphasis on taxpayer rights, and requires its managers to conduct regular reviews that measure

35 *See generally* IRC §§ 6103(c) and 7521(b)(2) and (c); Treas. Reg. § 301.6103(c)-1; IRM 11.3.3 (Mar. 18, 2008); IRM 4.11.55.3 (Jan. 15, 2005); and IRM 5.1.1.7.7 (Aug. 21, 2006).

36 IRC §§ 7521(b)(2) and (c).

37 TIGTA, Ref. No. 2010-30-060, *Statutory Review of Restrictions on Directly Contacting Taxpayers* 7 (June 3, 2010).

38 *Id*.

39 TAS Teleconference with AICPA (Aug.18, 2009) and ABA LITC Teleconferences (Sept. 21, 2009; May 27, 2010; and Sept. 30, 2010).

40 National Taxpayer Advocate 2009 Annual Report to Congress 261.

41 1,193 new IRS compliance employees (job series 1169 (revenue officer (RO)); 512 (revenue agent (RA)); 526 (tax compliance officer (TCO)); and 962 (ACS customer service representative (CSR)) were hired between August 29, 2009 and August 28, 2010. IRS Human Resources website, http://persinfo.web.irs.gov/track/workorg.asp (last visited Oct. 13, 2010).

conformance with POA guidelines, it needs better education and management controls to increase awareness of these procedures.[42] Further, the National Taxpayer Advocate remains concerned that, in the absence of an effective measurement system, violations are going undetected. She reiterates her prior recommendations for the IRS to establish a process of gathering and tracking taxpayer and POA complaints on direct contact violations and provide, at minimum, mandatory annual training for all contact employees.[43]

The IRS Should Send Dual Confirmation Letters for Address Changes of Taxpayers Using Third Parties.

When a POA changes a taxpayer's address of record with the IRS and the IRS does not notify the taxpayer, he or she may be left unaware of any tax delinquencies created by the representative's actions. For example, in the *Firstpay* case,[44] a third party payer (TPP) routinely asked its customers to sign a POA on Form 2848, and then changed the customers' addresses on Forms 941, *Employer's Quarterly Federal Tax Return*, to its own. Thus, the affected employers did not receive delinquency notices from the IRS.[45] The IRS Criminal Investigation function found thousands of such notices at the defunct TPP's place of business.[46] Acting on the National Taxpayer Advocate's recommendation that the IRS should implement dual address change letters alerting employers that a third party has initiated a change of address in cases where the third party payer has access to the client employer's funds, the IRS's Small Business/Self-Employed (SB/SE) Collection Policy function, Office of Chief Counsel, and TAS created a team in 2009 to work on these so-called "Are You There?" letters. This team is studying the viability of and funding for adopting the National Taxpayer Advocate's recommendation.[47] TAS applauds the IRS's efforts and encourages the IRS to resolve the issue in FY 2011.

CONCLUSION

Although the IRS has improved POA processing, practitioners are still plagued by delays and errors often caused by inefficient and outdated systems, along with inadequate staffing. As illustrated, these POA processing problems impair practitioners' ability to represent their clients, thereby undermining fundamental taxpayer rights.

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42 All compliance employees are trained on Publication 1, *Your Rights as a Taxpayer*, which discusses the taxpayer's right to representation.

43 National Taxpayer Advocate 2007 Annual Report to Congress 140-155.

44 *Wolff v. U.S.* (*In re: Firstpay, Inc.*), No. 03-30102, 2006 Bankr. LEXIS 2339 (Bankr. D. Md. Aug. 17, 2006).

45 Present law does not define the term "third party payer," nor does it specifically authorize the IRS to promulgate regulations to that effect. Generally, IRC § 3504 allows employers to designate agents to act on their behalf to perform duties such as payment of employee wages and company payroll taxes. The IRS regulates only designated Form 2678 agents and reporting agents. *See generally* IRC § 3504; Treas. Reg. § 31.3504; Rev. Proc. 70-6, 1970-1 C.B. 420; Rev. Proc. 2007-38, 2007-1 C.B. 1442; Notice 2003-70, 2003-2 C.B. 916.

46 FirstPay, Inc., a payroll service provider business, defrauded its clients of millions of dollars in employment taxes. It routinely asked its clients to sign a Form 2848 appointing FirstPay a recognized representative, and then changed clients' addresses on file with the IRS so that the clients did not receive delinquency notices and correspondence. National Taxpayer Advocate 2007 Annual Report to Congress 337.

47 IRS Office of Chief Counsel Memorandum, Ref. No. PRESP-116879-09, *Use of Dual Confirmation Letters for Address Changes of Form 941 Filers Who Use Reporting Agents or Other Third Parties* (Aug. 19, 2009). The Office of Chief Counsel found no legal prohibition under IRC § 6103(e) to the IRS sending such dual confirmation letters to the taxpayer's prior and new addresses.

In conclusion, the National Taxpayer Advocate offers the following preliminary recommendations:

1. The IRS should establish a process of gathering and tracking taxpayer and POA complaints on direct contact violations and provide mandatory annual training for all contact employees.
2. The IRS should implement a Correspondence Imaging System (*i.e.*, a paperless fax) to prevent lengthy CAF delays and potential adverse actions to taxpayers.
3. The CAF unit should timely acknowledge receipt of all POA forms to prevent costly rework when a POA cannot determine if his or her request is being processed in a reasonable time.
4. The IRS should implement dual address change letters alerting employers that a third party has initiated a change of address in cases where the third party payer has access to the client employer's funds.
5. The IRS should create a POA form specifically for LITCs to allow the clinic director, as a primary representative, to substitute student POAs at the end of an academic term with new students.
6. W&I should conduct research to determine the cause of the increase of POA requests by individuals.

IRS COMMENTS

The IRS acknowledges that it experienced delays in processing POAs earlier this year. Due to an unexpected increase in receipts, processing timeframes were temporarily extended to 15 days. The IRS took immediate actions to address the situation including training additional staff to process overage inventory as quickly as possible. Since mid-July, the IRS has maintained a ten-day or less processing timeframe on all receipts except TAS priority cases, which continued to be processed within 24 hours of receipt.

The IRS revised IRM 21.3.7 procedures related to processing POAs and made significant updates to instructions, simplified procedures and streamlined timeframes to improve the process to avoid future delays. We appreciate the National Taxpayer Advocate for acknowledging these steps were taken.

The IRS also partnered with the practitioner community to educate tax practitioners on Power of Attorney and Other Third Party Authorizations, including procedural changes and ways to avoid processing delays or rejections when submitting POAs. Delays often occur when third-party representatives submit incomplete forms or send multiple submissions to the IRS. We conducted nationwide phone forums and delivered presentations through our annual Tax Forums to assist tax professionals in correctly preparing and submitting Power of Attorney Form 2848 and Tax Information Authorization Form 8821. The following topics were covered in depth and a question and answer session was included at the end of each presentation.

- Differences between Form 2848 and Form 8821;
- Overview of Authorization Forms 2848 and 8821;
- Unenrolled return preparers and Authorization Forms;
- Joint and separate Authorizations;
- Processing Authorization Forms, including processing timeframes;
- Common reasons for rejection of Authorization Forms; and
- Authorization for ordering transcripts.

While it is true that the overall number of dedicated CAF staffing declined from 2004 to 2009, the decrease is substantially due to attrition and a reduction in clerical staff. There has been only a two percent decrease in employees who actually work or process POAs. Each CAF processing site has trained alternate staff (Toll-free Customer Service Representatives (CSRs) and Inventory Control Team Clerks) to assist with processing during periods of high inventory.

Submission of a POA to the CAF is not a requirement for representation before the IRS. Any recognized representative may represent a taxpayer before any officer or employee of the IRS by providing that officer or employee with a copy of a valid POA, regardless of whether the POA has been recorded on the CAF. Recording a POA on the CAF is intended to enable IRS personnel who do not have access to the actual POA to act upon the POA (See Conference and Practice Requirements, Statement of Procedural Rules § 601.506(d)).

Although it is IRS policy to send copies of taxpayer correspondence to the taxpayer's Power of Attorney under Statement of Procedural Rules § 601-503(a), this policy does not create a representative's legal right to receive taxpayer correspondence directly from the IRS. The IRC does not mandate that the IRS provide a taxpayer's POA with copies of taxpayer correspondence.

Low Income Taxpayer Clinics

Although many students are assigned to a clinic for more than one semester, we were not aware of any clinics which have a semester that goes beyond 130 days. When a student works for the clinic for more than one semester, OPR currently requires the LITC to resubmit the student's name for approval each new semester. The 130-day period, therefore, is consistent with the period of time for which each student's special orders are approved.

The IRS generally accepts powers of attorney that satisfy the POA requirements. However, the IRS cannot record a POA on the CAF unless the POA is on a Form 2848 or a completed

Form 2848 has been attached to the document.[48] Thus, if the taxpayer authorizes the LITC director to substitute representatives on the initial POA, the LITC director may substitute the student POAs at the end of the academic term by completing a document that contains all of the necessary requirements of a POA. However, if the LITC director wants the new student POA recorded on the CAF, the Conference and Practice Requirements require that a completed Form 2848 signed on the taxpayer's behalf by the LITC director be completed. All persons who practice before the IRS are subject to these same requirements.

Taxpayer Representative Designations

Preservation of taxpayer rights is of utmost importance to the IRS and we continue to take steps to ensure our employees are aware of direct contact provisions. The IRS published a new IRM 5.1.23 (Oct. 12, 2010), *Taxpayer Representation*, that contains guidance regarding bypassing a taxpayer's representative. All compliance employees receive training on Publication 1, *Your Rights as a Taxpayer*, which discusses the taxpayer's rights to representation. In fact, the new revenue officer (RO) hire training curriculum,[49] currently in revision, will address the taxpayer's right to representation and the right to select a qualified person to represent him/her before the IRS. The RO On-the-Job Training Workshop 6,[50] offered to group managers and on-the-job instructors as part of the recruit's on-the-job training, will continue to reinforce this information. This workshop recommends discussion on the contents of Publication 1, part of which also discusses the taxpayer's right of representation as well as the IRC § 7521 requirements. These provisions are also reinforced in case studies that are contained throughout the curriculum. IRM 1.4.50.5.12 (Sept. 14, 2010), *Resource Guide for Managers*, requires group managers to ensure their group is in conformance with IRC § 7521 through meetings, reviews, visitations, or taxpayer/representative inquiries.

Preliminary Recommendations

The National Taxpayer Advocate recommends that the IRS establish a process of gathering and tracking taxpayer and POA complaints on direct contact violations and provide mandatory annual training for all contact employees. The IRS recognizes that a single violation of the provisions of IRC § 7521 is a matter of concern. However, due to the very small number of complaints involved, establishing a separate and dedicated system to gather and measure complaints on this issue, and provide mandatory annual training for all contact employees, would entail significant costs that outweigh the potential benefits. The IRS dedicates a significant amount of guidance, training, and monitoring for employees and will continue to take steps to ensure employees are adhering to the rules regarding taxpayer rights and POA procedures.

48 Conference and Practice Requirements, Statement of Procedural Rules § 601.503(b)(2).

49 Training Publication 11568-102 (*Workshop 6: Publication 1 and Other Publications*).

50 *Id*.

The IRS agrees in part with the National Taxpayer Advocate's recommendations to implement a Correspondence Imaging System (paperless fax) for use by the CAF unit. As the National Taxpayer Advocate states, we were unable to implement such a paperless fax system in 2010 due to budgetary constraints. However, the IRS is currently exploring other options, such as the Enterprise e-Fax Solution, to find alternative methods that would allow electronic inventory management and enhance the efficiency of the CAF unit in 2011.[51] This would also allow for the IRS to fully automate acknowledgement of POA receipts, as the National Taxpayer Advocate also recommends.

There is an alternative to the traditional methods for submitting POAs (mail and fax) available for eligible tax professionals. Disclosure authorization is offered through e-Services and allows tax professionals to electronically submit Form 2848 and Form 8821. This e-service expedites processing and issues a real-time acknowledgment of accepted submissions. Eligible tax professionals can complete authorization forms, view and modify existing forms, and receive acknowledgement of accepted submissions immediately.

The National Taxpayer Advocate also recommends the implementation of dual address change letters alerting employers when a third party has initiated a change of address in cases where the third party payer has access to the client employer's funds. As noted by the National Taxpayer Advocate, the IRS assembled a team comprised of Collection, Specialty Tax, TAS, Submission Processing, Office of Chief Counsel, and SB/SE Research personnel to address this issue. The team received Office of Chief Counsel advice noting that the change of address notices may only be sent in limited circumstances when the IRS has reason to believe that the address change was not authorized by the taxpayer. Once this advice was received, the team began discussing options for more accurately identifying employer accounts involving third party payers and determining how many changes of address are input yearly. The team is currently working to determine the scope of the problem and discuss various approaches to addressing the change of address issue.

The National Taxpayer Advocate also recommends that the IRS create a POA form specifically for LITCs to allow the clinic director, as a primary representative, to substitute student POAs at the end of an academic term with new students. As previously stated, the IRS cannot record a POA on the CAF unless the POA is on a Form 2848 or a completed Form 2848 has been attached to the document.

Finally, the IRS agrees with the National Taxpayer Advocate's final recommendation to conduct research to determine the cause of the increase of POAs by individuals. We believe a better understanding of increasing volumes will allow us to further enhance and improve our systems and processes.

51 The Enterprise e-Fax Solution will provide an electronic fax solution that can send, receive, route, and deliver electronic fax documents. This will allow the IRS to reduce its reliance on paper records and eliminate the need for standalone fax hardware and consumables. The solution will act as a 'fax utility' or edge service that provides the fax-handling infrastructure.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS has taken steps to improve processing of POA forms by simplifying procedures laid out in the IRM and partnering with the practitioner community through phone and tax forums. She is also encouraged that the IRS will conduct research to determine the cause of the recent increases in POA CAF requests. Identifying these causes should provide valuable information, including the appropriate staffing levels, and prevent lengthy delays in the future. However, as long as POA processing problems exist, practitioners' ability to represent their clients will be impaired and fundamental taxpayer rights will be undermined.

While the 2010 spike in POA CAF requests appears temporary, the POA processing timeframes are still longer than normal, possibly due to reductions in CAF unit staffing.[52] The IRS states in its response that CAF staffing (employees who process POAs) has decreased by only two percent, compared to the previously reported 20 percent decrease in CAF unit staffing between 2004 and 2009.[53] However, the two percent figure does not include the unit's attrition rate or reductions in support staff, and does not truly reflect CAF unit staffing or its decline since 2004. Further, as demonstrated by Chart 1.12.1, Volume of Power Attorney Filings, CAF unit inventory has increased by 83 percent during the same time. It is logical to assume a correlation between staffing, inventory, and efficiency. Given the importance of the CAF unit's function, a skilled, dedicated staff is essential to maintain accurate and reasonable processing timeframes

We agree that a recognized representative may represent a taxpayer before any IRS officer or employee by providing that employee with a copy of a valid POA form (regardless of whether the POA form has been recorded on the CAF). However, there have been numerous reports from practitioners and LITCs that even when time sensitive tax issues are present, some IRS employees will not speak with a student or practitioner until the CAF records the POA form. Further, not all frontline employees have the technical expertise to validate a POA form or its submitter. Establishing an adequate, permanent staff will permit the IRS to address the increase in inventory and prevent spikes in processing time seen in the past few months. This proactive approach will also prevent the IRS from having to remove employees from its other functions to process POAs.

In its response, the IRS states that the Statement of Procedural Rules § 601-503(a) does not create a representative's legal right to receive taxpayer correspondence directly from the IRS. However, Treasury Regulation 601.506(a) expressly requires the IRS to send all original correspondence to the taxpayer and provide a copy to the representative when there is

52 IRM 21.3.7.1.7 (Oct. 26, 2009).

53 W&I response to TAS questions (Oct. 19, 2010). In FY 2004, the CAF unit had a total of 252 employees and in FY 2009 the number had declined to a total of 206 CAF unit employees. W&I stated that all CAF sites have trained additional staff to assist when inventory spikes, but if POA requests spike during filing season or other periods where campus work is high, these additional personnel may not be available to the POA unit.

a valid POA form on file, unless the taxpayer has indicated otherwise on Form 2848.[54] The IRS's attempt to ignore or explain away this regulation demonstrates its failure to grasp that the taxpayer's right to representation is a key component to a fair and just tax system. Additionally, violation of this regulation may be a cause of action for damages under IRC § 7433 for negligence in collection.[55]

Low Income Taxpayer Clinics

The National Taxpayer Advocate and the LITCs have for years advised the IRS that each clinic's semester is different, and some extend beyond the 130-day period in which a student's POA remains valid. While the OPR approves special orders, it does not regulate time for which a POA form is valid, a policy that is nonetheless burdensome for clinics in situations where a student's representation expires before the end of the semester or before a taxpayer's problem is fully resolved. Adopting the National Taxpayer Advocate's recommendation to extend the 130-day time period via a revised POA form 2848, or a newly developed LITC-specific POA form, would allow for seamless representation by LITCs and their students without violating any statutory guidelines.[56] Reducing these burdens is crucial because low income taxpayers may not have access to any other form of representation.

The National Taxpayer Advocate believes creating a POA form for the LITCs may reduce some of the burden. She understands that current procedures do not permit such a solution, but encourages the IRS to explore the possibility of designing a new form and procedures specifically for LITCs.

Taxpayer Representation Designation

The National Taxpayer Advocate is pleased that the IRS is taking steps to protect a taxpayers' right to representation. However, practitioners with the LITC program and the AICPA have raised concerns that IRS employees in various functions have bypassed representatives without reason and without regard for the bypass procedures.[57] In an informal review cited in the 2009 Annual Report, the National Taxpayer Advocate found eight potential POA bypass violations, of which only one was elevated to TIGTA for investigation.[58] Moreover, the TIGTA report states "for the 12th consecutive year it could not give an opinion on how well the IRS is complying with IRC 7521 restrictions on direct contact because of limitations within the IRS's management information systems."[59]

54 Treas. Reg. § 601.506(a). The 601 part of the regulations is signed by the Commissioner of the IRS without the approval of the Secretary of the Treasury, and therefore does not have the force and effect of law as regulations issued by the Secretary. IRC § 7805(a).

55 IRC § 7433(a) permits taxpayers to sue for civil damages in District Court when the IRS has taken an unauthorized collection action by way of an IRS employee recklessly or intentionally, or by reason of negligence has disregarded any provision of the Internal Revenue Code or any regulations promulgated there under.

56 National Taxpayer Advocate 2009 Annual Report to Congress 260-262 (see specifically recommendation 3 on page 262).

57 TAS Teleconference with AICPA (Aug.18, 2009) and ABA LITC Teleconferences (Sept. 21, 2009; May 27, 2010; and Sept. 30, 2010).

58 National Taxpayer Advocate 2009 Annual Report to Congress 261.

59 TIGTA, Ref. No. 2010-30-060, *Statutory Review of Restrictions on Directly Contacting Taxpayers* 7 (June 3, 2010).

The National Taxpayer Advocate fully understands the IRS's budget constraints and its competing priorities. However, considering the significance of an IRC § 7521 violation, the National Taxpayer Advocate remains concerned that, in the absence of an effective measurement system, violations will continue to go undetected. The National Taxpayer Advocate encourages the IRS to work with TAS to establish a process of gathering and tracking taxpayer and POA complaints on direct contact violations. This process will enable the IRS to develop better training for its employees and provide more effective oversight. At a minimum, the IRS should provide mandatory annual training for all contact employees.[60]

The National Taxpayer Advocate is encouraged to learn that the IRS agrees with her on the importance of implementing a Correspondence Imagining System or a substantially similar alternative that enhances the efficiency of the CAF. Fully automating the acknowledgement of POA receipts can effectively eliminate the backlog created by duplicate filings. The National Taxpayer Advocate applauds the IRS for taking these steps and is optimistic that they will help reduce processing time and burden for practitioners and IRS employees.

However, National Taxpayer Advocate is concerned about the alternative method of filing a POA form referenced in the IRS response – the electronic submission of Forms 2848 and 8821 through the IRS e-Services system. Several LITC directors have encountered problems with the system. For example, practitioners cannot electronically modify Form 2848 by substituting a tax representative on line 5 of Form 2848. Additionally, qualified practitioners who do not have a filing history cannot obtain access to e-Services. This policy affects students even though they derive their authority through the LITC director (a Circular 230 representative) and receive clearance by the OPR. Every e-Services user must register with the IRS's Management Information Technology Services (MITS) division. The registration process requires an ID check, including verification of the person's adjusted gross income (AGI) from his or her most recent tax return. Since many students do not have a filing requirement and therefore have no AGI to report, they cannot complete the process and are essentially excluded from the e-Services program. Both of these problems are barriers to the use of e-Services, especially for the LITCs.

Finally, the National Taxpayer Advocate is pleased that the IRS is collaborating with TAS to implement dual address change letters which will alert employers when a third party initiates a change of address (in cases where the third party payer has access to the client employer's funds). Through these efforts, she is optimistic that the IRS and TAS will achieve implementation by the close of 2011.

60 National Taxpayer Advocate 2007 Annual Report to Congress 140-155.

Recommendations

The National Taxpayer Advocate recommends that the IRS take the following specific actions:

1. The IRS should establish a process of gathering and tracking taxpayer and POA complaints on direct contact violations and provide mandatory annual training for all contact employees.
2. The IRS should implement a Correspondence Imaging System (*i.e.*, a paperless fax) or alternative system to prevent lengthy CAF delays and potential adverse actions to taxpayers.
3. The CAF unit should timely acknowledge receipt of all POA forms to prevent costly rework when a POA cannot determine if his or her request is being processed in a reasonable time.
4. The IRS should, by the close of FY 2011, finalize implementation of dual address change letters alerting employers that a third party has initiated a change of address in cases where the third party payer has access to the client employer's funds.
5. The IRS should create a POA form specifically for LITCs to allow the clinic director, as a primary representative, to substitute student POAs at the end of an academic term with new students.

MSP #13 IRS Collection Policies Channel Taxpayers Into Installment Agreements They Cannot Afford

RESPONSIBLE OFFICIALS

Chris Wagner, Commissioner, Small Business/Self-Employed Division
Richard E. Byrd Jr., Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

If a taxpayer owes $25,000 or less and agrees to pay the liability in full within five years (and before the collection statute expiration date or CSED), the IRS may accept a "streamlined" installment agreement (IA) without analyzing the taxpayer's ability to pay.[1] While streamlined IAs are appropriate for many taxpayers, an IRS study found that of the requests for streamlined IAs received by IRS toll-free Customer Service Representatives (CSR) or Automated Collection System (ACS) personnel, about 42.3 percent and 28.3 percent, respectively, were from taxpayers who *could not afford the payments.*[2]

The following IRS policies and procedures are likely to channel some taxpayers into streamlined IAs they cannot afford in lieu of more appropriate alternatives (*e.g.*, IAs with lower payments, offers in compromise (OIC), or currently not collectible (CNC) designations):

- The IRS generally requires extensive financial documentation and files a lien when taxpayers request alternatives to streamlined IAs;[3]
- The IRS uses computers and non-collection employees to process streamlined IAs in less than five minutes without asking if the taxpayer can afford the proposed payments or discussing alternatives;[4] and
- When the IRS receives a written request for an IA that does not include an acceptable payment amount, the IRS puts the taxpayer into a streamlined IA with payments sufficient to satisfy the liability within five years – without first obtaining the taxpayer's express consent – even though this practice may *violate the law.*[5]

These and other policies that channel taxpayers into streamlined IAs may divert them from more appropriate collection alternatives, prompt them to go without basic living expenses, or cause them to fall behind on taxes due in the future.

1 "Streamlined," "guaranteed," and "in-business trust fund express" IAs are all very similar and none of them require an analysis of the taxpayer's ability to pay. *See* Internal Revenue Manual (IRM) 5.14.5 (June 5, 2010). We do not discuss them separately.

2 Small Business/Self-Employed Division (SB/SE) Research, Ft. Lauderdale/Greensboro, Project 04.08.002.03, *The Impact on the Installment Agreement Default Rate When Using a "Financial Calculator"* 9 (June 2005). Surprisingly, the study concluded the IRS should not identify payment amounts that taxpayers could afford because it estimated that such a procedure would not significantly decrease short-term default rates. *Id.* at iii.

3 *See* IRM 5.12.2.4.1 (Oct. 30, 2009); IRM 5.14.1.4.2 (June 1, 2010); IRM 5.8.4.13 (June 1, 2010); IRM 5.16.1.1(4) (May 5, 2009).

4 IRM 5.19.1.3.5.1(1) (May 14, 2008).

5 IRS response to TAS information request (Aug. 18, 2010); National Office Program Manager Technical Advice, PMTA-2009-2032 (Nov. 26, 2008).

ANALYSIS OF PROBLEM

Background

Collection alternatives allow the IRS to avoid creating economic hardships, collect what is feasible, and improve voluntary compliance.

Collection alternatives allow the IRS to avoid inflicting economic hardships as it attempts to collect taxes. If a taxpayer cannot pay without experiencing an economic hardship, the IRS may classify the taxpayer's account as CNC and suspend collection.[6] If the taxpayer can pay over time, the IRS may accept an IA. If payments the taxpayer can afford will not fully satisfy the liability before the CSED, the IA is called a "partial payment" installment agreement (PPIA).[7] Another option is for the IRS to accept an offer in compromise to settle the tax debt for an amount that reflects the debtor's "reasonable collection potential."[8] These collection alternatives make sense from the government's perspective because they allow the government to collect what is feasible while promoting future compliance.[9] They also allow the IRS to focus its limited enforcement resources on other taxpayers who refuse to try to pay what they owe.

Most collection alternatives require taxpayers to submit detailed financial information and prompt the IRS to file liens.

The IRS generally requires taxpayers to provide detailed financial information before accepting a non-streamlined IA or an offer, or classifying a taxpayer's account as CNC based on hardship.[10] However, taxpayers who cannot pay their taxes are often hesitant to provide such information to the IRS.[11] In addition, standard procedures generally require the IRS to file a lien upon receipt of a request for any of these collection alternatives, particularly if the taxpayer owes $5,000 or more.[12] Thus, both taxpayers and the IRS may seek other alternatives, such as streamlined IAs.[13]

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6 *See, e.g.*, IRM 5.16.1.2.9 (May 5, 2009).

7 *See, e.g.*, IRM 5.14.2 (Aug. 5, 2010).

8 *See* Internal Revenue Code (IRC) § 7122. For a discussion of the IRS's reluctance to use OICs, see, *e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 374; National Taxpayer Advocate 2009 Annual Report to Congress 196.

9 *See, e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 374 (Most Serious Problem: *Offer in Compromise*).

10 *See, e.g.*, IRM 5.14.5 (Aug. 5, 2010) (IA); IRM 5.16.1.2.9 (May 5, 2009) (CNC); IRM 5.8.1.1.3(1) (Sept. 23, 2008) (OIC).

11 One survey of taxpayers eligible for TAS services but not using them found that about 43 percent are intimidated by the IRS and 31 percent are distrustful of the IRS. *See* Russell Marketing Research, *Findings from Task 149 – Taxpayer Advocate Service Research Program, With A Focus on the Detailed Study of the Underserved Segment, Phase II, Study #3*, 18-21 (July 2002). Moreover, about 11 percent are "income secretive" and refuse to discuss their income. *Id*.

12 *See* IRM 5.12.2.4.1 (Oct. 30, 2009) (non-streamlined IA processing); IRM 5.14.1.4.2 (June 1, 2010) (same); IRM 5.8.4.13 (June 1, 2010) (offer processing); IRM 5.16.1.1(4) (May 5, 2009) (CNC processing). For a discussion of problems with the IRS's lien filing policies, see National Taxpayer Advocate 2009 Annual Report to Congress 17-40.

13 For a discussion of policies and procedures that discourage taxpayers from utilizing most collection alternatives, see, *e.g.*, National Taxpayer Advocate 2006 Annual Report to Congress 83 (Most Serious Problem: *IRS Collection Payment Alternatives*).

The IRS Restructuring and Reform Act of 1998 expanded the availability of IAs.

In 1997, the National Commission on Restructuring the IRS concluded that collection alternatives such as IAs and OICs increase IRS revenues and improve voluntary compliance.[14] However, taxpayers in certain geographic areas found it difficult to obtain them.[15] The Commission recommended requiring the IRS to enter into these alternatives if certain requirements were satisfied.[16] In 1998, Congress responded by generally requiring the IRS to enter into so-called "guaranteed" IAs if the taxpayer owed $10,000 or less, had a clean compliance history, was financially unable to pay the liability timely, and would repay the liability within three years under the agreement.[17]

In 1998, the IRS further expanded the availability of IAs by allowing taxpayers who owed $15,000 or less to enter into three-year "streamlined" agreements if they met certain other requirements, without requiring them to submit any financial information.[18] In 1999, the IRS expanded the streamlined IA threshold and increased the repayment period.[19]

Streamlined IAs generally do not require an analysis of detailed financial information or prompt the IRS to file liens.

Under current procedures, if a taxpayer owes $25,000 or less and agrees to pay the liability in full within five years (and before the CSED), the IRS may accept a "streamlined" IA without analyzing his or her ability to pay.[20] A taxpayer can easily obtain a streamlined IA online, by submitting a one-page form or sending a letter, or calling a customer service representative.[21] In addition, the IRS generally does not file a lien in connection with routine streamlined IA processing.[22] Thus, the IRS provides significant incentives for taxpayers to use streamlined IAs.

Streamlined IAs also require few IRS resources because the IRS does not need to analyze the taxpayer's financial situation. The IRS will not request the financial information necessary to determine the most appropriate resolution of a delinquent account unless no other options appear feasible.[23] If it did, it would have to either train customer service

14 Report of the National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 51-52 (June 25, 1997) (Appendix I).

15 *Id.*

16 *Id.*

17 Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3467, 112 Stat. 685 (1998) (codified at IRC § 6159(c)). This legislation codified the IRS's standard practice. Conf. Rep. No. 105-599, at 292-93 (1998).

18 Memorandum from Assistant Commissioner (Collection), *Increase in Streamlined Installment Agreement Dollar Authority* (Mar. 31, 1998), *reprinted as*, *Memo on Streamlined Installment Agreements Released*, 1999 TNT 111-26 (June 10, 1999).

19 *See* IRM 5.14.2.2 (Oct. 18, 1999); Memorandum from Assistant Commissioner (Collection), *Increase in Streamlined Installment Agreement Authority* (Mar. 17, 1999), *reprinted as*, *Memo on Streamlined Installment Agreements Released*, 1999 TNT 111-24 (June 10, 1999). However, this guidance contemplated a conversation between the IRS and taxpayers. *Id*. (noting "[t]axpayers should be questioned on the amount they can pay every month…").

20 *See* IRM 5.14.5 (Sept. 26, 2008). If a taxpayer is ineligible for a streamlined IA because he or she owes more than $25,000, the IRS encourages the taxpayer to pay amounts in excess of $25,000 so that he or she can avoid submitting financial information. IRM 5.14.5.2(9) (Aug. 5, 2010).

21 *See* IRM 5.14.5 (Sept. 26, 2008); IRS, *Online Payment Agreement Application*, http://www.irs.gov/individuals/article/0,,id=149373,00.html (last updated Dec. 7, 2010); IRS Form 9465, *Installment Agreement Request* (Dec. 2009) (one-page form with two pages of instructions).

22 *See* IRM 5.12.2.4.1 (Oct. 30, 2009); IRM 5.14.5.2 (Aug. 5, 2010).

23 *See, e.g.*, IRM 5.19.1.5(4) (Dec. 4, 2009).

representatives in financial analysis (a higher-graded duty) or move the streamlined IA work to other employees.[24] Thus, streamlined IAs allow the IRS to use non-collection personnel and to close cases quickly – often in five minutes or less – without spending the time and resources that would be needed to determine if other collection alternatives are more appropriate.[25]

The IRS sometimes puts taxpayers into streamlined IAs without express consent, notwithstanding legal concerns with this practice.

The IRS sometimes puts taxpayers into streamlined IAs without their express consent. For example, if the IRS receives correspondence from a taxpayer offering to pay in installments, but not specifying a monthly payment amount, it sets up a streamlined IA with monthly payments equal to the liability divided by 60.[26] The IRS may do this for up to a quarter of all IAs because during the peak filing season in fiscal year (FY) 2009, 25 percent of all IA requests did not include a proposed amount.[27] The IRS may also initiate a streamlined IA without express consent if the taxpayer proposes a monthly amount insufficient to repay the debt within 60 months and does not include the financial information the IRS needs to process a non-streamlined IA.[28]

In 2008, the IRS Office of Chief Counsel identified legal concerns with the practice of initiating IAs with payment terms to which the taxpayer had not expressly agreed.[29] Its main concern was that the practice may violate the statutory requirement under IRC § 6159(a) that the Secretary enter into "written agreements" for the payment of tax by installment. The Chief Counsel opinion reasons that even if the taxpayer actually makes the payment proposed by the IRS, the taxpayer has not agreed to it in writing. According to the opinion, the same concern is not present when a taxpayer requests an IA by submitting Form 9465, *Installment Agreement Request*, with a blank payment amount, because language on the form authorizes the IRS to compute the amount.[30] However, many taxpayers do not use

24 In FY 2009, about 40 percent of the IAs accepted by the IRS (1,270,239/3,197,862) originated from Toll-Free Accounts Management rather than collection. IRS, Collection Activity Report (CAR) NO-5000-6 (May 25, 2010).

25 *See* IRM 5.19.1.3.5.1(1) (May 14, 2008) (indicating that a streamlined IA processing is an example of work that should be completed in less than five minutes by persons opening the mail in connection with the "Collection First Read Process").

26 If an IRS employee receives "[c]orrespondence or Forms 433 without a proposed amount, or the amount proposed was insufficient to meet SIA" criteria, then IRS guidance directs the employee to "[s]end Letter 2274C advising the taxpayer of the minimum amount that could be accepted." IRM 5.19.1.5.5(16) (Dec. 4, 2009). One paragraph of this letter states: "Your request for an Installment Agreement was received with no proposed monthly payment amount. The minimum payment we can accept without a review of your financial information is $____. We have approved an Installment Agreement for this amount." Letter 2274(c), *Your Request for Installment Agreement Has Been Granted*, ¶G (Apr. 2010). A similar form letter provides: "The minimum payment we can accept without a review of your financial information is $[____]. We've approved an agreement for this amount." Letter 2273(c), *Installment Agreement Accepted; Terms Explained*, ¶N (July 2010).

27 IRS response to TAS information request (Aug. 18, 2010).

28 Another paragraph of the IRS letter states: "We cannot accept the monthly payment amount you proposed without a review of your financial information. The minimum payment we can accept at this time is $____. We have approved an Installment Agreement for this amount." Letter 2274(c), *Your Request for Installment Agreement Has Been Granted*, ¶H (Apr. 2010).

29 National Office Program Manager Technical Advice, PMTA-2009-2032 (Nov. 26, 2008) (raising concerns the practice may (1) violate the statutory requirement that IAs be in writing, (2) cause collection of the IA user fee to be improper, and (3) create uncertainty as to when a levy is prohibited).

30 The form states: "If a payment amount is not listed on line 11, one will be determined for you by dividing the balance due by 60 months." Form 9465, *Installment Agreement Request* (Dec. 2009).

this form to request an IA. While we understand the IRS may revise these procedures, it has not done so. In August of 2009, the IRS estimated that changing the practice would require it to send out 281,000 more letters in FY 2010, which would generate 94,400 more incoming calls that it was not necessarily prepared to receive.[31]

The IRS puts more taxpayers into streamlined IAs than any other collection alternative.

Given the strong incentives for taxpayers and the IRS to favor streamlined IAs in lieu of other collection alternatives, it is not surprising that in FY 2009 the IRS accepted more streamlined IAs (3,031,163) than offers (10,665), PPIAs (33,274), regular IAs (166,699), and CNC hardship determinations (217,135) combined.[32] Moreover, streamlined IAs represented about 95 percent of all IAs.[33]

The IRS does not know if its streamlined IA default rates are high or low.

The streamlined IA default rate is slightly lower than the non-streamlined or "regular" IA default rate. According to IRS figures, for FY 2009 it was about 17.4 percent, as compared to a regular IA default rate of about 22.6 percent.[34] However, the non-streamlined IA default rate may not provide an appropriate comparison. The IRS's financial analysis methodology overestimates the amount a taxpayer can pay by disallowing (*i.e.*, ignoring) payments due to certain junior creditors.[35] As a result, in some cases the IRS requires regular IA or PPIA payments that exceed what the taxpayer can reasonably pay. Because it is difficult to find an appropriate benchmark, the IRS does not really know if the streamlined IA default rate is high or low.[36]

The IRS does not know the impact of accepting streamlined IAs that taxpayers cannot afford.

A 2002 Booz Allen Hamilton study recommended the IRS use an Excel spreadsheet that it developed (called a "financial calculator") to allow employees to identify streamlined IAs that taxpayers could not afford.[37] For taxpayers who could not afford the proposed

31 IRS, *Impact Assessment: New CSCO Installment Agreement Letter Containing the CAS AM Phone Number* (Aug. 3, 2009).

32 IRS, CAR NO-5000-6 (Oct. 5, 2009); IRS, CAR NO-5000-108 (Oct. 7, 2009) (reflecting offers accepted in FY 2009); IRS, Compliance Data Warehouse Individual Master File (IMF) (cycle 201033) (CNC figures). We computed the number of regular IAs by starting with the total number of IAs and then subtracting streamlined IAs and PPIAs.

33 Of the 3,197,862 IAs accepted in FY 2009, 3,031,163 (*i.e.*, 94.8 percent) were streamlined IAs. IRS, CAR NO-5000-6 (Oct. 5, 2009).

34 IRS, CAR NO-5000-6 (Oct. 5, 2009). The IRS computes IA default rates on a yearly basis by dividing the number of IAs that defaulted in a given period by the total number of opportunities to default. *Id*. However, it does not default an IA when a taxpayer fails to make a tax payment during the IA repayment period, provided the taxpayer agrees to roll the additional liability into the IA repayment schedule. IRM 5.19.1.5.5.22 (May 10, 2010); IRM 5.19.1.5.5.22 (May 10, 2010); IRM 5.19.1.5.5.21 (May 10, 2010). If it did, the FY 2009 default rates would rise to 36.1 percent for streamlined IAs and 63.2 percent for regular IAs. Compliance Data Warehouse (Sept. 10, 2010).

35 This may be because the IRS disallows debt when computing how much a taxpayer can pay. *See The IRS Does Not Know the Impact of Ignoring Non-IRS Debt When Analyzing a Taxpayer's Ability to Pay an IRS Debt, supra*.

36 Regardless of the benchmark, however, a 17.4 percent default rate is burdensome for the taxpayer because the IRS will charge another user fee and hold the default against him or her when he or she seeks another IA or other collection alternative, as described below. *See, e.g.*, IRM 5.14.3.2(3)(d) (June 12, 2009).

37 SB/SE Research, Ft. Lauderdale/Greensboro, Project 04.08.002.03, *The Impact on the Installment Agreement Default Rate When Using a "Financial Calculator"* (June 2005).

streamlined IA, the study recommended the IRS either reduce the monthly payments or find a more appropriate collection alternative.

A 2004 IRS study designed to follow up on these recommendations found that in communications with employees at IRS toll-free and ACS sites, a significant number of taxpayers proposed to enter into IAs that (according to the financial calculator) they could not afford – approximately 42.3 and 28.3 percent, respectively, for toll-free and ACS.[38] Of the cases where taxpayers proposed amounts they could not afford, most – 86.3 and 82.1 percent, respectively – could not even afford a payment that would pay the liability within 60 months.[39] For purposes of the study, the IRS would accept the amount the calculator determined the taxpayer could afford.[40] While IA default rates over a ten-month period were lower for taxpayers who could afford the payments than for those who could not, the differences were not statistically significant.[41] Thus, the study concluded the IRS should not use the financial calculator because it did not reduce IA default rates by a statistically significant amount.

However, the extent to which IRS policies prompt taxpayers to do without reasonable basic living expenses or promote future noncompliance is just as important as, if not more important than, the default rates. Even with respect to default rates, the study raised more questions than it answered. It looked at IA default rates over ten months, rather than over the life of the IAs.[42] Although the calculator did prompt users to consider some non-tax debts in determining a taxpayer's ability to pay, it did not collect information about many common debts, such as payments on student loans or state and local tax delinquencies.[43] Thus, it may have overestimated the amount a taxpayer could afford. This problem could help to explain the study's conclusion that a taxpayer's financial condition, as determined by the financial calculator, had no statistically significant impact on the IA default rate.

Taxpayer attempts to avoid defaulting on unrealistic streamlined IAs may trigger economic hardship and noncompliance.

Taxpayers have significant incentives to avoid defaulting on streamlined IAs. For example, a taxpayer who defaults is likely to be subject to an IRS lien or levy more quickly than others, and is ineligible for another IA unless an IRS manager considers the reason for the

38 SB/SE Research, Ft. Lauderdale/Greensboro, Project 04.08.002.03, *The Impact on the Installment Agreement Default Rate When Using a "Financial Calculator"* 9 (June 2005).

39 *Id*. at 10.

40 *Id*. Normally the IRS does not allow certain "conditional expenses," including most junior debts, unless the taxpayer can fully pay the liability within 60 months. IRM 5.15.1.10 (Oct. 2, 2009).

41 SB/SE Research, Ft. Lauderdale/Greensboro, Project 04.08.002.03, *The Impact on the Installment Agreement Default Rate When Using a "Financial Calculator"* iii, 8-12 (June 2005) ("Although there appears to be a slightly lower default rate for the test group, the control and test group default rates are not statistically different.... The 'financial calculator' should not be used since the test results indicate that using it will not help reduce the installment agreement default rate.").

42 In FY 2009, taxpayers made payments on IAs for 56 weeks, on average – significantly longer than the 10 months covered by the study. IRS, CAR NO-5000-6 (Oct. 5, 2009) (cumulative data for FY 2009). Ten months is also too short a time to assess the impact of the IA on future compliance.

43 For a discussion of debts that the IRS typically ignores for purposes of its financial analysis, see *The IRS Does Not Know the Impact of Ignoring Non-IRS Debt When Analyzing a Taxpayer's Ability to Pay an IRS Debt, supra*.

default and analyzes the taxpayer's ability to pay.[44] He or she is more likely to be subject to seizure because of the IRS's inference that the default means he or she "won't pay" voluntarily.[45] In addition, if the taxpayer requests another IA, the IRS is more likely to determine that the request is "solely to delay collection," in which case it will ignore the request and continue collection activity.[46] To live up to the agreement and avoid these consequences, some taxpayers are likely to make payments on IAs they cannot afford.

When taxpayers enter into IAs they cannot afford, they are more likely to experience economic hardship or default on current or future tax liabilities. While the law does not expressly prevent the IRS from using streamlined IAs to create economic hardship, it does prevent the IRS from using levies to do so.[47] The IRS should not use streamlined IAs to undermine the rules applicable to levies. In addition, channeling taxpayers into IAs they cannot afford when other payment alternatives are more appropriate sets them up for failure, rather than future compliance.

CONCLUSION

The IRS does not know the consequences of encouraging taxpayers to enter streamlined IAs they cannot afford. Some taxpayers will make the payments even if they create economic hardships while others will default on their agreements or future tax liabilities. The IRS needs to know the extent to which streamlined IAs prompt taxpayers to do without reasonable basic living expenses or to fall behind on taxes due in future periods.

The National Taxpayer Advocate offers these preliminary recommendations:

1. Discontinue the practice of putting taxpayers into streamlined IAs without their express consent, as recommended by the IRS Office of Chief Counsel;
2. Revise the streamlined IA acceptance form letter to explain that the taxpayer should contact the IRS to request another collection alternative such as a regular IA, PPIA, or offer if he or she cannot make the payments for any reason (including any extenuating circumstances);[48] and
3. Study the impact of collection alternatives, including streamlined IAs, on future compliance by various taxpayer segments. As part of this study, survey taxpayers who default on IAs to find out why.

[44] *See, e.g.*, IRM 5.19.5.3.2(1)(d) (Aug. 1, 2008) (levy); IRM 5.14.11.5(2) (Aug. 9, 2010) (lien); IRM 5.14.9.2 (Aug. 5, 2010) (new IA requires managerial approval); IRM 5.14.11.5 (Aug. 5, 2010) (new IA requires analysis of reasons for default and ability to pay). The taxpayer also becomes ineligible for a "guaranteed" IA. IRC § 6159(c)(2)(C).

[45] *See, e.g.*, IRM 5.10.1.6(2) (July 3, 2009).

[46] *See* IRM 5.14.3.2(3)(d) (June 12, 2009).

[47] *See, e.g.*, IRC § 6343(a)(1)(D) (requiring the IRS to release a levy if it is creating an "economic hardship"). An economic hardship exists when a taxpayer is unable to pay his or her "reasonable basic living expenses." *See* Treas. Reg. § 301.6343-1(b)(4).

[48] *See, e.g.*, Letter 0681C (Mar. 2010); Letter 2840C (Mar. 2010); Letter 3217C (Mar. 2009). In redesigning the letters, the IRS can draw on the principles described in Siegel & Gale's recent review of the OIC form. *See* Siegel & Gale, *Offer in Compromise, Strategic Recommendations* 10-13 (July 31, 2009).

IRS COMMENTS

The streamlined installment agreement process allows the IRS to serve a greater number of taxpayers by reducing the burden of both the taxpayer and the government in resolving balance due accounts. The process is beneficial to both the taxpayer and the IRS. The streamlined installment agreement provides taxpayers with an easy method with minimal burden by which to return to compliance with their tax responsibilities. These agreements may be processed quickly, without financial analysis or managerial approval, and do not require the filing of the Notice of Federal Tax Lien. Streamlined installment agreements are set up for a monthly payment amount that the taxpayers have determined is reasonable and affordable.

The qualification criteria to be considered for a streamlined agreement include:

- Types of accounts – Individual, in-business (income tax only) or out of business accounts;
- Unpaid balance of assessments not to exceed $25,000; and
- Agreement must full pay within 60 months (or within the collection statute).[49]

The IRS provided streamlined installment agreements to over three million taxpayers in fiscal year 2010. These streamlined agreements accounted for 94 percent of all installment agreements granted by the IRS during that period.[50]

The IRS provides information on the installment agreement process through various publications, notices and the IRS.gov website to educate the public about the process. In September 2008, the Taxpayer Communications Taskgroup (TACT) program was established to develop strategies and solutions to increase the clarity, accuracy, and effectiveness of the IRS written communications associated with taxpayer accounts.[51] All correspondence to taxpayers related to installment agreements were reviewed. Several installment agreement letters were revised to provide additional clarity and increase customer satisfaction.

The IRS disagrees with the National Taxpayer Advocate that collection policies related to streamlined agreements channel taxpayers into agreements they cannot afford and create hardship. The streamlined agreement process allows the taxpayer to make the decision to enter into an agreement to resolve the liability without requiring the IRS to analyze the taxpayer's personal finances. The taxpayer determines whether the payment amount is appropriate for them given their current income and expenses. If the payment amount does not meet the requirements of the streamlined installment agreement, the IRS explores other payment alternatives to resolve the liability.

49 IRM 5.19.1.5.5 (Dec. 4, 2009) ("Installment Agreements") and IRM 5.14.5.2 (Aug. 5, 2010) ("Streamlined Installment Agreements").

50 IRS, CAR NO-5000-6 (Sept. 2010).

51 TACT Charter (Nov. 20, 2008).

Taxpayers who have installment agreements are informed in various forms, publications, and letters that if they cannot meet the terms of their agreement that they should contact the IRS. Changes in financial condition can impact the taxpayer's ability to make installment payments on an existing agreement. The IRS will assist the taxpayer in determining the best resolution depending on the current circumstances. If taxpayers have set up unrealistic streamlined agreements, this process will help them to revise their agreements as well.

The report makes three preliminary recommendations to improve streamlined installment agreement process. The IRS is taking or has taken the following actions with respect to these recommendations:

The IRS worked with the National Taxpayer Advocate to develop procedures and a response letter for situations when a taxpayer requests an installment agreement and either they do not propose an amount or the amount does not meet the streamlined installment agreement criteria.[52] The letter explains to taxpayers that either no amount or an insufficient amount was proposed. In the letter, the IRS proposes a monthly payment sufficient to meet the streamlined installment agreement criteria. The taxpayer can either accept the amount proposed, or contact the IRS to make other arrangements. The Office of the Taxpayer Advocate was involved in the development of this policy and was supportive of it.[53]

The IRS agrees to consider revising the installment agreement acceptance letters and other publications and letters to further educate taxpayers about other collection alternatives. The IRS recently revised many of the letters and forms to make them easier to understand as part of the TACT program. The IRS agrees to review suggestions for improvements to installment agreement correspondence to ensure sufficient educational material is provided.

The IRS agrees to research the impact of collection alternatives on future compliance. We will consult with research on the appropriate method, which may include contacting taxpayers that have defaulted.

52 Letter 2274(c), *Your Request for Installment Agreement Has Been Granted* (Apr. 2010).

53 E-mails from TAS Office of Systemic Advocacy and National Taxpayer Advocate Attorney-Advisor (Dec. 9, 2008).

Taxpayer Advocate Service Comments

The National Taxpayer Advocate commends the IRS for recognizing the need to study the impact of collection alternatives on future compliance. She is also pleased that the IRS acknowledges the need to improve communications with taxpayers about collection alternatives. In addition, she appreciates the IRS's effort to seek TAS comments on a 2008 draft version of a letter it planned to send to taxpayers who requested an IA without proposing a specific amount.[54]

However, the IRS's comments mischaracterize the National Taxpayer Advocate's office as being supportive of putting taxpayers who requested specific IA payment amounts into IAs that require higher payments than they proposed.[55] Moreover, the IRS's response does not address the conclusion by attorneys in the IRS Chief Counsel's office that this practice may violate the law.[56] To be clear, the National Taxpayer Advocate does not support this practice. When a taxpayer contacts the IRS seeking to pay in installments, but proposes an insufficient monthly amount, the IRS should attempt to contact the taxpayer by phone and by letter. If it cannot reach the taxpayer, it should reject the proposed IA rather than placing the taxpayer into an IA with a higher monthly payment or deeming the proposed IA as "not processable."

The IRS comments also assert, "[S]treamlined installment agreements are set up for a monthly payment amount that the taxpayers have determined is reasonable and affordable." Of course, some taxpayers may determine that streamlined IA payments are affordable. However, there are many reasons (discussed above), which we will not repeat here, that may prompt taxpayers to enter into streamlined IAs requiring monthly payments that they cannot afford. Even the IRS's multifunctional Collection Process Study Team concluded:

> Due to concerns that taxpayers will agree to enter into SLIAs they cannot afford to avoid liens, IRS employees should confirm verbally that the taxpayer can make monthly payments at the level required; if the taxpayer cannot make the minimum monthly payment, the IRS should discuss other payment options.[57]

The National Taxpayer Advocate agrees.

54 The draft letter computed the streamlined IA payment that would be acceptable to the IRS and requested that the taxpayer contact the IRS if he or she could not afford the payment. If the IRS did not receive a response within 30 days, it would initiate the proposed IA.

55 The 2008 draft version of the Letter 2274C that TAS reviewed did not address situations where taxpayers proposed IA amounts that were too low to meet the streamlined IA criteria. TAS voiced concerns when it learned about this practice in 2009.

56 While TAS itself had questions about the analysis contained in the opinion, the IRS appears to be ignoring the opinion rather than raising its own concerns.

57 IRS Collection Process Study § 6.3.3.6 (Sept. 30, 2010). One recent report by the Treasury Inspector General for Tax Administration (TIGTA) was also critical of the IRS's practice of initiating streamlined IAs without contacting the taxpayer or considering if the taxpayer could pay. TIGTA, Ref. No. 2010-30-019, *Processing and Monitoring of Balance Due Notice Cases Needs Improvement* 2 (Mar. 1, 2010).

Recommendations

The National Taxpayer Advocate offers these recommendations:

1. Discontinue the practice of putting taxpayers who have requested a specific IA payment into IAs that require a higher payment without the taxpayers' express consent;
2. Work with the Office of Chief Counsel to ensure the IRS is processing IAs lawfully;
3. Revise the streamlined IA acceptance form letter to explain that the taxpayer should contact the IRS to request another collection alternative such as a regular IA, PPIA, or offer if he or she cannot make the payments for any reason;[58] and
4. Collaborate with TAS to study the impact of collection alternatives, including streamlined IAs, on future compliance by various taxpayer segments. As part of this study, survey taxpayers who default on IAs to find out why.

58 *See, e.g.*, Letter 0681C (Mar. 2010); Letter 2840C (Mar. 2010); Letter 3217C (Mar. 2009).

MSP #14

The IRS's Over-Reliance on its "Reasonable Cause Assistant" Leads to Inaccurate Penalty Abatement Determinations

RESPONSIBLE OFFICIAL

Chris Wagner, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

Every year, the IRS assesses penalties on millions of taxpayers, many of whom ask that the penalties be abated.[1] To promote consistent and fair abatement decisions, the IRS requires its employees to use software called the Reasonable Cause Assistant (RCA) for Failure to File (FTF), Failure to Pay (FTP), and Failure to Deposit (FTD) penalty abatement requests.[2] The IRS designed the RCA to assist employees in determining whether to abate a penalty for reasonable cause.

However, IRS data illustrate that employees do not receive proper training in tax law to make accurate abatement determinations using the RCA. A 2010 usability test shows that employees using the RCA determined penalty abatement requests correctly in only 45 percent of the cases.[3] What is perhaps more telling is that *all* of the employees in the study believed they were making correct legal determinations based on reasonable cause.[4]

Thus, a tool originally designed to encourage consistency is having the opposite effect. The National Taxpayer Advocate attributes this problem to the following factors:

- Employees charged with using the RCA lack adequate knowledge or training about reasonable cause;[5]
- IRS policies do not encourage employees to use the override feature when they believe an RCA determination is incorrect;[6]

1 In fiscal year (FY) 2009, the IRS assessed at least one of the following penalties – Failure to File, Failure to Pay, or Failure to Deposit – against 12.2 million taxpayers, including both individuals and businesses. A taxpayer may have been assessed more than one of these penalties or had these penalties assessed on more than one tax module (counted as one taxpayer). IRS, Enforcement Revenue Information System (ERIS) (Sept. 2009).

2 RCA can only consider FTF or FTP penalties on certain individual tax returns, and the FTD penalty only on certain business returns.

3 IRS, *Reasonable Cause Assistant (RCA) Usability Test Final Report Summary* 4 (May 28, 2010), hereinafter 2010 Usability Report.

4 2010 Usability Report. TAS and the Government Accountability Office (GAO) have previously voiced concerns about inaccurate penalty assessments and abatements. In her 2008 Annual Report to Congress, the National Taxpayer Advocate reported that IRS miscalculations of FTP penalties and interest affected 8.3 percent, or approximately two million, of the taxpayers involved. National Taxpayer Advocate 2008 Annual Report to Congress 306. In 2009, the GAO recommended that the IRS take numerous actions, including ensuring that penalties are effectively, efficiently, fairly, and consistently administered to achieve the purpose of encouraging voluntary compliance. GAO, GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* 15 (June 2009).

5 *See* IRS Enterprise Learning Management System (ELMS) Course 17907, *Reasonable Cause Assistant (RCA) for AMS*; ELMS Course 25261, *SB-CO-RO Reasonable Cause Assistant for Revenue Officers*; Student Guide, *Accounts Management CPE IMF Issues, Lesson 11 – Penalties and Penalty Relief* (Catalog No. 10342-102). While these training materials mention reasonable cause, they do not specify the criteria for a reasonable cause determination.

6 On September 24, 2010, the IRS added a section to the Internal Revenue Manual (IRM) explaining the override feature. IRM 20.1.1.3.6.10.1 (Sept. 24, 2010). The National Taxpayer Advocate is hopeful that this new section will encourage IRS employees to use the override when appropriate.

- The RCA does not incorporate a feedback system to improve both human knowledge of reasonable cause and programming accuracy; and
- Taxpayers must initiate contact with the IRS to receive a First-Time Abatement (FTA), even though this function can be automated, freeing IRS employees to spend more time on reasonable cause determinations.

The result is that the RCA is not supplementing human judgment as intended – it is supplanting it. Without proper training and safeguards to ensure employees arrive at appropriate abatement decisions using the RCA, the IRS continues to unnecessarily harm taxpayers and create unnecessary re-work for itself.

ANALYSIS OF PROBLEM

Background

The IRS assesses penalties when taxpayers fail to timely file their returns, pay amounts due, or make required tax deposits.[7] These penalties are assessed automatically once the IRS's computer system detects a return filed after a due date or with an underpayment of tax.[8] The IRS removes (abates) these penalties if the taxpayer can show reasonable cause for the delinquency (*e.g.*, death, serious illness, fire, natural disaster, casualty, or loss).[9] The IRS also abates penalties for reasonable cause when taxpayers exercise ordinary business care and prudence in determining tax obligations but are unable to comply with those obligations due to circumstances beyond their control.[10] When taxpayers seek to have penalties abated, they must contact the IRS directly. Each case is judged on its individual facts and circumstances.[11]

What Is the Reasonable Cause Assistant?

The RCA is an interactive decision support program used by IRS employees to evaluate a taxpayer's request for penalty relief due to reasonable cause. Even though the RCA guides the user through the determination process, the employee must still be trained and proficient in evaluating requests that cite reasonable cause criteria.[12] In 1998, the IRS Penalty Task Group led an effort to expand the RCA from a limited-use program to an enhanced version that was implemented in 2001.[13] The task group recommended that RCA use be

7 *See* Internal Revenue Code (IRC) §§ 6651(a), 6656(a). IRC § 6651(a) refers to the failure to file and failure to pay penalties as "additions to tax," while IRC § 6656(a) refers to the failure to deposit penalty as a "penalty." For the sake of simplicity, all references to "penalties" also refer to "additions to tax."

8 A "manual" assessment of penalties typically follows tax audits, investigations, or other post-filing account adjustments.

9 IRC §§ 6651(a), 6656(a); *Sanders v. Comm'r*, 225 F.2d 629 (10th Cir. 1955), *cert. den*. 350 U.S. 967 (1956); *Ferrando v. United States*, 245 F.2d 582 (9th Cir. 1957); Treas. Reg. §§ 301.6651-1(c), 301.6656-1; IRM 20.1.1.3.2.2.1 (Dec. 11, 2009).

10 *See United States v. Boyle*, 469 U.S. 241 (1985) (holding that the IRS's correlation of "reasonable cause" with "ordinary business care and prudence" is consistent with Congress' intent and with case law as well, and such interpretation merits deference).

11 IRM 20.1.2.1.3 (Sep. 4, 2009).

12 IRM 20.1.1.3.2 (Dec.11, 2009).

13 Office of Servicewide Penalty (OSP) response to TAS information request (July 1, 2010). RCA was limited in use in that it did not interact with other IRS systems as it does today. *Id*.

mandatory because previous reviews found that the IRS was not consistent in granting relief from penalties when employees used their own discretion. Currently, the IRS requires use of the RCA for all employees who decide whether to abate FTF, FTP, and FTD penalties based on reasonable cause criteria.[14] As indicated by a 2010 RCA usability test, the use of the tool continues to generate inconsistent determinations.[15]

The RCA User Accuracy Rate Is Unacceptably Low.

Since 2002, TAS has received reports through its Systemic Advocacy Management System (SAMS) that the RCA program promotes unfair bias against taxpayers.[16] These reports led to discussions between TAS and the IRS Office of Servicewide Penalties, resulting in a 2010 RCA usability study.[17] The IRS's Usability Lab[18] found that RCA users have varying levels of system skills and ability to analyze the penalty request, identify the applicable information, and apply the reasonable cause criteria that are critical for a correct determination.[19] Despite a mere 45 percent accuracy rate, *all* participants thought they were working reasonable cause issues correctly, and using the system as intended. In fact, the Usability Lab study found a majority of employees were using RCA incorrectly and making erroneous determinations over half the time.[20]

Employees Charged with Using the RCA Do Not Have Adequate Knowledge or Training about Reasonable Cause.

The initial training required of all RCA users covers the use of the RCA software in detail, but does not address issues of substantive law and reasonable cause criteria.[21] In other words, the IRS trains RCA users on how to work the machine, but it leaves the thinking and judgment to the computer. Moreover, the 2010 Usability Lab report concludes that to

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14 IRM 20.1.1.3.6(1) (Dec. 11, 2009).

15 2010 Usability Report 4.

16 National Taxpayer Advocate Fiscal Year 2010 Objectives Report to Congress 66-67 ("Since 2002, there have been 35 RCA-related submissions on SAMS."). SAMS is a TAS application that acts as the primary method of receiving and prioritizing systemic issues and problems submitted by IRS employees and the public. TAS employs SAMS to facilitate taxpayers' ability to submit issues, suggestions, and ideas to help reduce or eliminate the burdens facing taxpayers.

17 Although the IRS assigns overall responsibility for its penalty programs to the OSP, which is part of the Small Business/Self-Employed (SB/SE) operating division, many IRS functions have a role in promoting voluntary compliance through penalty administration. The IRS's goal is to maintain consistent coordination of penalty programs so the information can be used to identify and respond to compliance problems. IRM 20.1.1.1.3 (Dec. 11, 2009). The OSP is responsible for administering policy and procedures that ensure consistency with the penalty policy statement; reviewing and analyzing penalty information; researching penalty effectiveness on compliance trends; and determining how to promote voluntary compliance. IRM 20.1.1-1 (Dec. 11, 2009); Penalty Policy Statement 20-1. The servicewide approach to penalties is embodied in the IRS Penalty Policy Statement 1.2.20.1 (Aug. 28, 2007); IRM 20.1.1-1 (Dec. 11, 2009). *See also* National Taxpayer Advocate 2008 Annual Report to Congress 414-418 (Legislative Recommendation: *Reforming the Penalty Regime*) vol. 2, 2-45 (*A Framework for Reforming the Penalty Regime*); Department of the Treasury, Office of Tax Policy, *Report to the Congress on Penalty and Interest Provisions in the Internal Revenue Code* (Oct. 1999); Joint Committee on Taxation, *Study of Present-Law Penalty and Interest Provisions as Required by Section 3801 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Including Provisions Relating to Corporate Tax Shelters)* (July 22, 1999).

18 The IRS Ogden (Utah) Usability Lab staff provides a variety of usability services for product development and is well versed in all phases of usability methodology. IRM 2.25.14.5 (Sept. 10, 2004).

19 2010 Usability Report 4.

20 *Id*. ("When de-briefing the participants, most thought they were working reasonable cause issues correctly and utilizing the system the way it was intended, yet, the majorities were not working the scenarios correctly.").

21 *See* IRS ELMS Course 17907, *Reasonable Cause Assistant (RCA) for AMS*; ELMS Course 25261, *SB-CO-RO Reasonable Cause Assistant for Revenue Officers*; Student Guide, *Accounts Management CPE IMF Issues, Lesson 11 – Penalties and Penalty Relief* (Catalog No. 10342-102).

properly use RCA, employees must first possess a basic understanding of the application of reasonable cause criteria, in addition to computer training to input data into the program.[22] Consequently, the IRS operates a penalty abatement practice that charges untrained and often inexperienced employees with the task of deciding which facts and circumstances legally constitute reasonable cause. Not surprisingly, untrained employees do not question the machine's results, thereby harming taxpayers by failing to abate penalties where reasonable cause does in fact exist.

The IRS Should Encourage Appropriate Use of the Override Feature.

The IRS programmed an override feature for employees to use at their discretion when RCA recommendations do not properly reflect a taxpayer's unique facts and circumstances.[23] Therefore, the IRS did not initially intend RCA to remove all human discretion from penalty abatement determinations, nor did it intend for RCA to address every potential issue raised by a taxpayer.

Although, the RCA override rate increased from one percent in 2005 to two percent in 2009, the low usage rate suggests that the IRS's failure to educate employees about the override option may result in its underutilization.[24] Since the purpose of the RCA is to generate fair and unbiased conclusions, the IRS should not discourage employees from overriding the RCA when human judgment, common sense, and limited RCA options make overriding appropriate.[25]

The RCA Needs a Corrective Feedback Feature to Increase Program Accuracy and User Proficiency.

The 2010 Usability Test also revealed that the RCA program does not educate users about their mistakes and how to prevent them in the future.[26] After completing the initial computer software training, users do not receive adequate follow-up instruction.[27] Thus, it is understandable why users continue to believe they are making correct reasonable cause determinations, even though the report showed inaccurate results 55 percent of the time. The RCA program should incorporate an online feedback link exclusively for RCA users to ask questions, improve competency, and identify programming errors or policy discrepancies.[28]

22 *See* 2010 Usability Report 7.

23 Until September 24, 2010, an IRS employee could only override RCA's recommendation with a manager's approval. IRM 5.1.15.16.1(4) (Apr. 16, 2010); *but see* IRM 20.1.1.3.6.10.1 (Sept. 24, 2010) (stating that managerial approval is recommended, but not required).

24 *See* OSP response to TAS Information request (July 1, 2010); 2010 Usability Report 4. *See* National Taxpayer Advocate 2005 Annual Report to Congress 363.

25 A 2005 report by the Treasury Inspector General for Tax Administration (TIGTA) noted "judgment decisions are high-risk transactions because Revenue Officers use discretion in determining if a taxpayer is eligible for the [penalty] abatement based on the taxpayer's circumstances." However, TIGTA found no inconsistencies or erroneous determinations associated with decisions based upon employee judgment and discretion. TIGTA, Ref. No. 2005-30-139, *Collection Field Function Penalty Abatements Need Proper Documentation and Coding* 2 (Sept. 23, 2005).

26 2010 Usability Report 4.

27 *Id*.

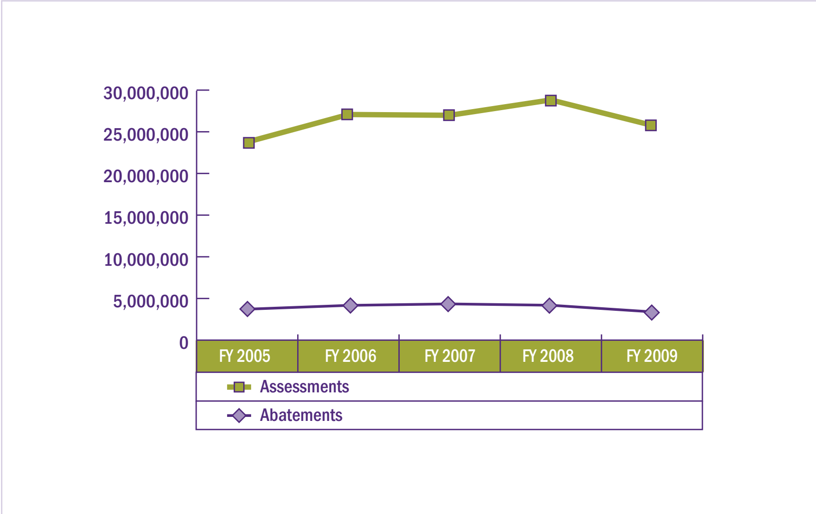
28 *Id*. at 5 ("[C]onsistent review/feedback could have a positive effect for employees utilizing RCA.").

First-Time Abatement Policies Should Be Expanded to Automatically Abate Penalties for Compliant Taxpayers.

The RCA provides an additional option for penalty relief under an administrative waiver known as First-Time Abatement.[29] FTA grants relief to certain taxpayers who receive a penalty but have a compliant tax history for the three prior years.[30] Since the FTA is an administrative waiver and not technically an abatement for reasonable cause, an IRS employee is not required to go through a reasonable cause analysis if a taxpayer was compliant for the three years immediately preceding the penalty year.[31] The IRS implemented this waiver in response to the National Taxpayer Advocate's 2005 Annual Report to Congress on the RCA.[32] The IRS stated the waiver would reduce both penalty assessments and abatements.[33] However, the IRS still assesses the penalty first, and then requires the taxpayer to request an abatement before it will perform a three-year compliance check and abate the penalty.

Although the FTA is a positive change and is now part of the IRM,[34] the IRS can improve the efficiency and effectiveness of the FTA program.[35] The fact that the FTA is not systemically generated *before* a penalty assessment has limited the results the IRS attempted to achieve. Figure 1.14.1 indicates that neither the number of penalty assessments nor the number of abatements has significantly changed since the IRS implemented the FTA.

FIGURE 1.14.1, FTF, FTP, and FTD Penalty Assessment and Abatement Counts, FY 2005 – FY 2009



29 IRM 20.1.1.3.6.1 (Dec. 11, 2009).

30 *Id.*

31 *Id.*

32 National Taxpayer Advocate 2005 Annual Report to Congress 364.

33 *Id.*

34 IRM 20.1.1.3.6.1 (Dec. 11, 2009).

35 *See* National Taxpayer Advocate 2005 Annual Report to Congress 364.

The IRS is actually abating relatively fewer penalties now than it did before implementing the FTA policy. Of all penalties assessed for each fiscal year, the IRS abated 15.6 percent in 2005, 15.4 percent in 2006, 16.1 percent in 2007, 14.5 percent in 2008, and 13.2 percent in 2009.[36] It is logical to hypothesize that penalty assessments are not decreasing even with the FTA policy because taxpayers must still contact the IRS after the assessment to receive an FTA abatement.

Moreover, 82 percent of all FY 2009 penalties abated under the RCA were attributable to the FTA waiver. This is down only slightly from 85 percent for both FY 2008 and FY 2007.[37] This means that eight out of ten penalty abatements could have been granted automatically without the IRS expending valuable human resources to receive the taxpayer's abatement request, process it, and then manually access the RCA to perform a three-year compliance check. These employees could have used their time more constructively to determine abatement requests that require human discretion; namely, requests based on reasonable cause.[38]

The National Taxpayer Advocate recommends programming IRS systems to waive penalties based on FTA before they are assessed, without requiring taxpayers to contact the IRS first. By waiving penalties before assessment and following up with a "soft notice" that explains the reason for the waiver, the IRS can reduce the cost of administering RCA-related penalty requests, while educating taxpayers and encouraging voluntary compliance.

Expand RCA Programming to Check Primary and Secondary Tax Identification Numbers.

Another concern is that IRS systems only check the tax identification number (TIN) of the primary taxpayer when performing a three-year compliance check, which means the IRS fails to consider the compliance history of the spouse when married couples file jointly.[39] The IRS should consider programming its systems to automatically perform a three-year compliance check on both the primary and secondary TINs when considering an FTA abatement.[40]

36 ERIS (Dec. 2009).

37 OSP response to TAS information request (July 1, 2010).

38 OSP recently began a study to consider future compliance behavior as it relates to expansion of the FTA. OSP expects to have results by the end of calendar year 2010.

39 The IRS computer system searches for prior delinquencies under the primary taxpayer's tax identification number assigned to the Master File Transaction (MFT) code. *See* IRM 20.1.1.3.6.1(1) (Dec. 11, 2009) ("RCA provides an option for penalty relief for the FTF, FTP, and/or FTD penalties if no prior penalties have been assessed on the same MFT in the prior 3 years."); *see, e.g.*, IRM 2.3.2.2.2, Tax Information File (TIF). The TIF provides taxpayer account information which is accessed using the primary taxpayer's identification number. As TIF is the data dictionary for RCA, RCA only researches the primary taxpayer's Social Security number in the case of a married couple filing jointly.

40 For further discussion on this topic, see Most Serious Problem: *IRS Policy Implementation Through Systems Programming Lacks Transparency and Precludes Adequate Review, supra.*

CONCLUSION

The National Taxpayer Advocate recognizes the importance of penalty administration on tax compliance. However, she is concerned that complete reliance on the RCA may lead to incorrect penalty abatement decisions. Further, she is concerned that the RCA may discourage IRS employees from exercising judgment in appropriate situations, thereby causing taxpayer harm. These issues undermine the IRS's mission of promoting fair tax administration.

In conclusion, the National Taxpayer Advocate offers the following preliminary recommendations:

1. Review all training and guidance materials to determine whether they provide the user with the ability to analyze the penalty request, select the applicable information, and apply reasonable cause criteria.
2. Train all RCA users in tax law and reasonable cause criteria, with frequent continuing education to keep users abreast of developments in the law.
3. Train those who manage RCA users in tax law and reasonable cause criteria so that management approvals of abatement decisions are accurate.
4. Encourage employees to use the override feature when they believe the RCA's recommendation is inappropriate based on the facts and circumstances of the case.
5. Review and report RCA functionality findings to improve communication between users by incorporating an online feedback link exclusively for RCA users to ask questions and identify programming errors or policy discrepancies.
6. Program IRS systems to identify compliant taxpayers prior to a penalty assessment, automatically grant FTA waivers if taxpayers meet the compliance criteria, and send "soft notices" to the taxpayers explaining the reason for the waiver to encourage future compliance.
7. Program systems to search primary and secondary taxpayer identification numbers when checking compliance history.

IRS COMMENTS

The RCA is an interactive decision-support program used by IRS employees when it is determined that a taxpayer has requested penalty relief due to reasonable cause. RCA applies the information input by the users against the reasonable cause standards outlined throughout IRM 20.1.1.3.2 to make the determination. RCA users are trained to be proficient in evaluating reasonable cause requests utilizing the reasonable cause criteria to ensure the correct determinations are reached.

The IRS agrees it is important for penalty administration to promote tax compliance through accurate, fair, and equitable treatment of taxpayers. As such, we are taking steps to ensure users of RCA properly enter information into the system and make screen selections that result in appropriate RCA determinations. In furtherance of this goal, the IRS conducted a RCA Usability Test, working with the Office of the National Taxpayer Advocate in preparation for the test.

Usability testing is designed to observe the users' selections, and how they interact with the system, to determine if enhancements need to be made. The two types of usability metrics that were captured during this test are performance (how users react to the RCA selection screens) and preference (what users think when working through a scenario and how much they like using the system).[41] Results from the test indicated a 45 percent success rate. This means that users made appropriate screen selections in 45 percent of the scenarios presented to them. The 55 percent unsuccessful rate means that users did not make a correct screen selection or input correct information in 31 out of 56 scenarios. This test did not capture, nor were the users asked, if the RCA determination was correct. The IRS recognizes that the 55 percent unsuccessful rate for screen selection is an issue warranting improvement. However, the fact that a user may not use the RCA screens correctly does not necessarily mean the ultimate RCA determination is incorrect.[42] During actual use in a non-testing environment, a user may use their judgment to abort the RCA determination if they feel the system determination is legally incorrect.[43]

The usability test revealed the most significant areas of concern are:[44]

1. Users' interpretation of taxpayer correspondence may result in inconsistent category selections, and
2. Users need consistent feedback.

The IRS is taking a number of steps to address these concerns. While the results of the usability test do not mean that employees did not originally receive proper training, the results show that some users may need refresher training. In response to the first concern listed above (that users' interpretation of taxpayer correspondence may result in inconsistent category selections), the IRS provided a refresher training tool to management and users identifying:[45]

- What to do prior to accessing RCA;
- What RCA can and cannot do;
- What is reasonable cause; and
- How to use RCA.

41 IRS, *Reasonable Cause Assistant (RCA) Usability Test Final Report Summary* 4 (May 28, 2010) hereinafter 2010 Usability Report.

42 2010 Usability Report page 4.

43 ELMS Course 17907, *Reasonable Cause Assistant (RCA) for AMS.*

44 2010 Usability Report page 4.

45 RCA Usability Test Results memo dated October 4, 2010, for managers and RCA users included 2010 Usability Report and RCA Training Tool.

In response to the second concern that users need consistent feedback, the IRS created a dedicated e-mail address for questions and/or feedback.[46] The IRS communicated this to Collection executives on August 31, 2010.[47] This feedback system will also be offered to other RCA users. Users' questions will be promptly answered. RCA users may continue to use the Servicewide Electronic Research Program (SERP) feedback method as well.

As a result of the Usability Test, the IRS is working with RCA programmers to modify RCA by beginning each session with the RCA's 'Guided Selection' feature. 'Guided Selection' is currently optional and was seldom used by test participants. Mandatory use of 'Guided Selection' should significantly increase correct and consistent reasonable cause category selection by users. RCA programmers are exploring options to test the effectiveness of the programming change before implementing it into production.

The IRS also formed and funded an RCA project team to make programming changes to the system to make it more user-friendly. These enhancements to the system are currently scheduled for deployment in late 2011.

The National Taxpayer Advocate makes seven preliminary recommendations to improve the Reasonable Cause Assistant. The IRS is taking, or has taken, the following actions with respect to these recommendations:

The IRS routinely reviews training and guidance material to determine whether they provide the user with the ability to analyze the penalty request, select the applicable information, and apply reasonable cause criteria. We will continue to take these steps.

The IRS trains RCA users in reasonable cause and tax law as a prerequisite to RCA training. [48] The IRS will continue to ensure that all users understand the prerequisite to taking ELMS course #17907, Reasonable Cause Assistant (RCA) for AMS. We will continue to train users to keep abreast of developments in law.

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46 SB/SE RCA Help.

47 E-mail dated August 31, 2010 – Subject Line: "Reasonable Cause Assistant Tool," announcing the development of a quick reference guide, an electronic mailbox for RCA questions, and a RCA tool to answer questions immediately.

48 *See* IRS Forms and Pubs Training Course:

- 11138-102 = BMF Balance Due Modules A-D; Module B - Penalties;
- 28254-102 = Resolution of IMF Unagreed Balance Due; Module C - Penalties and Interest;
- 28683-102 = BMF Employment Taxes; Module A, Lesson 2-30 - Interest and Penalties and Lesson 3-23 - FTD Penalty
- 31921-102 = IMF Penalties and Interest (includes Lesson 3 - Navigating the Reasonable Cause Assistant).

Included within all these training courses is comprehensive information for all aspects of the penalties, in particular the ones RCA can consider (FTF, FTP, and FTD) and including penalty relief provisions primarily related to reasonable cause. Of note, every training course includes references to applicable IRM 20.1 sections and all employees are responsible for following IRM policies and procedures. Students must complete basic penalty training (though not all-inclusive, the penalty training from the above referenced courses are far more comprehensive than just 'basic') before completing ELMS course 17907, *Reasonable Cause Assistant (RCA) for AMS.*

The IRS developed a quick reference guide for revenue officers and group managers to answer the most frequently asked questions to help ensure abatement decisions are accurate. This document will be distributed as soon as it has been finalized.

The IRS issued IRM 20.1.1, SERP Interim Procedural Update, to remind employees of the appropriate use of the abort function. The alert advised users the abort feature can be used when RCA's determination is incorrect based on the facts and circumstances and reasonable cause criteria.

The IRS created an RCA training Tool to immediately answer some user questions and established an electronic mailbox for questions about RCA. This will improve communication with users and will assist in identifying programming errors or policy discrepancies.

We are in the process of studying whether FTA waivers promote tax compliance. If the results of the study indicate FTA is increasing compliance, we will explore the feasibility of programming the system to grant FTA waivers prior to assessment, pending programming resources.

We will consider exploring the feasibility of programming the system to search both primary and secondary taxpayer identification numbers when checking compliance history, pending programming resources. However, if implemented, it is expected that both the primary and secondary taxpayers would be required to have a clean compliance history to be considered eligible for FTA to ensure fair and equitable treatment of both single and married taxpayers.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate commends the IRS for taking steps to enhance training for users of RCA, such as usability testing and issuing a SERP Alert to remind employees of the appropriate use of the abort function. However, the National Taxpayer Advocate remains concerned about the IRS's lack of commitment to resolve the fundamental need for RCA user technical training. Before using the RCA, employees should be proficient in tax law and reasonable cause criteria to correctly interpret taxpayer correspondence. Without such basic knowledge, the user may rely too heavily on automation, rather than sound judgment and discretion, when considering the facts of a case. Although the IRS developed a "quick reference" guide for revenue officers and group managers, the National Taxpayer Advocate believes more substantive training is necessary to ensure abatement decisions are accurate.

The National Taxpayer Advocate acknowledges that usability testing is an excellent means of assessing whether employees understand a particular system and if the system is functioning as designed. For example, the recent RCA test revealed that interpretation of taxpayers' correspondence and RCA user feedback are significant areas of concern. However, the test also indicates that RCA users need further technical training on the Failure to Deposit penalty.[49] The IRS should adequately train its employees to analyze penalty requests, select the applicable information, and apply reasonable cause criteria to interpret taxpayer requests correctly.

The IRS states that RCA users need only refresher training. While revenue officers receive technical tax instruction and would likely benefit from refresher training, most reasonable cause abatement requests are handled by the Accounts Management function at various IRS campuses. Campus RCA users and managers should also be proficient in tax law and reasonable cause criteria to properly assess penalty abatement requests. This training should include case studies and examples of when an override election would be appropriate. This allows the trainees to think through actual scenarios. The National Taxpayer Advocate offers her assistance in developing this training. Further, the IRS needs a review process for field and campus employees to monitor quality and consistency. The National Taxpayer Advocate encourages the IRS to provide dedicated technical training in reasonable cause criteria and evaluating correspondence, and then consider a follow-up usability test to determine if its training has been effective.

The National Taxpayer Advocate is pleased that the IRS has initiated a dedicated e-mail address for questions or feedback. However, it should also develop a continuous feedback link exclusively for RCA users to ask questions. This approach would allow programmers and policy analysts to quickly identify errors or discrepancies and inform users. Although the IRS did publish a SERP alert regarding the abort function of RCA, and campus employees typically use SERP alerts, field revenue officers are not likely to receive important

[49] IRS, *Reasonable Cause Assistant (RCA) Usability Test Final Report Summary* 7 (May 28, 2010).

information through this medium. It is important that the IRS also find ways to update field RCA users on the system. Additionally, OSP should incorporate a human feedback loop where analysts review cases that users chose to abort the RCA recommendation. These analyses might identify circumstances that are not properly addressed by the RCA programming and can be improved. Human intelligence should inform RCA instead of being supplanted by the computer system.

The National Taxpayer Advocate looks forward to ongoing dialogue with OSP as it explores the feasibility of programming the system to grant FTA waivers prior to assessment. Since 82 percent of all FY 2009 penalties abated under the RCA were attributable to the FTA waiver, waiving penalties before assessment and following up with a "soft notice" of explanation will allow the IRS to reduce the cost of administering RCA-related penalty abatement requests, while educating taxpayers and encouraging voluntary compliance. OSP states that it will only explore the feasibility of granting automatic FTA penalty relief if its study shows that doing so will promote future compliance. However, as the GAO wrote in its 2009 report, the IRS should examine the relationship between penalties and voluntary compliance and determine whether any penalty promotes future compliance.[50] Postponing RCA to grant automatic FTA relief based on some proof of future compliance only makes sense if OSP looks at future compliance rates of all penalties and all abatements as a baseline. Consequently, the National Taxpayer Advocate disagrees that exploring the feasibility of granting automatic FTA relief should be contingent on a future study of FTA compliance rates and urges OSP to begin its exploration of this relief now.

OSP states it will consider programming its computer system to search both the primary and secondary taxpayer identification numbers when checking compliance history for the FTA. However, OSP concludes that if it does reprogram its system to check both taxpayer identification numbers, it will require both taxpayers to have a clean compliance history before granting FTA relief from the penalties. The National Taxpayer Advocate disagrees with this policy and wonders why both taxpayers need to be in compliance for the IRS to grant the FTA to one. Such a policy reflects an antiquated understanding of the marital unit. The IRS already has policies to meet the needs of married individuals who become divorced, separated, or widowed to provide different relief for the primary and secondary taxpayers.[51] The National Taxpayer Advocate sees no reason why the IRS cannot adopt similar policies when granting FTA relief from jointly assessed penalties.

RCA is designed to encourage consistency. Therefore, proper guidance on reasonable cause, tax law training, and safeguards to ensure that employees arrive at appropriate abatement decisions are all vital to avoid harm to taxpayers and unnecessary rework for the IRS.

50 GAO, GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* 10 (June 2009); *see also* National Taxpayer Advocate 2008 Annual Report to Congress, vol. 2, *A Framework for Reforming the Penalty Regime*, 5-12.

51 *See, e.g.*, IRC § 6015 (innocent spouse relief); IRM 21.6.8 (Nov. 16, 2010) (split assessments for innocent spouses); IRM 5.19.1.5.4.21 (Aug. 5, 2010) (manually-monitored installment agreements for separate spouses with joint liabilities); and IRM 5.16.1.3.2(2) (May 5, 2009) (offers in compromise accepted to compromise the tax debt of the spouse who made the offer).

Recommendations

The National Taxpayer Advocate recommends that the IRS take the following specific actions:

1. Partner with the Taxpayer Advocate Service to develop case studies for use in basic and refresher training to develop employees' skills in recognizing and analyzing facts, including those requiring override of RCA.
2. Train those who manage RCA users in tax law and reasonable cause criteria so that management approvals of abatement decisions are accurate.
3. Establish a human feedback system that analyzes override cases and e-mail feedback, and program "lessons learned" into the system to enhance its accuracy and scope.
4. Program IRS systems to identify compliant taxpayers prior to a penalty assessment, automatically grant FTA waivers if taxpayers meet the compliance criteria, and send "soft notices" to the taxpayers explaining the reason for the waiver to encourage future compliance.
5. Program systems to search primary and secondary taxpayer identification numbers when checking compliance histories, and permit separate FTA abatements of each spouse in certain circumstances.

MSP #15 State Domestic Partnership Laws Present Unanswered Federal Tax Questions

RESPONSIBLE OFFICIALS

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DEFINITION OF PROBLEM

While numerous tax provisions turn on individual and family relationships, state domestic relations law has outpaced federal tax law. In recent years, 11 states have established domestic partnerships or civil unions between individuals of the same gender,[1] while eight states,[2] as well as ten foreign countries,[3] have recognized marriage between individuals of the same gender. Generally, marriages are valid if recognized where celebrated,[4] but under the Defense of Marriage Act (DOMA), "marriage" for federal purposes does not encompass same-gender spouses.[5] DOMA does not disregard domestic partnerships, which may create parent-child relationships, property rights, and obligations under state law. Consequently, numerous federal tax questions arise for domestic partners, as well as same-gender spouses, whose marriages are disregarded under DOMA, but who nevertheless may have relationships, rights, and obligations under state law with ambiguous federal tax consequences. The IRS has not provided answers to these questions, requiring many taxpayers to file returns without knowing which rules apply and potentially subjecting them to audits and penalties, as well as costs for tax advice.

According to demographic research, the populations of individuals in same-gender marriages and domestic partnerships were 63,658 and 174,760, respectively, in 2008, when only three states authorized same-gender marriages and ten recognized domestic partnerships.[6] Nationwide, more than a million individuals are estimated to be living as same-gender

1 *See* Calif. Fam. Code § 297; Conn. Gen. Stat. § 46b-38aa *et seq.*; D.C. Code § 32-702; Haw. Rev. Stat. § 572C-1 *et seq*. (establishing reciprocal beneficiary relationships); Me. Rev. Stat. tit. 22, § 2710; Nev. Rev. Stat. § 122A.010 *et seq.*; N.H. Rev. Stat. § 457-A:1 *et seq.*; N.J. Stat. § 37:1-1 *et seq.*; Or. Rev. Stat. § 432.405; Vt. Stat. tit. 15, § 1201 *et seq.*; Wash. Rev. Code § 26.60.010 *et seq*.

2 *See Strauss v. Horton*, 46 Cal. 4th 384 (2009) (preserving marriages performed in 2008); *Kerrigan v. Comm'r* of Public Health, 289 Conn. 135, 957 A.2d 407 (2008); D.C. Code § 46-401; *Varnum v. Brien*, 763 N.W.2d 862 (Iowa 2009); *Goodridge v. Dep't of Public Health*, 440 Mass. 309, 798 N.E.2d 941 (2003); N.H. Rev. Stat. § 457:1-a; *Martinez v. County of Monroe*, 50 A.D.3d 189, 850 N.Y.S.2d 740 (4th Dep't 2008), *cert. den'd* 10 N.Y.3d 856, 889 N.E.2d 496 (2008) (recognizing same-gender marriage performed out-of-state); Vt. Stat. tit. 15, § 8.

3 Netherlands, Belgium, Canada, Spain, South Africa, Norway, Sweden, Iceland, Portugal, Argentina. *See* Dan Fastenberg, *International Gay Marriage*, Time, July 22, 2010.

4 *See* Restatement of Conflict of Laws § 121.

5 Pub. L. No. 104-199, 110 Stat. 2419 (1996).

6 The 2008 same-gender marriage states were California, Connecticut, and Massachusetts; domestic partnership states were California, Connecticut, District of Columbia, Hawaii, Maine, Massachusetts, New Jersey, Oregon, Vermont and Washington. *See* Gary J. Gates, *Same-Sex Spouses and Unmarried Partners in the American Community Survey, 2008*, Williams Institute, Univ. of Calif. at Los Angeles (Oct. 2009) Table 1 at 4, App. Table 2 (reporting 31,829 same-gender marriages and 87,380 other couples with non-marital legal recognition). Because these same-gender married and partnered couples cannot file jointly for federal tax purposes, the relevant number of individual taxpayers is twice the number of couples.

couples (whether or not registered), over 20 percent of which are raising children.[7] Consequently, hundreds of thousands of taxpayers need guidance.

ANALYSIS OF PROBLEM

Background

Certain States Recognize Domestic Partnerships and Same-Gender Marriages While the Federal Government Disregards the Latter

Domestic partnerships or civil unions between adults of the same gender continue to be established in California, Hawaii, Maine, Nevada, New Jersey, Oregon, and Washington. Additional states, even those that preclude performance of same-gender marriages, may offer more limited rights to domestic partners.[8] In some states, these couples are entitled to the benefits of marriage.[9] In other states, statutes set forth certain rights and obligations and may grant domestic partners the same rights and responsibilities as spouses, including attendant relationships, such as those of in-laws.[10] Some states permit certain persons of opposite gender to register as domestic partners.[11]

Connecticut, Iowa, Massachusetts, New Hampshire, Vermont, and the District of Columbia authorize same-gender marriages. During 2008, California issued licenses for approximately 18,000 such marriages, which still are valid.[12] Additionally, New York recognizes same-gender spouses whose marriages were performed out of state.[13] Five of these states allowed domestic partnerships (or civil unions) before recognizing same-gender marriages. In some states, same-gender spouses are constitutionally guaranteed the right to marry,[14] while other states legislatively grant marriage rights with attendant responsibilities.[15]

As enacted in 1996, DOMA states that in "determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States, the word 'marriage' means only a legal union between one man and one woman as husband and wife, and the word 'spouse' refers only to a person

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7 *See* Gary J. Gates, *Same-Sex Spouses and Unmarried Partners in the American Community Survey, 2008*, Williams Institute, Univ. of Calif. at Los Angeles (Oct. 2009) App. Table 1.

8 *See, e.g.*, Md. Code, Tax-Prop. Art. § 12-101(e-2); Wis. Stat. § 770.001 *et seq*.

9 *See Lewis v. Harris*, 188 N.J. 451, 908 A.2d 196 (2006).

10 *See, e.g.*, Wash. Rev. Code § 26.60.015.

11 *See, e.g.*, Calif. Fam. Code § 297(b)(5)(B); Haw. Rev. Stat. § 572C-5; Wash. Rev. Code § 26.60.030(6).

12 *See Strauss v. Horton*, 46 Cal. 4th at 385 (upholding "the estimated 18,000 marriages of same-sex couples that were performed" between June 17 and November 4, 2008). In August 2010, a federal district court ruled California's Prop. 8, which had suspended performance of same-gender marriages, unconstitutional under the Equal Protection Clause of the 14th Amendment, holding that it denied a fundamental right without a legitimate reason. *See Perry v. Schwarzenegger*, 704 F. Supp. 2d 921 (N.D. Calif. 2010). The Ninth Circuit court has granted a stay pending appeal. *See* Order, No. 10-16696 (9th Cir. Aug. 16, 2010).

13 *See Martinez v. County of Monroe.*

14 *See Varnum v. Brien; Kerrigan v. Comm'r of Public Health; Goodridge v. Dep't of Public Health*.

15 *See* D.C. Code § 46-401; N.H. Rev. Stat. § 457:1-a; Vt. Stat. tit. 15, § 8.

of the opposite sex who is a husband or a wife."[16] In July 2010, the federal district court in Massachusetts declared DOMA unconstitutional under the Equal Protection Clause of the Fifth Amendment because the court could not discern a rational basis for denial of federal recognition to same-gender spouses.[17] Appeal to the First Circuit court is anticipated, with the federal government defending the constitutionality of DOMA even though the current Administration "does not support DOMA as a matter of policy, believes that it is discriminatory, and supports its repeal."[18]

At this point, same-gender spouses do not know whether they should continue to take certain tax positions as if DOMA applies and whether they will have to amend their returns if an appellate court reaches a contrary conclusion. The discussion below assumes that DOMA continues to apply.[19]

The Effect of State Laws on Federal Taxation Is Unclear

Generally, it has been well settled that "federal income tax liability follows ownership" which "state law controls,"[20] along with domestic relations.[21] However, DOMA calls the latter proposition into question, while previous IRS advice appears inconsistent with the general rule. In particular, domestic partners in California have community property.[22] In 2006, the IRS Chief Counsel nonetheless advised California domestic partners that they must report all earned income individually because of the inapplicability "of a state's community property law outside the context of a husband and wife."[23] Four years later, the Office of Chief Counsel effectively reversed this result, concluding that a California domestic partner now must report half of community income.[24] A retrospective rationale for the 2006 advice was that although earned income of a California partner was community property for state property law purposes, earned income had not been treated as community income for California income tax filing until 2007.[25] This pre-2007 treatment may have created symmetry with federal tax filing, but in any case, the 2006 advice appeared inconsistent with the principle that "Federal tax law generally respects state property law

16 1 U.S.C. § 7 (1996).

17 *See Gill v. Office of Personnel Management* (OPM), 699 F.Supp.2d 374 (D. Mass. 2010). In a companion case, the district court held that DOMA was unconstitutional under the Tenth Amendment (reserving unenumerated powers to the states) and the Spending Clause. *See Commonwealth of Mass. v. Dep't of Health & Human Services* (HHS), 698 F. Supp. 2d 234 (D. Mass. 2010).

18 *Gill v. OPM*, Memo. of Law in Support of Def.s' Mot. Dismiss 1.

19 Under IRC § 6013(a), same-gender spouses file singly for federal tax purposes. In the eight states that recognize same-gender marriage, same-gender spouses reformulate their tax returns as married for state purposes, a function that may require overriding commonly available software.

20 *See United States v. Mitchell*, 403 U.S. 190, 197 (1971).

21 *See Elk Grove United School District v. Newdow*, 542 U.S. 1 (2004).

22 As of 2005, registered "domestic partners shall have the same rights, protections, and benefits, and shall be subject to the same responsibilities, obligations, and duties under law, whether they derive from statutes, administrative regulations, court rules, government policies, common law, or any other provisions or sources of law, as are granted to and imposed upon spouses." Calif. Family Code § 297.5.

23 CC Advisory 2006-08-038 (issued Feb. 24, 2006).

24 *See* CC Advisory 2010-21-050 (issued May 5, released May 28, 2010). Chief Counsel Advice memoranda are not precedential. IRC § 6110(k)(3).

25 *See id*. at n. 1. A companion piece that was silent on the state tax treatment of earned income in 2005-2006 but pertained to collection potential for purposes of IRC § 7122 (regarding offers in compromise) stated that "California state law provides that both domestic partners have an equal interest and liability in the community property." CC Advisory 2010-21-049 (issued May 6, released May 28, 2010).

characterizations and definitions."[26] Uncertainty surrounding the government's observance of fundamental principles, not to mention particular results, of federal taxation makes legal guidance necessary here.[27]

Uncertainty Leaves Taxpayers in an Untenable Position

Uncertainty concerning the federal taxation of same-gender spouses or domestic partners could put taxpayers and their return preparers in an untenable position. Generally, a taxpayer may take a filing position to which a penalty would not attach if there is substantial authority, such as a court case (not overruled by the U.S. Court of Appeals).[28] Thus, there may be substantial authority for same-gender spouses to take certain tax positions as married as long as the Massachusetts district court's opinion stands.[29] At the same time, DOMA itself may constitute substantial authority to continue to avoid numerous provisions that result in a marriage penalty.[30] Presumably, same-gender spouses and domestic partners need not file jointly, even if their underlying state law relationship is conjugal, under provisions requiring married couples to file jointly in order to claim a tax benefit.[31]

On the other hand, a return preparer faces a penalty unless a position would more likely than not be sustained on the merits.[32] Given the constitutional uncertainty of DOMA as well as the reversal of IRS advice between 2006 and 2010, it is unclear which position would be sustained. Meanwhile, hundreds of thousands of taxpayers need advice.[33]

Although the Office of Chief Counsel has issued a Private Letter Ruling (PLR) as well as the Chief Counsel advice on domestic partners discussed above, [34] it is unclear that this non-precedential type of guidance would be effective here. A PLR can cost hundreds or thousands of dollars, while many of the tax provisions at issue are targeted at low and moderate-income families who lack the resources to pay the fee.[35] Moreover, the relevant questions could be answered by the application of federal taxation to state law, rather

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26 CC Advisory 2010-21-050.

27 *See* Dennis J. Ventry, Jr., *No Income Splitting for Domestic Partners: How the IRS Erred*, 110 Tax Notes 1221 (2006). Moreover, the National Taxpayer Advocate 2005 Annual Report to Congress at 407, observing inequities in taxation of family income, proposed legislation to repeal the rule of *Poe v. Seaborn*, 282 U.S. 101 (1930), that each spouse is taxed on half of community income. If enacted, this previous proposal would resolve this particular issue.

28 *See* Treas. Reg. § 1.6662-4(d)(3)(iii).

29 *See Gill v. OPM; Mass. v. HHS*.

30 *See* Theodore P. Seto, *The Assumption of Selfishness in the Internal Revenue Code: Reframing the Unintended Tax Advantages of Gay Marriage*, Loyola Legal Studies Paper No. 2005-33.

31 *See, e.g.*, IRC §§ 21(e)(2) (child-care credit), 32(d) (Earned Income Tax Credit), 25A(g)(6) (Lifetime Learning, Hope Scholarship, and American Opportunity Tax Credits), 221(f)(2) (student loan interest deduction), 135(d)(3) (U.S. savings bond interest exclusion for college expenses), 163(h)(4)(A)(ii) (home mortgage interest deduction), 36(c)(5) (First-Time Homebuyer Credit), 23(f)(1) (adoption credit), 137(e) (adoption exclusion), 22(e)(1) (elderly or disabled credit).

32 *See* IRC § 6694.

33 *See* Patricia A. Cain, *Taxing Families Fairly*, 48 Santa Clara L. Rev. 805, 848 (2008) (noting that lawyers have requested IRS guidance).

34 *See* PLR 2010-21-048 (issued May 5, released May 28, 2010); CC Advisory 2010-21-050.

35 *See* Rev. Proc. 2010-1, 2010-1 I.R.B. 1, 67, App. A (including reduced user fee of $625 for individual with gross income of less than $250,000, or $2,000 for gross income between $250,000 and $1 million). A general "information letter" would be free but would relate only to "a well-established interpretation or principle of tax law." *See id*. at 7, 69.

than unique facts posed by taxpayers. Given the scope of the concerns, the Office of Chief Counsel should issue guidance of general applicability.

Taxation Affects Family Costs

Under substantive tax provisions, discussed below, the following questions arise for same-gender spouses or domestic partners:

- Does a parent-child relationship persist even if DOMA disregards the parent's marriage?
- Is a domestic partner or same-gender spouse in a community property state deemed to provide, for dependency purposes, the support that he or she earns?
- Is alimony under state domestic partnership or same-gender marriage law includible by the recipient and deductible by the payer?
- Is community property created upon marrying or partnering with an individual of the same gender a taxable gift?
- Do same-gender tenants by the entirety have a qualified joint interest for estate tax purposes?

Tax Law Contains Provisions for Children and Other Dependents

Federal tax law contains various provisions for costs of child care, health care, and education. Central to these provisions is the definition of "child," which figures in eligibility for head of household filing status and the dependency deduction,[36] as well as the child-care credit,[37] child tax credit (CTC),[38] and earned income tax credit (EITC).[39] These provisions have significant tax consequences, and taxpayers need guidance to determine their applicability.[40] In pertinent part, all of these provisions depend on whether the taxpayer has a child, which may include a stepson or stepdaughter.[41] A taxpayer who is a same-gender spouse may have a stepchild by virtue of marriage to the child's parent. The applicable definition of "child" does not refer to marriage, nor does DOMA define a child. Nevertheless, if

36 IRC § 2(b) head of household filing status generally provides favorable income tax rates under § 1(b) for an unmarried individual who maintains a home for a child. IRC §§ 151 and 152 allow a personal exemption deduction ($3,650 in 2010) for a child or other dependent.

37 The IRC § 21 child-care credit, which in conjunction with the § 129 exclusion of employer-provided child care historically has "represented the largest source of federal financial support for child care," generally allows a credit up to $2,100 in 2010 for household and dependent care services necessary for gainful employment of a taxpayer. Mary Louise Fellows, *Rocking the Code: A Case Study of Employment-Related Child-Care Expenditures*, 10 Yale J. L. & Feminism 307, 310 n. 11 (1998).

38 The IRC § 24 CTC allows a credit of $1,000 per child, a portion of which the IRS may refund to a low-income parent even in excess of any tax owed.

39 The IRC § 32 EITC, popularly recognized as "the nation's largest anti-poverty program," operates as a refundable wage supplement of up to $5,666 in 2010 to working parents (with reduced benefits to workers without children). Daniel P. Gitterman, Lucy S. Gorham & Jessica L. Dorrance, *Expand the EITC for Single Workers and Couples Without Children*, Pol'y Brief Prepared for the Ctr. on Poverty, Work & Opportunity, Univ. of N.C. at Chapel Hill 1 (Jan. 2007).

40 The child-care credit, the CTC, and the EITC provide tax benefits worth, nationwide, an estimated $3.75, $23.45, and $6.19 billion, respectively, in 2010. *See Budget of the United States Government* (USG) FY 2011, Analytical Perspectives, Ch. 16, Table 16-1, lines 122, 121 & 159, at 211-212 (noting significant additional outlay effects of $30.29 and $51.50 billion, respectively, for refundable portions of the CTC and EITC). Additionally, IRC § 129 excludes employer-provided child care, which results in an estimated $1.21 billion expenditure for 2010. *See USG Budget, loc. cit.*, line 116.

41 *See* IRC §152(f)(1)(A)(i).

DOMA has the effect of disregarding the marriage, the question arises whether the child is no longer a stepchild of this taxpayer for federal tax purposes.

In another section, the federal tax law defines "parent" by reason of "parental rights and duties in respect of the child."[42] Moreover, state law may stipulate that a parent-child relationship is not dependent on the persistence of either a marriage or a domestic partnership.[43] On the other hand, if a taxpayer has a stepchild by virtue of a domestic partnership with the parent under state law, DOMA, which applies only to marriage, presumably would not call this parent-child relationship into question. In any case, the fundamental issue of the parent-child relationship needs clarification before same-gender spouses can comply with significant provisions of federal tax law.

Another type of dependency deduction is the spousal exemption, for which a same-gender spouse or domestic partner is categorically ineligible.[44] Nonetheless, a dependent may be deductible as a qualifying relative in the household if, among other requirements, one same-gender spouse or domestic partner provides over half of the other's support for the year.[45] In a community property state, however, would half the support be deemed to belong to each same-gender spouse or domestic partner such that one could never be a dependent of the other? Clarification is necessary to allow these taxpayers to file correct returns.

Tax Law Contains Health and Education Provisions

The definition of "dependent" similarly has consequences for tax-favored health care and education provisions. With respect to medical care expenses of dependents, the tax law excludes from gross income certain employer reimbursements, allows a deduction, and provides for Flexible Spending Accounts, Archer Medical Savings Accounts, and Health Savings Accounts.[46] With respect to a dependent's college tuition, student loan interest, and related expenses, the tax law allows Lifetime Learning, Hope Scholarship, and American Opportunity Tax Credits, certain deductions and exclusions.[47] All of these are major federal programs for which eligibility should be clarified. While the policy of DOMA may be to discourage same-gender spouses, it is unclear how the law should affect health, education, and welfare provisions for domestic partners and children.

Taxation Pertains to Life Events such as Separation and Death

The federal tax law contains a number of provisions for the separation of individuals presumably attendant to divorce. For example, if married individuals in a community

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42 IRC § 73(c).

43 *See, e.g.*, D.C. Code § 16-908.

44 *See* IRC § 151(b).

45 *See* IRC § 152(d)(1)(C).

46 *See* IRC §§ 105, 213, 125, 220, 223.

47 *See* IRC §§ 25A, 221, 222, 135.

property state live and file separately, their income is proportionately divided for federal tax purposes.[48] However, this provision does not apply to similarly situated same-gender spouses or domestic partners. Should they each report half of community income? Under a divorce or separation agreement, certain amounts paid and received are defined for federal tax purposes as alimony includible in gross income by the recipient and deductible by the payer.[49] Presumably, individuals not married for federal purposes cannot be divorced, but can they have "a written separation agreement"?[50] In another context, the U.S. Tax Court has held that individuals who never had been married could come within a provision that encompassed divorcees or individuals with "a written separation agreement" as well as parents living apart for the last half year.[51] On the other hand, before enactment of the alimony tax law, the U.S. Supreme Court held that alimony was neither includible nor deductible.[52] Similarly, federal tax law defines a Qualified Domestic Relations Order (QDRO) for division of employee plan benefits relating to child support, alimony, or otherwise.[53] Would a QDRO apply to same-gender spouses or domestic partners? Again, answers to these questions would enable taxpayers to comply with the law.

Under the federal transfer tax, a marital deduction does not apply to same-gender spouses or domestic partners,[54] but other provisions are ambiguous. For example, would the creation of community property as a consequence of marriage or partnership result in a federally taxable gift within same-gender couples? For married couples, courts have not viewed the creation of community property as a taxable transfer.[55]

In some cases, the federal estate tax deems half of spousal property to be included in the decedent's gross estate. [56] However, it is unclear if same-gender spouses or domestic partners who own property by the entirety in common law states have a "qualified joint interest" even though the federal tax law defines that term in part by reference to tenants by the entirety.[57] While federal tax law ordinarily designates the treatment of "interests or rights, so created" by state property law,[58] the statutory terms may have ambiguous consequences in this context.

48 *See* IRC § 66(a).

49 *See* IRC §§ 71, 215.

50 *See* IRC § 71(b)(2)(B).

51 *See King v. Comm'r*, 121 T.C. 245 (2003) (relating to IRC § 152(e)(1)(A)). The result was codified in Treas. Reg. § 1.152-4(b)(2)(i)(C). *See* 72 Fed. Reg. at 24,194 (May 2, 2007).

52 *See Gould v. Gould*, 245 U.S. 151 (1917).

53 *See* IRC § 414(p). The Dep't of Labor has regulatory authority under IRC § 414(p)(13).

54 *See* IRC §§ 2056, 2523.

55 *See Poe v. Seaborn*, 282 U.S. 101; *see also* PLR 2010-21-048 (ruling privately in a format not precedential under IRC § 6110(k)(3)).

56 *See* IRC § 2040(b)(2).

57 *See* IRC § 2040(b)(2)(A).

58 *Morgan v. Comm'r*, 309 U.S. 78, 80 (1940).

CONCLUSION

DOMA and various state laws regarding domestic partnerships and same-gender marriages give rise to a large number of unintended or unforeseen federal tax law ambiguities, making it possible for hundreds of thousands of taxpayers to take inconsistent positions in good faith. The National Taxpayer Advocate believes that it is a basic responsibility of government to provide taxpayers with sufficient guidance to enable them to comply with the law.

In conclusion, our preliminary recommendation is the IRS Office of Chief Counsel should publish a revenue ruling, establish adequate safe harbors, or issue other precedential guidance of general applicability.

IRS COMMENTS

As the National Taxpayer Advocate indicates in the report, states vary in the degree to which they recognize same-sex relationships. Some states recognize same-sex marriage, others provide for civil unions, and others permit couples to register as domestic partners. The IRC, on the other hand, generally categorizes individuals for federal income tax purposes either as unmarried individuals or as married individuals ("spouses"). The Defense of Marriage Act prohibits the IRS from publishing guidance that recognizes same-sex couples as "married" individuals or "spouses" for purposes of federal tax law.

The Office of Chief Counsel focuses its published guidance resources on resolving uncertain tax issues that affect a significant number of similarly-situated taxpayers. The existence of DOMA and the litigation over its validity, the wide variation among states in the extent of rights and obligations provided to same-sex couples, and the evolving nature of state laws make it unlikely that published guidance could provide a uniform set of rules that resolve the issues facing same-sex couples nationwide.

In the absence of legislation resolving these issues, the IRS and the Office of Chief Counsel intend to continue, where appropriate, to respond to taxpayer requests for advice tailored to their particular state's law. As the National Taxpayer Advocate's report recognizes, the Office of Chief Counsel provided advice in response to inquiries about California's domestic partner statute. In addition, the IRS and the Office of Chief Counsel will continue to monitor developments in state and federal law to ensure that federal tax laws are applied correctly to same-sex couples. The IRS and the Office of Chief Counsel will consider publishing guidance on discrete issues arising under a particular state's domestic relations laws if we determine that published guidance is necessary to ensure that federal tax laws are applied correctly to same-sex couples.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS will continue monitoring developments to ensure the correct application of federal tax laws to same-gender couples, and that the Office of Chief Counsel will consider publishing guidance on discrete issues arising under a state's domestic relations laws.[59] IRS responsiveness to taxpayer requests, illustrated in the discussion above by a Private Letter Ruling and other cited advice, will continue to be helpful.

Nevertheless, the National Taxpayer Advocate remains concerned that a significant number of individual taxpayers will face these issues, yet lack the resources to formulate a request for clarification of federal tax law. Among other examples, there are specific questions concerning the qualification of children and domestic partners for a dependency deduction. Even if Congress were to enact legislation clarifying the federal status of same-gender marriages, issues such as these likely would remain in the realm of administrative rule-making.

On domestic relations, property rights, and many other subjects, state laws vary significantly, yet taxpayers generally have been able to rely on the principle that interests or rights created by state law serve as the basis for federal taxation. In this case, however, both legislative and other legal pronouncements have called this principle into question. It is precisely because of the resulting uncertainty that guidance is necessary. While uniformity of result is neither requested nor particularly desirable, guidance could establish consistent principles of interpretation. Under current law, same-gender marriages do not create "spouses" for federal tax purposes. Should taxpayers therefore conclude that a federal tax statute referring to "spouses" is inapplicable, even if the relevant state law interest otherwise fits the requisite description, as, for instance, a tenancy by the entirety?

If a taxpayer takes a position on an ambiguous federal tax question on which the IRS has declined to issue guidance, any subsequent reversal by the IRS could create a perception of unfairness, frustrating taxpayers and ultimately undermining voluntary compliance. In any case, it is a basic responsibility of government to provide taxpayers with sufficient guidance to enable them to comply with the law.

59 In its response, the IRS noted that the Office of Chief Counsel focuses resources on guidance for a significant number of taxpayers. Nonetheless, guidance has been published for relatively discrete populations. *See, e.g.*, Rev. Proc. 2010-41, 2010-48 I.R.B. 781 (including guidance for return preparers without a Social Security Number due to religious objection); Rev. Proc. 2010-31, 2010-40 I.R.B. 413 (setting forth guidance on when a foreign adoption is final for parents who claim a tax credit for expenses of adopting a child); Notice 2010-30, 2010-18 I.R.B. 650 (containing guidance for military spouses who are civilians working in a U.S. territory but claiming residence in a state); Rev. Rul. 2004-71, 2004-2 C.B. 74 (applying IRC § 6402 to community property in Arizona and Wisconsin); Rev. Rul. 2004-72, 2004-2 C.B. 77 (applying IRC § 6402 to community property in California, Idaho, and Louisiana); Rev. Rul. 2004-73, 2004-2 C.B. 80 (applying IRC § 6402 to community property in Nevada, New Mexico, and Washington); Rev. Rul. 2004-74, 2004-2 C.B. 84 (applying IRC § 6402 to community property in Texas); Rev. Rul. 68-277, 1968-1 C.B. 526 (disregarding anti-miscegenation statutes as unconstitutional); Rev. Rul. 58-66, 1958-1 C.B. 60 (recognizing common-law marriage).

Recommendations

The National Taxpayer Advocate recommends that the IRS, through published guidance:

1. Clarify the qualification of children, same-gender spouses, and domestic partners for the dependency deduction.
2. Establish consistent principles of interpretation to answer various other questions associated with state domestic partnership and related laws.

MSP #16 The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers

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DEFINITION OF PROBLEM

The proper delivery of refunds, notices, and other official correspondence is essential for effective tax administration. The IRS mails over 200 million pieces of correspondence to taxpayers each year, yet it does not track how much of this mail is annually returned as "undeliverable as addressed" (UAA).[1] A recent Treasury Inspector General for Tax Administration (TIGTA) audit estimated that during fiscal year (FY) 2009, approximately 19.3 million pieces of mail, or almost ten percent of all correspondence for the year, were returned to the IRS at an estimated cost of $57.9 million.[2] TIGTA reported that 37 percent of the UAA mail could not be delivered due to bad addresses.[3] Additionally, IRS internal studies have shown that 65 percent of all international mail is classified as UAA and may be returned if not corrected.[4]

When mail does not reach taxpayers, a host of problems can ensue. For example, if mail is undeliverable, a levy, lien, or other enforcement action may be the taxpayer's first notice of an IRS problem. Despite the impact on taxpayers of not receiving IRS correspondence, the IRS does not routinely notate a taxpayer's account when mail is returned as undeliverable, nor does it effectively use available tools to determine a better address for a taxpayer.

Most Serious Problems

1 IRS, Wage and Investment (W&I) Division, CARE/M&P Mail Management Project Office, Distribution Media and Publications; *Correspondence Production Services (CPS) Volume History*; and National Print Site Data (National Print Sites) Warehouse, *available at* http://nps.web.irs.gov/print%20warehouse/CPS%20FY-09-Site-Summ%20(2).xls (last visited July 6, 2010). In FY 2009, 201,254,976 notices and letters were printed and mailed at the two National Print sites (NPS). According to the IRS's W&I CARE/M&P: Mail Management Project office, an additional 45 million tax forms, publications, and other information items were mailed by Media and Publications.

2 TIGTA, Ref. No. 2010-40-055, *Current Practices Are Preventing a Reduction in the Volume of Undelivered Mail* 2 (May 14, 2010).

3 *Id*.

4 IRS, W&I, CARE/M&P: Mail Management Project Office, *International Mail Impact Analysis Final Report* (July 2007). "It is estimated that more than 7 million Americans reside outside of the United States (not including military personnel)." IRS, *Reaching Out to Americans Abroad*; International Tax Gap Series, *available at* www.irs.gov/businesses/article/0,,id=205889,00.html (last visited Mar. 31, 2010).

ANALYSIS OF PROBLEM

Background

IRS Mails Correspondence to the Last Known Address

When corresponding with a taxpayer, the IRS uses the "address of record," which is generally the address given on the taxpayer's last return.[5] IRS policy requires the taxpayer to provide "clear and concise" notice of any change of address.[6] When the IRS sends a notice or document to a taxpayer's "last known address," it is legally effective even if the taxpayer never receives it.[7] Although many provisions of the Internal Revenue Code (IRC) require the IRS to mail notices to the taxpayer's "last known address," there is no statutory definition of this term.[8]

Despite the lack of a definition of last known address, the U.S. Tax Court has addressed the standards needed to notify the IRS of a new address as well as the IRS's obligations in determining the correct address for the taxpayer. In *Pyo v. Commissioner*, the Tax Court stated that the IRS must exercise reasonable care and diligence in mailing a notice of deficiency to the correct address once it becomes aware of a change of address.[9] Whether or not the taxpayer has provided clear and concise notification of a new address, and the IRS has then exercised reasonable care and diligence, is a facts and circumstances interpretation. The Tax Court has commented extensively on cases involving both situations. In *Hunter v. Commissioner*, the court stated the IRS is charged with knowing information it has readily available when it sends notices, and technological advances have left the IRS with a minimal burden in searching its own computer systems.[10] The IRS Office of Chief Counsel concluded that the IRS must use the information available in its own files when it sends notices, and document that the search for the address is correct based on information the IRS possesses.[11]

A Transient Taxpayer Population Can Lead to Mismatches Between IRS and USPS Address Records.

In FY 2009, the U.S. Postal Service (USPS) reported that 46 million people moved and over a million new addresses were identified in the United States.[12] In 2001, the IRS began using the USPS NCOA system, which provides weekly domestic changes of address, to

5 Taxpayers can also change their "addresses of record" with "clear and concise" instructions during telephone calls with the IRS, in correspondence submitted to the IRS, or through a change of address filed with the U.S. Postal Service (USPS) and transmitted to the IRS via the National Change of Address (NCOA) system. Treas. Reg. § 301.6212-2; Rev. Proc. 2010-16, 2010-1 C.B. 664.

6 Treas. Reg. § 301.6212-2; Rev. Proc. 2010-16, 2010-1 C.B. 664.

7 *Id.*

8 *See, e.g.*, IRC §§ 6212, 6303, 6320, and 6330.

9 *Pyo v. Comm'r*, 83 T.C. 626, 633.

10 *Hunter v. Comm'r*, T.C. Memo. 2004-81.

11 Chief Counsel Memorandum, *Addressing Issues* (Jan. 9, 2008).

12 USPS/Pitney Bowes Webinar: Address Validation (2010), *How Government Agencies Use Address Quality; America Is on the Move and Growing* 3.

ease taxpayer burden and maintain accurate address records. In 2007 alone, the USPS electronically sent the IRS records of up to 800,000 address changes per week.[13]

The IRS requires an exact match between NCOA and its Integrated Data Retrieval System (IDRS) to change the Master File address record for a taxpayer. Thus, many taxpayer records cannot be matched and the existing "bad" address remains on the taxpayer's account.[14] A "no match" may occur when a taxpayer uses a nickname instead of his or her formal first or given name on one record but not the other. If the taxpayer used "William" on a tax return but "Billy" appeared on the NCOA database, it would not be an exact match.[15] If a taxpayer-furnished NCOA change of address does not *exactly* match IRS records, the IRS does nothing further to identify a changed address for any future notices and letters.

New Postal Standards Create Barriers for IRS Correspondence Delivery

Until 2008, mail that contained a correct city, state, and ZIP code was given to the local mail carrier, who was familiar with the people and addresses on his or her route and could potentially deliver mail with misspelled or incomplete street addresses. However, in 2008, the USPS standards for a deliverable address changed and now include the requirement for a "perfect" street address in addition to the traditional city, state, and ZIP code perfection guidelines.[16] These requirements were added to streamline postal delivery operations, qualify customers for reduced postal rates, and accommodate 911 emergency responses.[17] At the same time, the USPS increased its use of address perfection software to identify UAA mail at its distribution centers. This process requires a "perfect" or deliverable address before it is sent on to the local postal carriers, resulting in increased UAA mail.[18]

The IRS Does Not Use Address Perfection Software to Validate Addresses of Record Placed on Taxpayer Accounts.

Although taxpayer error in reporting new addresses may account for a large portion of undelivered mail, NCOA mismatches and IRS data input errors are also contributing factors.[19] IRS "key punch" mistakes can easily place an undeliverable address on an account without the taxpayer's knowledge. These internal mistakes, such as street, city, or state misspellings, often go undetected by IRS employees or systems. Addresses on paper returns receive a cursory review to ensure that the city, state, and ZIP code are present and agree, but the IRS

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13 IRS, W&I, CARE/M&P: Mail Management Project Office, *International Mail Impact Analysis Final Report* 2 (July 2007).

14 Treas. Reg. § 301.6212-2(b)(2) states that the IRS will update taxpayer addresses maintained in IRS records by referring to data accumulated and maintained in the NCOA database, and if that taxpayer's name and last known address in IRS records match the taxpayer's name and old mailing address contained in the NCOA database, the new address in the NCOA database is the taxpayer's last known address, unless the IRS is given clear and concise notification of a different address.

15 National Office Program Manager Technical, PMTA-1634 (Jan. 9, 2008), *available at* http://www.irs.gov/pub/lanoa/pmta01634_7415.pdf.

16 USPS, Pub. 28, *Postal Addressing Standards* (July 2008), *available at* http://www.usps.com/ncsc/addressservices/addressqualityservices/lacsystem.htm.

17 *Id*.

18 TAS was unable to determine differences between undelivered mail in FY 2007 (just prior to USPS address standard changes) and FY 2009 (after the changes) because the IRS did not track data on undelivered mail during that time. IRS response to TAS request for UD/UAA mail (May 28, 2010).

19 IRS, W&I, CARE/M&P: Mail Management Project Office, *International Mail Impact Analysis Final Report* 5 (July 2007).

does not validate the street address. Electronically filed returns receive *no* address review, even though they account for approximately two of every three individual tax returns filed.[20] The address information on an e-filed return will overwrite an existing deliverable address on the Master File with anything the taxpayer places on the e-filed return, including an e-mail or website address.

IRS systems also pose significant problems for international accounts. The layout and space provided on IRS databases do not accommodate most foreign addresses.[21] The absence of international address perfection software to detect and correct address problems is especially problematic since receiving countries require over 200 different address standards.[22] IRS studies show that international mail is classified as UAA 65 percent of the time, primarily due to improper addresses and formatting.[23] The IRS could greatly reduce the volume of undelivered overseas mail by using USPS-approved software that can perfect the address to the receiving countries' standards.[24]

The IRS Does Not Measure the Impact of Undeliverable Mail on Taxpayers.

The IRS does not adequately track the amount of correspondence returned as "undelivered as addressed."[25] TAS performed an independent review of undelivered mail returned to two IRS campuses and found the IRS could perfect 38 percent or more of the UAA mail reviewed *prior* to printing and mailing notices and letters, but fails to do so.[26] TIGTA found 37 percent of the correspondence it reviewed could not be delivered due to bad addresses.[27]

The IRS Does Not Have an Enterprise-Wide Strategy to Resolve Undeliverable Mail Issues.

All IRS operating divisions and functions, including TAS, issue correspondence to taxpayers almost daily. Although the Wage and Investment division is primarily responsible for processing outgoing and incoming mail, printing and mailing notices and letters, the overall maintenance of addresses, and processing undelivered mail, no one organization

20 IRS, Statistics of Income; *see Internal Revenue Service Data Book, 2009, available at* http://www.irs.gov/pub/irs-soi/09databk.pdf.

21 IRS, W&I, CARE/M&P: Mail Management Project Office, *International Mail Impact Analysis Final Report* (July 2007).

22 *Id*.

23 *Id*.

24 *Id*.

25 TIGTA, Ref. No. 2010-40-055, *Current Practices Are Preventing a Reduction in the Volume of Undelivered Mail* (May 14, 2010).

26 Independent TAS review, *Review and Compilation of Available Undelivered Mail (UD & UAA) Data* (Nov. 2009). The findings in this review result from a limited sample of 1,000 undelivered notices from the Kansas City and Fresno campuses. An in-depth review of 135 of these notices showed that using USPS-approved address perfection software would provide a "deliverable" address for 38 to 54 percent of the sample. Also, the use of other third-party software identified new or "better" addresses in 32 to 48 percent of the sample but would require taxpayer verification before the addresses could be used.

27 TIGTA, Ref. No. 2009-40-044, *Current Practices Are Preventing a Reduction in Undeliverable Mail* (May 14, 2010).

within the IRS is responsible for overseeing agency-wide mail operations.[28] No single IRS unit is tasked with:

- Overall accountability and responsibility for collecting and analyzing all mail data, including undelivered mail;
- Monitoring all of the print and mail systems and fixing problems timely;
- Identifying funding and programming needs to update print and mail systems; and
- Identifying and incorporating organizational efficiencies, such as reducing undelivered mail, into print and mail systems.

Undelivered mail affects the efficiency of every IRS operation. However, the rules for processing undelivered mail are left up to the individual operating divisions. A recent search of seven major Internal Revenue Manual (IRM) sections produced many different undelivered mail processing references,[29] most of which discussed processing for specific notices while others spoke to the general processing of undelivered mail. The guidelines often conflict with each other on how to process changes of address. Several refer to the practice of destroying selected notice types upon return, some require an "undelivered" notation in the taxpayer's account while others do not, and several of the references allow only written authorization from the taxpayer to change an address.[30] Undelivered mail, and information from the USPS, are processed in many different ways. The IRS needs to have one servicewide operation responsible for mail activities to maintain consistency for such an important function of tax administration.

The IRS Does Not Notate All Taxpayer Accounts When Undeliverable Mail Is Returned.

Although the IRS routinely notates its Master File when sending certain letters and notices to a taxpayer, it does not update its records when the USPS returns this correspondence as undeliverable. If an initial notice is sent back, the IRS continues to send future notices to this "bad" address.[31] Most non-certified undelivered mail and certified unclaimed or

28 For a more detailed discussion of the National Taxpayer Advocate's concerns with the functions placed in the IRS's W&I operating division, see Most Serious Problem: *The Wage & Investment Division is Tasked with Supporting Multiple Agency-Wide Operations, Impeding its Ability to Serve its Core Base of Individual Taxpayers Effectively, supra*.

29 The search covered major IRM sections in the Servicewide Electronic Research Program (SERP), including IRM 1 (Organization, Finance, & Management); IRM 2 (Information Technology); IRM 3 (Submission Processing); IRM 4 (Examining Process); IRM 5 (Collecting Process); IRM 21 (Customer Account Services); and IRM 25 (Special Topics).

30 IRM 3.13.62-56 (Jan. 1, 2010). Approximately 200 notice types are listed for destruction upon receipt. These notices include: CP 05, *We Have Received Your Income Tax Return and Are Holding Your Refund*; CP 85, *Exam EIC "Soft" Notice*; CP 75, *Exam Initial Contact Letter – EIC – Refund Frozen*; CP 21E, *Examination Adjustment Notice*; CP 33, *Error Delay for Return and Refund Processing*; and Refused or Unclaimed CP 504, *Final Notice - Balance Due, Intent to Levy*.

31 This practice can particularly harm taxpayers in the collection notice stream. If the IRS's initial collection notice is returned undelivered, the IRS continues to send remaining notices, including the Final Notice and Collection Due Process (CDP) notice, to the invalid address. Not only does the taxpayer lose remedies available to resolve the issue, but the IRS can cite the taxpayers' "unresponsiveness" as justification for lien and levy action.

refused mail (including Collection Due Process notices)[32] that is returned to the IRS is destroyed upon receipt at the various campuses, with no attempt to perfect or locate a new address. This procedure overlooks the IRS's requirement to "...exercise due diligence based on information the Service knew or should have known in order to ascertain a taxpayer's last known address."[33] Moreover, since the IRS does not generally notate undelivered mail in a taxpayer's account, a levy, lien, or other enforcement action may be the taxpayer's first notice of a problem with the account.[34]

The IRS Is Not Effectively Using Available Research Tools to Obtain "Better" Addresses.

The IRS maintains a research tool, the Address Research (ADR) system, to attempt to perfect or locate a "good" or "better" address.[35] However, only 24 notices are processed through the ADR system when mail is returned as UAA.[36] Most of these are collection-related notices such as balance due, return delinquency, intent to levy, or installment agreement default notices.[37] When it identifies potential addresses, the IRS issues Letter 2797, commonly referred to as the "Are You There" letter. This letter is generated and mailed to all potential taxpayer addresses, asking the taxpayer to confirm the address and sign and return the letter.[38] However, this process can take 100 days or more.[39]

The IRS Is Taking Some Steps to Improve Mail Delivery.

The National Taxpayer Advocate acknowledges that the IRS is attempting to address undeliverable mail concerns, including a recent request for funding of additional address perfection software and programming changes to integrate domestic and international

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32 IRM 3.13.62-56 (Jan. 1, 2010). Approximately 200 notice types are listed for destruction upon receipt. Notices listed under the "Destroy" column with the notation ADR/DESTROY are destroyed if the returned mail has "Refused" or "Unclaimed" notations from the USPS. Independent TAS review, *Review and Compilation of Available Undelivered Mail (UD & UAA) Data* (Nov. 2009). Research has shown that refused and unclaimed designations may actually be UAA mail.

33 National Office Program Manager Technical, PMTA-1634 (Jan. 9, 2008), *available at* http://www.irs.gov/pub/lanoa/pmta01634_7415.pdf.

34 Historically, when TAS has raised concerns about the IRS's failure to take additional measures to contact taxpayers, the IRS has cited resource constraints. *See* 2004 National Taxpayer Advocate Annual Report to Congress 243 (Most Serious Problem: *IRS Collection Strategy*) ("Although early personal contact would be ideal for identifying the reasons for the delinquency at hand and going beyond that to foster future compliance, we must use our limited resources to address the most egregious cases, which are usually those who do not respond to the early phone calls.").

35 IRM 5.19.7.5 (Jan. 16, 2009). ADR is an IRS system that uses internal databases and Accurint to search for potential new taxpayer addresses. When potential addresses are secured, IRS letter 2797 is generated and mailed to all potential taxpayer addresses, requesting that the taxpayer confirm the address, sign and return the letter. This process can take 100 days or more. IRM 3.13.62-56 (Jan. 1, 2010).

36 IRM 5.19.7.5 (Jan. 16, 2009). Count only includes notices (excludes letters run through ADR).

37 Undelivered CP 504, *Final Notice; Notice of Intent to Levy*, is included in ADR address research while CDP notices such as the LT11 Final Notice, *Notice of Intent to Levy and Your Notice of a Right to a Hearing*, are not processed through ADR. IRM 3.14.1-28 (Jan. 1, 2010). These two notices are confusing as the both indicate they are the "Final Notice" with "Intent to Levy." The CP 504 does not provide taxpayer appeals rights, whereas the LT11 and other CDP notices do provide appeal rights associated with the intent to levy. Confusion exists over which notice or letter is actually the final notice with an intent to levy. When the CP504 is returned "Undeliverable as Addressed" and processed through ADR, since no notation is appended to the account, the CDP notice will probably be sent to the same undeliverable address. This is particularly true when mail is returned as "Unclaimed" or "Refused" since such mail is destroyed upon receipt with no research for a "good" or "better" address. Some notices are refused or unclaimed by the current occupant because the taxpayer moved, not because the taxpayer refused or did not claim the mail. Since these are "Final" notices and carry with them an "intent to levy" and taxpayer appeal rights, then even the unclaimed and refused mail should be processed through ADR to try and obtain a "deliverable" address.

38 IRM 5.19.7.5 (Jan. 16, 2009).

39 *Id*. ADR is an IRS system that uses internal databases and Accurint (a contracted service that supplies "potential current" address information for taxpayers, upon request from the IRS) to search for potential new taxpayer addresses.

CODE1+ software into many IRS systems that process Master File address changes.[40] These enhancements will allow the IRS to conduct final address checks before printing and mailing notices, and we applaud these initiatives.

The IRS is also reviewing the use of a full-service intelligent bar code on most outgoing mail, which would allow the IRS to electronically exchange mail status information (*e.g.*, notice and mail tracking data) with the USPS. Undelivered mail can be notated in the electronic file and the IRS could quickly process this information to detect addressing errors or to find a new or "better" address and request taxpayer verification. Address change information from the USPS would confirm a "direct match" with NCOA database information and the new address provided by the USPS could be used to update the address of record on the taxpayer's account. Additionally, information contained in a full-service bar code can be used to quickly route return correspondence to the proper IRS organization.[41]

The IRS Can Take Further Action to Address Undelivered Mail Concerns.

Notwithstanding these improvement efforts, there is much more the IRS can do. To ensure that taxpayers actually receive important correspondence, the National Taxpayer Advocate previously recommended that Congress amend IRC § 7701 to add a definition of "last known address" that incorporates case law and current regulations. She also recommended that the IRS:

1. Develop procedures for checking third-party databases for credible alternate addresses prior to sending notices that establish legal rights and obligations (*e.g.*, Statutory Notices of Deficiency, CDP notices, and notices of federal tax lien filing); and
2. When the taxpayer has a credible alternate address, require the IRS to mail the notice simultaneously to the last known address and the credible alternate address (as defined by the Secretary).[42]

The IRS can take some of these actions without legislation. As the Office of Chief Counsel noted, the IRS can use third-party software to obtain a potential new address for a taxpayer and send a letter to that address requesting that the taxpayer update his or her account.[43]

CONCLUSION

Communication with taxpayers is a basic and essential function of tax administration. It helps taxpayers comply voluntarily with the increasingly complex tax laws. Thus, when IRS correspondence does not properly or timely reach a taxpayer, unnecessary problems can

40 Information from IRS work requests (request numbers WSP1011240TH and WSP9078300TH) to provide programming for implementation of address perfection software. Code 1+ software is a USPS-approved program that identifies an address that is "undeliverable as addressed" and provides alternative addresses for users to choose from.

41 For a more detailed discussion of IRS internal mail routing problems, see Most Serious Problem: *The IRS Does Not Process Vital Taxpayer Responses Timely, infra*.

42 National Taxpayer Advocate 2008 Annual Report to Congress 449-451.

43 Chief Counsel Memorandum, *Addressing Issues* (Jan. 9, 2008).

ensue for taxpayers and the IRS alike. The IRS needs to take a comprehensive approach to resolving domestic and foreign undelivered mail problems to allow more taxpayers to receive notices and correspondence and provide earlier opportunities to resolve problems. The IRS has opportunities to reduce the volume of undeliverable mail through procedural updates and system enhancements. If properly addressed as an enterprise-wide problem, improved service to taxpayers and an increase in overall organizational efficiency will be the result.

In conclusion, the National Taxpayer Advocate offers these preliminary recommendations:

1. Study undelivered mail and address perfection problems, including the establishment of baseline data and periodic data reporting to measure the impact of future software integration and programming;
2. Designate one enterprise-level organization to provide policy, procedures, protection, and maintenance of taxpayer addresses, including one-stop processing of undelivered mail;
3. Use full-service intelligent bar coding on all outgoing mail to allow mail tracking and electronic file exchange between the USPS and IRS; and
4. Apply the existing address research system (ADR) to all undelivered mail returned to the IRS.

IRS COMMENTS

The IRS appreciates the National Taxpayer Advocate's review of the impact of undelivered mail on taxpayers, as well as the acknowledgement of steps that the IRS is taking to improve mail delivery.

The law requires that certain notices and other documents be sent to the taxpayer at his or her "last known address."[44] The legislative history of the predecessor to § 6212(b) indicates *the intended purpose of the "last known address" standard was to relieve the IRS of* the *obviously impossible task of keeping an up-to-date record of taxpayers' addresses* (emphasis added).[45]

Treasury Regulations (Treas. Reg.) interpret and give directions on complying with the law and generally have the force and effect of law once adopted. Treas. Reg. 301.6212-2(a) defines a taxpayer's "last known address" as the address provided by the taxpayer on the most recently filed and properly processed federal tax return. This regulation also provides that if a taxpayer no longer wishes the address of record to be the one shown on the most recently filed return (for example, because the taxpayer moved after the return was filed), "clear and concise notification" should be provided to the IRS.

44 IRC § 6212(b).

45 H.R. Rep. No. 2, 70th Cong., 1st Sess. 22 (1927), 1939-1 (Part 2) C.B. 384, 399; *see also* Program Manager Technical Advice (PMTA)-1634 (Jan. 9, 2008).

Revenue Procedures (Rev. Proc.) are official statements regarding procedure that affects the rights or duties of taxpayers or other members of the public under the law and regulations that should be a matter of public knowledge. What constitutes "clear and concise notification" of a taxpayer change of address is very specifically set forth in Rev. Proc. 2010-16 (effective June 1, 2010). This Rev. Proc. advises taxpayers that they should be aware of the need to update their address with the IRS in order to receive refunds of tax as well as other notices and provides that:

- Clear and concise written notification is a written statement signed by the taxpayer and mailed to an appropriate IRS address informing the IRS that the taxpayer wishes the address of record changed to a new address. And, any such notification must be specific as to a change of address. Thus, a new address reflected in the letterhead of taxpayer correspondence will not, by itself, serve to change a taxpayer's address of record. However, correspondence sent by the IRS that solicits a response by the taxpayer that is returned to the IRS with corrections marked on the taxpayer's address information will constitute clear and concise written notification of a change of address. Additionally, Form 8822, *Change of Address*, can be used by taxpayers to provide clear and concise written notification of a change of address.
- Clear and concise electronic notification is new address information submitted by the taxpayer through one of the secure applications found on the IRS website, located at www.irs.gov. A "secure application" is one that requires the taxpayer to verify the taxpayer's identity before accessing the application. Other forms of electronic notification, such as electronic mail sent to an IRS e-mail address do not meet this definition.
- Clear and concise oral notification is a statement made by a taxpayer in person or directly via telephone to an IRS employee who has access to the IRS Master File, informing the IRS employee of the address change.

In addition, the IRS will automatically update a taxpayer's address of record based on a new address that the taxpayer provides to the USPS and that the USPS retains in its NCOA database.[46]

Under Treas. Reg. 301.6212-2, the IRS may not use any other change of address information to update a taxpayer's last known address, even commercially available or other government agency databases.[47]

The IRS must operate in accordance with the law and these implementing regulations and procedures. Undelivered mail is also a complex problem with no easy solutions, since the IRS must carefully weigh any benefits from changing a taxpayer's address to improve the chances of mail delivery against the potential for unauthorized disclosure of confidential tax information whenever such mail is delivered to the wrong address. Further, as

46 Treas. Reg. 301.6212-2(b)(2).

47 IRS, *PMTA-1634* (Jan. 9, 2008).

acknowledged by TIGTA, a significant portion of the mail returned to the IRS as undelivered cannot be eliminated because the causes are external or beyond IRS control.[48]

Nevertheless, the IRS recognizes the importance of enhancing systems and practices as they relate to address updates and has made or is planning a substantial number of improvements to ensure, to the extent possible, that mail is properly delivered. For example, Rev. Proc. 2010-16, cited above, was recently issued to supersede Rev. Proc. 2001-18 in order to allow our IRS toll-free telephone assistors to make an address change when speaking with a taxpayer. This Rev. Proc. was also changed to authorize the IRS to update taxpayer addresses when a taxpayer responds to correspondence received directly from the IRS and provides a new address.

Further, the IRS has been using address hygiene software on its Master File of taxpayer accounts for approximately 28 years. The IRS Master File is the central database that IRS uses to manage taxpayer returns and accounts, which is in the process of being replaced by the modernized Customer Account Data Engine (CADE). Address hygiene software identifies bad addresses. For instance, it will identify when a house number is not included with the street or when a city and state do not match. In some cases, this software can also be programmed to make corrections when such errors are identified.

While many of IRS' modernized systems, including CADE, Accounts Management Services, Modernized Internet Employer Identification Number, and On-Line Payment Agreement have been designed to include initial address checks using address hygiene software, many other applications and independent computer systems remain to be updated. To this end, the IRS obtained an IRS-wide licensing agreement on March 31, 2010, and is in the process of integrating and sequencing implementation of address hygiene software into these systems.

In addition:

- We are adding an indicator that will post to taxpayer accounts whenever addresses are known to be bad or do not produce the required exact match with the USPS NCOA database. Establishment of this indicator will allow the various functions to suppress generation of notices, when appropriate.
- We revised applicable IRMs to require our employees to perform research before overlaying or updating taxpayers' addresses when an address is not provided by the taxpayer on a return.
- We are redesigning IRS notices to include a contact stub that provides space for taxpayers to communicate new address information to the IRS when they respond.
- We are working to expand address fields in our systems to adequately hold foreign addresses.

48 TIGTA, Ref. No. 2010-40-055, *Current Practices Are Preventing a Reduction in the Volume of Undeliverable Mail* (May 14, 2010).

- We conducted a study to assess whether the IRS could benefit from using the Intelligent Mail barcode (IMBC).
- We are exploring the potential to automatically identify accounts when mail is undeliverable and populating an indicator by leveraging the capabilities of the USPS' electronic mail tracking system through the IMBC.
- We are conducting a study to determine the feasibility of developing standardized procedures for processing undeliverable mail for all IRS functional offices.

With regard to the National Taxpayer Advocate's preliminary recommendations, we offer the following comments:

Study undelivered mail and address perfection problems, including the establishment of baseline data and periodic data reporting to measure the impact of future software integration and programming.

As shown by our work in this area, the IRS acknowledges that undelivered mail and address perfection are issues that warrant attention. We have taken many steps and studies as outlined above. We will continue to measure the results of these changes to systems and procedures as we move forward.

Designate one enterprise-level organization to provide policy, procedures, protection, and maintenance of taxpayer addresses, including one-stop processing of undelivered mail.

The W&I Division of the IRS is primarily responsible for the processing of mail and the overall maintenance of addresses. As outlined above, we are implementing procedural changes and have requested substantial programming changes that will reduce the incidence of undelivered mail within our corporate systems. We are also conducting a study to determine the feasibility of developing standardized procedures for processing undeliverable mail for all IRS functional offices.

Use full-service intelligent bar coding on all outgoing mail to allow mail tracking and electronic file exchange between the USPS and IRS.

As outlined above, IRS is already studying, in consultation with the Taxpayer Advocate Service, the benefits of using IMBC. That study is in its final stages. In addition, the use of IMBC on outgoing mail is only a first step towards leveraging the full capabilities of the USPS' electronic mail tracking system. The IRS is exploring the potential to electronically update accounts with undelivered mail, feed address research systems, and update our files with USPS address corrections. If feasible, this would significantly enhance our address correction capabilities, as well as eliminate the need for the IRS to wait for the return of undelivered mail by the USPS or the handling of this mail in our campuses.

Apply the existing address research system (ADR) to all undelivered mail returned to the IRS.

The IRS currently screens a select number of notice types for ADR research based on their purpose and impact on taxpayers. It would be cost prohibitive to screen all undelivered mail in this manner. Further, when the system enhancements already planned or under study as outlined above are fully implemented, we expect them to achieve similar results.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS recognizes that undelivered mail creates problems for both the IRS and taxpayers. The National Taxpayer Advocate applauds the significant efforts the IRS has made in response to the problems, in particular the commitment to add an indicator to taxpayer accounts when an address is known to be bad. However, we continue to have concerns in specific areas.

As a threshold matter, we note that the IRS cited legislative history from 1927 in its response as a partial reason for the current state of mail operations.[49] The world has changed greatly since the last-known-address statue was enacted in 1927 and resources that could not have been imagined at the time for locating more accurate taxpayer addresses now exist. IRS Chief Counsel has acknowledged that the IRS may locate a better address for a taxpayer using, for example, third party software, and send an "Are You There" letter to that address.[50]

Centralize Mail Operations

The IRS should consider moving mail operations to an agency-level organization. Undelivered mail is a servicewide problem. All operating divisions (ODs) send mail and thus have some rate of return on undelivered mail as well as an interest in ensuring that they send mail to the best available taxpayer addresses. However, while each OD handles undelivered mail in its own way, W&I is primarily responsible for processing mail and maintaining addresses. Placing mail operations primarily in one division, instead of at the agency level, leaves these operations secondary to the main mission of that OD. It does not provide the IRS with a centralized unit to focus on and maintain the agency's overall mail functions, including analyzing undelivered mail, monitoring all mail systems, and identifying necessary system-wide changes.

Conduct a Complete Study of Undelivered Mail Issues

While the IRS has taken important steps to study the problem of undelivered mail, it lacks even a basic knowledge of how much of its mail is returned as undelivered. When asked for figures on the scope of the problem, the IRS could not provide data for total undelivered mail, let alone the types of mail that go undelivered. Proper delivery of mail to taxpayers is an essential component of effective tax administration. If a taxpayer fails to receive a piece of IRS correspondence, a levy or lien may be the taxpayer's first indication that he or she has a tax problem. In these situations, the burden on the taxpayer is substantial and could have been relieved had the taxpayer timely received correspondence. The IRS needs to complete, at minimum, a baseline study that identifies the scope as well as the

49 H.R. Rep. No. 2, 70th Cong., 1st Sess. 22 (1927), 1939-1 (Part 2) C.B. 384, 399

50 *See* Chief Counsel Memorandum, *Addressing Issues* (Jan. 9, 2008); IRM 5.19.7.5 (Jan. 16, 2009).

types of undelivered mail so that it can judge whether any changes are effective in reducing undelivered mail.

Begin Using the Full Service IMBC

The National Taxpayer Advocate is pleased that the IRS is studying the use of the IMBC and urges its swift adoption, which would relieve many undelivered mail problems. The full-service IMBC would allow the IRS to process all mail in the current ADR system, perfect addresses, and provide for a complete information exchange between the USPS and the IRS.

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Study undelivered mail and address perfection problems, including the establishment of baseline data and periodic data reporting to measure the impact of future software integration and programming;
2. Designate one enterprise-level organization to provide policy, procedures, protection, and maintenance of taxpayer addresses, including one-stop processing of undelivered mail;
3. Use full-service intelligent bar coding on all outgoing mail to allow mail tracking and electronic file exchanges between the USPS and IRS; and
4. Apply the existing address research system (ADR) to all undelivered mail returned to the IRS, once the full-service IMBC is applied to outgoing mail.

MSP #17

The IRS Does Not Process Vital Taxpayer Responses Timely

RESPONSIBLE OFFICIALS

Richard E. Byrd Jr., Commissioner, Wage and Investment Division
Chris Wagner, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

The IRS does not measure the accuracy or timeliness with which it handles taxpayer correspondence, despite the critical importance of this task in tax administration. The IRS lacks any comprehensive, reliable data that would allow it to understand the sources or causes of misrouted mail.[1]

The IRS receives over 11 million pieces of taxpayer correspondence each year.[2] IRS data indicate that over 75 percent of mail at two Compliance Services Collection Operation (CSCO) sites took longer than the 14-day goal to process.[3] Moreover, nearly 40 percent of collection correspondence at these sites was assigned more than 30 days from the IRS-received date.[4] For all Correspondence Imaging System (CIS) correspondence cases closed in fiscal year (FY) 2009, the average time to assign the correspondence was between 15 and 30 days.[5]

Delayed or inaccurate mail processing can result in premature and incorrect tax assessments and unnecessary collection actions, which harm taxpayers and create rework for the IRS. Incorrect mail processing can also delay refunds, not only increasing the economic burden on taxpayers but also creating additional workloads, resource costs, and refund interest costs for the government. Thus, improper handling of taxpayer correspondence can cause real harm to the taxpayer and real burden to the IRS.

1 IRS response to TAS research request (Sep. 23, 2010).

2 IRS responses to TAS research requests (June 18, 2010 and June 23, 2010). These data include 11,439,851 pieces of mail processed between January and September 2009 by the Receipt and Control functions in six campuses: Atlanta, Austin, Cincinnati, Fresno, Kansas City, and Ogden.

3 CCA 4243 Reports for Memphis and Brookhaven, October 1, 2008 – September 30, 2009. For a full explanation of the methods used to analyze the date, see *infra*. The CCA 4243 report is an automated listing, compiled weekly, showing all cases assigned on the Integrated Data Retrieval System (IDRS) system on the day the report generates. IRS procedures require the CSCO and Accounts Management to control incoming correspondence on the Integrated Data Retrieval System (IDRS) within 14 days of the IRS received date. Internal Revenue Manual (IRM) 5.19.1.1 (May 10, 2010); IRM 21.5.4.1.2.2 (Aug. 31, 2010).

4 CCA 4243 Reports for Memphis and Brookhaven, October 1, 2008 – September 30, 2009.

5 Wage and Investment division (W&I) response to TAS request (June 23, 2010). These statistics are not limited to the Memphis and Brookhaven campuses and include all CIS cases closed in fiscal year (FY) 2009.

ANALYSIS OF PROBLEM

Background

The IRS has approximately 1,000 different letters and notices, and sends over 200 million pieces of correspondence to taxpayers each year.[6] Because many of these documents require taxpayers to respond in writing, the IRS receives annually over 11 million taxpayer replies in its mailrooms.[7] The W&I operating division is responsible for the initial processing of incoming mail at IRS campuses.[8] Two IRS functions – Receipt and Control and Campus Support – receive the mail and stamp it with the received date.[9] Mail is then sorted and delivered throughout each campus, going to W&I and Small Business/Self-Employed (SB/SE) functions such as Accounts Management, Examination, Automated Underreporter (AUR), CSCO, Automated Collection System (ACS) Support, and Appeals.[10] Employees of these and other IRS organizations process the mail and update automated systems to show that it has been received.[11]

Because the IRS does not track how much correspondence the various functions receive, it is impossible to calculate the total volume of mail the IRS receives. However, the campuses and ACS together received over 11 million written taxpayer responses in the first nine months of 2009.[12] Timely and accurate routing of these replies to the correct function is critical to helping taxpayers resolve their tax issues and receive any refunds due.

Mail Processing Delays Negatively Impact Taxpayers

Misrouting and delays in processing mail within the IRS can have deleterious affects on taxpayers. The information is not timely associated with the taxpayer's account, so the IRS does not have a record of the correspondence in its automated systems, and examination and collection actions continue. In an effort to understand how the IRS processes mail and how it affects taxpayers' accounts, TAS analyzed balance due correspondence data for the Memphis and Brookhaven campuses.[13]

IRS procedures require the Compliance Services Collection Operation and Accounts Management to control incoming correspondence on the IDRS within 14 days of the IRS

6 IRS, Office of Taxpayer Correspondence website *at* http://win.web.irs.gov/TPC/Background.htm (last visited July 5, 2010).

7 Information based on data from January through September 2009. IRS responses to TAS research requests (June 18, 2010 and June 23, 2010). These data include 11,439,851 pieces of mail processed between January and September 2009 by the Receipt and Control functions in six campuses: Atlanta, Austin, Cincinnati, Fresno, Kansas City, and Ogden.

8 IRM 3.10 (Jan. 1, 2010); IRM 21.1.7.5 (Oct. 10, 2007).

9 Receipt and Control functions are located in the Atlanta, Austin, Fresno, Cincinnati, Kansas City, and Ogden campuses. Campus Support functions are located in Andover, Brookhaven, Memphis, and Philadelphia.

10 IRM 3.10.72 (July 2, 2010); IRM 21.1.7 (June 21, 2010).

11 IRM 3.10.72 (July 2, 2010); IRM 21.1.7 (June 21, 2010); IRM 21.2.1.9 (Aug. 14, 2009); IRM 4.19.4.3 (Apr. 1, 2010); IRM 4.19.20 (Jan. 1, 2010).

12 Receipt and Control Operations received 11,439,851 pieces of mail from January through September 2009 while the ACS Support function received 283,463 pieces in FY 2009. The IRS was unable to provide the total volume of mail received by the campus Examination, Compliance Services Collection, or AUR operations in FY 2009. IRS responses to TAS research requests (June 18, 2010, and June 23, 2010).

13 TAS used these data because information for all types of taxpayer correspondence was not available.

received date.[14] As part of the mail processes, IRS employees are also required to input computer codes at the time the mail is assigned to a function to stop subsequent notices or collection actions, including levies.

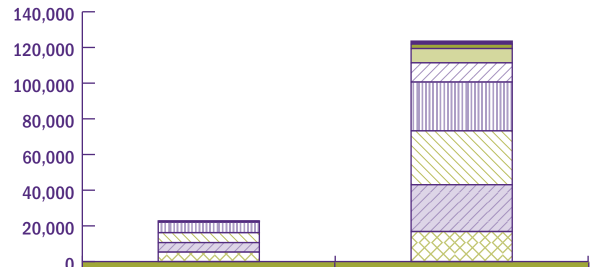
Data from more than 146,000 pieces of taxpayer correspondence received in FY 2009 showed that less than 25 percent of the correspondence was assigned to an IRS work unit within two weeks of receipt. Conversely, it took 15 days or more to assign 75 percent of balance due correspondence.[15] CSCO employees are instructed to resolve tax due correspondence issues within 30 days of the IRS received date or contact the taxpayer if additional time is needed.[16] However, it took more than 30 days from the IRS received date to assign nearly 40 percent of the correspondence received in CSCO. Chart 1.17.1 below breaks down the time between the first receipt of collection correspondence and when it was assigned to the function. While the TAS analysis was limited to two campuses' collection correspondence pertaining to balance due accounts, it indicates that problems exist with current mail routing processes and timelines.

14 Additionally, once the mail is assigned on IDRS, CSCO employees are instructed to resolve tax due correspondence issues within 30 days of the IRS received date. If the correspondence issues cannot be resolved within 30 days, employees are instructed to issue an interim letter to notify the taxpayer that additional time is needed to resolve the issue and to continue to suspend collection action until the issues are resolved. IRM 5.19.1.1 (May 10, 2010); IRM 21.5.1.4.2.2 (Aug. 31, 2010). *See also* National Taxpayer Advocate 2006 Annual Report to Congress 222 (Most Serious Problem: *Correspondence Delays*).

15 CCA 4243 Reports for Memphis and Brookhaven, October 1, 2008 – September 30, 2009. TAS research analyzed data (146,532) from the CSCO FY 2009 CCA 4243 reports for Memphis and Brookhaven campuses. Data include only balance due correspondence from these two campuses and are not representative of all correspondence or campuses. Correspondence never assigned on IDRS will not show in this report and was not part of this analysis. Upon receipt in CSCO, correspondence is routed through First Read (CFRP). Per the IRM, correspondence worked in CFRP includes correspondence that can be closed within five (5) minutes following appropriate balance due procedures. Some types of work completed in CFRP are address changes, telephone number input, streamlined installment agreements, and rerouting of correspondence. Cases closed in First Read (CSRP) and streamlined installment agreements (requests are worked through an automated process in Brookhaven) are excluded from this data set. SB/SE response to TAS request (October 18, 2010). SB/SE provided data showing that in 2009, Brookhaven CSCO resolved 40,644 pieces of correspondence in CFRP and Memphis CSCO resolved 88,492. Brookhaven CSCO resolved 50,920 streamlined installment agreement requests using automated processes. Correspondence assigned to an operation after the last weekly report generated, but closed before the next report was compiled, would not be included in any weekly CCA report. Overall, Brookhaven closed 179,639 total balance due correspondence cases and Memphis closed 232,043 balance due correspondence cases during FY 2009.

16 IRM 5.19.1.1 (May 10,2010).

FIGURE 1.17.1, Number of Days from when IRS Collection Correspondence Received until Assigned[17]



	BROOKHAVEN	MEMPHIS
+120 Days	4	1,695
91-120 Days	10	2,487
61-90 Days	102	8,002
46-60 Days	497	10,736
31-45 Days	5,875	27,391
21-30 Days	5,597	30,209
11-20 Days	5,271	26,210
1-10 Days	5,353	16,839

In a similar effort, W&I analysts used Customer Account Services (CAS) reports to calculate the average time it takes to process correspondence through the Correspondence Imaging System, including preparing, scanning, and cataloging documents.[18] Times are calculated from the original IRS received date to the date cases were assigned to Accounts Management. For all CIS correspondence cases closed in FY 2009, the average time to assign correspondence was between 15 and 30 days.[19] These findings suggest it takes two weeks or more to process correspondence through imaging, which is similar to the results of the TAS analysis.

The delay in initial mail processing not only prevents the IRS from meeting its own timelines, but also keeps employees from timely completing follow-up actions, including suspending collection activity. Therefore, some taxpayers may remain subject to collection actions, despite having timely provided information that could resolve the balance due.

17 CCA 4243 Reports for Memphis and Brookhaven, October 1, 2008 – September 30, 2009. TAS analyzed 146,532 records from which 254 items were excluded because the assigned date was earlier or equal to the IRS received date.

18 CIS is a system for scanning all Accounts Management correspondence receipts into digital images. An electronic workflow delivers the cases to IRS employees who work the cases from those images.

19 W&I response to TAS request (June 23, 2010). W&I used data from CIS Time in Motion weekly reports to provide an average processing time of all of the cases closed during each specific week, along with the average time taken for document preparation, scanning, and Customer Service Representative (CSR) processing time. Combining Customer Account Services data for the CIS, and available National Quality Review System (NQRS) data, W&I determined the average days to assign cases was less than 30 days in 2009, with 38 percent assigned in more than 15 days. The NQRS data is not statistically valid to the correspondence level; consequently, this data is only representative for the data reviewed. It cannot be generalized to all correspondence.

Timely Mail Processing Enables Taxpayers to Resolve Tax Issues Promptly and Prevents Rework for the IRS.

The IRS uses automated processes to generate tax notices and assessments. Examples of these systems include:

- Correspondence Examination;
- Automated Underreporter (AUR);
- Automated Substitute for Return (ASFR);
- Automated Internal Revenue Code (IRC) § 6020(b) program; and
- Combined Annual Wage Reporting (CAWR) program.

These systems move a potential tax assessment through various stages of the process until either the IRS assesses the tax or the taxpayer responds.[20] The IRS builds designated response times into its systems. When the IRS receives taxpayer correspondence, the system is updated to reflect the response and stop additional automated processing until the IRS reviews the correspondence. Any subsequent actions are based on the information the taxpayer provided.

If the taxpayer does not reply or the system is not updated to reflect a response by the designated time, the IRS will issue the next notice automatically or move an account to the next step of the assessment or collection process. Thus, it is critical that the IRS process taxpayer correspondence timely.

The IRS Does Not Monitor Timeliness of Correspondence Processing, Resulting in Taxpayer Burden.

Despite the negative consequences of failing to timely process taxpayer correspondence, W&I and SB/SE acknowledge they cannot measure the volume of correspondence the IRS receives.[21] More importantly, the IRS does not generally measure processing time (*i.e.,* the period from when the IRS first receives correspondence to the date the correct function receives it and associates it with the taxpayer's account).[22]

Quantifying processing time is crucial for correcting potential delays and building adequate response time into the IRS's systems. Failure to build in enough time can result in inappropriate assessments and collection actions. As discussed earlier, nearly 40 percent of the collections correspondence in the Memphis and Brookhaven campuses was received after the 30-day timeframe for taking follow-up action.[23] This means if the taxpayer responded

20 IRM 4.19.2.5.41 (Sep. 1, 2009); IRM 4.19.22 (Dec. 14, 2009; IRM 1.4.19.6.14.1 (Dec.1, 2009); IRM 5.8.2 (Jan. 1, 2008).

21 IRS responses to TAS research requests (June 18, 2010 and June 23, 2010).

22 *Id.*

23 CCA 4243 Reports for Memphis and Brookhaven, October 1, 2008 – September 30, 2009. TAS research analyzed data (146,532 records) from the CSCO FY 2009 CCA 4243 reports for Memphis and Brookhaven campuses.

timely, but in the later part of the time given to respond, correspondence would likely not be assigned in time to stop subsequent collection actions.

This issue is not limited to collection correspondence. A recent Treasury Inspector General for Tax Administration (TIGTA) study found that mail-processing delays, including misrouted and rerouted work, contributed to delays in resolving audit reconsiderations.[24] A 2008 review of W&I's correspondence examination program and subsequent audit reconsiderations found that in 89 percent of the cases, it took more than 30 days to work and close the reconsideration once it was stamped with the received date.[25] More than half the cases that exceeded the 30 days actually took more than 120 days from receipt until closure.[26] The study attributes this delay, in part, to "misrouted or rerouted mail."[27]

Misrouted and mishandled mail not only delays taxpayers' audit reconsiderations, but also creates additional burden because many taxpayers have to provide the same information to the IRS multiple times.[28] In a review of 78 audit reconsideration cases, TIGTA found evidence that in six cases, the taxpayers or their representatives complained of having to provide the same documentation more than once. In three instances, the case files contained multiple copies of the same document, each with a different IRS date stamp.[29]

The results of the TGITA audit support what the Taxpayer Advocate Service is hearing from tax professionals. Practitioners at Nationwide Tax Forum focus groups have expressed frustration with having to send documentation to the IRS multiple times.[30] TAS has also received submissions through the Systemic Advocacy Management System (SAMS) about mail processing delays and problems resulting from having to send in the same information several times.[31] In one example, a practitioner had a certified mail receipt showing an IRS campus had timely received his request for a Collection Due Process hearing, but no hearing was scheduled. His client's next contact with the IRS was an enforced collection action.[32]

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24 TIGTA, Ref. No. 2009-40-099, *The Discretionary Examination Program Performance Results Are Incomplete; Therefore, Some Measures Are Overstated and Inaccurate* 8-14 (Aug. 6, 2009). An Audit Reconsideration is the process the IRS uses to reevaluate the results of a prior audit where additional tax was assessed and remains unpaid, or a tax credit was reversed. If the taxpayer disagrees with the original determination, he or she must provide information not previously considered during the original examination. The IRS also uses reconsideration when a taxpayer contests a Substitute for Return determination by filing an original delinquent return.

25 The correspondence examination program (otherwise known as the Discretionary Examination Program) conducts audits by requesting that taxpayers submit documentation to support disputed items on their tax returns. The review was performed by W&I and later reviewed by TIGTA. TIGTA, Ref. No. 2009-40-099, *The Discretionary Examination Program Performance Results Are Incomplete; Therefore, Some Measures Are Overstated and Inaccurate* (Aug. 6, 2009).

26 *Id*.

27 *Id*.

28 *Id*.

29 TIGTA, Ref. No. 2009-40-099, *The Discretionary Examination Program Performance Results Are Incomplete; Therefore, Some Measures Are Overstated and Inaccurate* (Aug. 6, 2009).

30 2006 IRS Tax Forum Focus Groups, Most Serious Problems Facing Taxpayers, Taxpayer Advocate Service, Feb. 2007, *available at* http://tasnew.web.irs.gov/Files/ResearchStudies/OtherStudies/MSPFocusGrpR&A_Feb2007.pdf.

31 SAMS is a database of issues submitted to the TAS Office of Systemic Advocacy. Individual and business taxpayers, practitioners, research and professional organizations can submit issues via the TAS website *at* http://www.irs.gov/advocate.

32 SAMS submission 10001143. Enforced collection actions include issuance of a levy or filing of a notice of federal tax lien.

One result of the IRS's inability to timely process taxpayer responses and associate documents with a taxpayer's case is that taxpayers and their practitioners receive unnecessary statutory notices of deficiency (also known as 90-day letters).[33] In recent years, taxpayer representatives expressed concern that the Examination function was issuing notices of deficiency without first considering taxpayer replies to earlier notices.[34]

Improved Processing of Taxpayer Correspondence Minimizes Downstream Consequences.

Notice operations cost the IRS nearly half a billion dollars annually. Historically, 60 percent of these costs result from the downstream consequences of issued notices, including subsequent contacts between the IRS and taxpayers via phone calls, office visits, and correspondence.[35] The IRS has recently initiated actions to improve notice processes, including a notice clarity project.[36] Recognizing the significant problem with the correct routing of incoming correspondence, SB/SE and W&I formed a team to improve the accuracy and timeliness of mail routing.[37] The team is developing a model mail process capable of updating the taxpayer's account on the automated system within five days of Examination's receipt of correspondence.[38] In addition, SB/SE is testing new "first read" procedures for the campus CSCO function designed to allow certain employees to close simple correspondence upon receipt and correct routing errors.

Another potential improvement is the use of a full-service intelligent mail barcode (IMb) on most outgoing mail, which would allow the IRS to electronically exchange mail status information (*e.g.*, notice and mail tracking data) with the U.S. Postal Service (USPS). Mail labels with IMb technology could also be included with notices sent to taxpayers for use on their replies. The IRS could use this bar code information to quickly route return correspondence to the proper function for review and action.[39] The postal system can also provide the IRS with two to three day notice of taxpayer correspondence on its way

33 The notice of deficiency gives the taxpayer 90 days (150 days if the notice is mailed to a person outside of the United States) to file a petition with the U.S. Tax Court for a redetermination of the deficiency. If no petition is filed within 90 days, the IRS will assess the tax.

34 National Association of Enrolled Agents, Letter Regarding Concern over Recent Enforcement Actions by IRS (Nov. 28, 2007), *available at* http://www.naea.org/MemberPortal/Advocacy/Comments/letter_nov_28_2007.htm. *See also* National Taxpayer Advocate 2008 Annual Report to Congress 316 (Most Serious Problem: *The IRS Correspondence Examination Program Promotes Premature Notices, Case Closures and Assessments*).

35 IRS, *Notice Modernization Team Phase I Summary: Baseline of Current Operations & Vision for Future* 6 (Feb. 1, 2001).

36 The IRS has taken significant steps to improve the clarity of notices it sends to taxpayers. IRS, *TACT: Taxpayer Communication Taskgroup Report, available at* http://win.web.irs.gov/TPC/TPC_docs/Historical/TACT%20Presentation_NAEA_August%202009.pdf (last visited July 4, 2010). In July 2008, the IRS created the Taxpayer Communications Taskgroup (TACT) to increase the clarity, accuracy, and effectiveness IRS letters and notices. In January 2010, the TACT became the Office of Taxpayer Correspondence within W&I. Under this effort, IRS notices were rewritten in plain language to help taxpayers understand and respond to them quickly. However, these efforts have not addressed procedures for processing taxpayer replies and reducing downstream consequences. IRS, *Taxpayer Communication Taskgroup (TACT) Charter, available at* http://win.web.irs.gov/TPC/TACT.htm (last visited July 4, 2010).

37 The Misrouted Mail Team's work will be a six-month process, focusing on gathering data in the first month. The team will visit all the W&I and SB/SE programs (Exam, CSCO, etc.) and Campus Support and Receipt and Control. The team is mapping out the process from when the mail comes into a site to when it reaches an IRS function. IRS response to TAS research request (Sep. 23, 2010). Some initial results show that mail clerks in the functions are using their memory or an outdated mail routing list instead of using the updated electronic version. SB/SE response to TAS inquiry (Aug. 3, 2010).

38 IRS responses to TAS research requests (June 18, 2010, and June 23, 2010).

39 For a more detailed discussion of the intelligent bar code, see Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers, supra.*

to the IRS if the taxpayer uses the IMb label or voucher provided by the IRS in outgoing correspondence. This technology could allow the IRS to update accounts to reflect that the taxpayer provided a written reply as soon as the USPS processes the reply. This would prevent premature enforcement actions and invalid tax assessments, while protecting taxpayer rights and reducing rework.[40]

The IRS Needs to Reexamine Time Allowed for Taxpayer Response.

IRS computer systems are not updated to reflect the receipt of correspondence until after the mail has been routed from the incoming mail receipt unit to a function like Examination or Collection. Because the IRS does not measure the time between first receipt of correspondence and its receipt by the correct function, the taxpayer response timeframes built into automated processes may not be sufficient.

For example, the automated examination program allows 105 days for receipt of a response to a statutory notice of deficiency.[41] The notice instructs the taxpayer to respond within 90 days from the date of the notice. If the taxpayer mails a response on the 85th day and the IRS mailroom receives it on the 87th day, a mail processing time of 20 days would mean that Examination would not receive the response until the 107th day. The automated system would assess the proposed tax after 105 days, even though the taxpayer had responded timely.

While the IRS can correct erroneous assessments,[42] correcting the assessment after the fact creates burden and distress for the taxpayer and unnecessary rework for the IRS. The National Taxpayer Advocate previously reported that the correspondence examination process did not provide sufficient time to process taxpayer replies to audit notices.[43] The IRS should gather reliable data on its mail processing systems and use it to adjust automated timeframes to take into account the delay in handling taxpayer correspondence.

CONCLUSION

Despite acknowledging that misrouted mail is a problem, the IRS still lacks the data it needs to understand the source of the problem and implement solutions. While the IRS is taking some steps towards improvement, the impact of misrouted mail on taxpayers and the IRS demands that the IRS give this matter its full attention.

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40 *See* IRS, *IMB Briefing: A Summary of the USPS Intelligent Mail Barcode®: Full Services "How to", and Best Practices that the IRS Can Apply* (July 29, 2010).

41 IRM 1.4.19.6.14 (Dec. 1, 1009).

42 IRM 4.19.20.1.6.4 (Apr. 16, 2008).

43 National Taxpayer Advocate 2008 Annual Report to Congress 316 (Most Serious Problem: *The IRS Correspondence Examination Program Promotes Premature Notices, Case Closures and Assessments*).

To improve the timely and accurate processing of correspondence, the National Taxpayer Advocate offers these preliminary recommendations:

1. Track and assess the timeliness and accuracy of mail routing to each campus operation.
2. Revise timeframes for automated assessment processes so they provide sufficient time for the IRS to receive taxpayer responses and update its systems.
3. Test the use of technology such as Intelligent Bar Coding on envelopes to enable easier routing of incoming mail.

IRS COMMENTS

The issues involved in mail routing are complex and are an area of continued focus for the IRS. The National Taxpayer Advocate correctly points out that the IRS uses a thousand different letters and notices and sends over 200 million pieces of correspondence to taxpayers each year, many of which require a response. As a result, the IRS receives and acts upon at least 11 million pieces of taxpayer mail annually, as well as approximately 37-40 million pieces of mail containing paper tax returns.

Taxpayer mail received in IRS campuses deals with a multitude of tax issues. It is intended for and must be routed to multiple IRS functions responsible for the various tax issues involved. Such mail includes account-related taxpayer inquiries that are worked in the Accounts Management (AM) function. Also included are responses to notices and other IRS communications involving ongoing collection actions and audits handled by the CSCO, ACS Support, Automated Underreporter, and Correspondence Examination functions. Measures, such as timeliness and days to close are in place to monitor and manage the health of this correspondence inventory within each of the responsible IRS functional areas. In addition, inventory management tools, such as the CIS and the Automated Management System (AMS), have been implemented to automate and expedite the handling of much of this mail.

Accounts Management uses CIS Time in Motion reports to measure correspondence timeliness from the IRS-received date to the date of imaging and, ultimately, to the date of closing. Similarly, CSCO measures the age of correspondence using AMS reports that track cases from the IRS-received date to closure of a case. ACS Support and CSCO also measure timeliness utilizing various tools, such as Case Control Activity listings, AMS reports, and data from the National Quality Review System and the Embedded Quality Review System. Correspondence Examination also tracks the age of its correspondence using Audit Information Management System data but, as noted in more detail below, is currently in the process of implementing improved correspondence monitoring metrics.

Specifically with regard to the timeliness of routing mail to the appropriate function, Accounts Management has a requirement (IRM 21.5.1.4.2.3) that all cases must be prepped and scanned into the CIS within five calendar days of receipt by its Image Control Team, or within 14 calendar days of the IRS-received date. During FY 2010, AM met the 14-day timeframe 89 percent of the time. Misrouted mail received by AM from other functions typically accounts for cases scanned beyond the 14-day input timeframe. Nevertheless, CIS has built-in procedures that will systemically input a hold on a taxpayer's account (STAUP) when appropriate and issue an interim letter whenever AM has not closed a case within 30 days, which will also stop any subsequent IRS notices. Such automated interim letters are also generated by other IRS systems.

Similarly, CSCO has a 14-day requirement for mail to be controlled and assigned (IRM 5.19.1.1) and AMS generates reports weekly on the timeliness of correspondence processing. Additionally, CSCO quality review evaluates correspondence timeliness. While the National Taxpayer Advocate reports that much of CSCO mail is not controlled within the 14-day target timeframe, the figures reported for Memphis and Brookhaven are not representative of all correspondence or campuses. Nor do these figures include cases closed in First Read (within five minutes), which CSCO estimates to be as much as 25 percent of all balance due mail. Finally, once the mail is controlled on AMS, a letter is automatically generated to inform taxpayers that IRS is in receipt of their correspondence if the case is not closed within 23 days of the IRS received date.

Correspondence Examination requires taxpayer accounts to be updated to indicate correspondence has been received within five days of its receipt in the Correspondence Examination function. Program reviews reflect that this timeframe is being met. Further, by systemically populating suspense dates within the Report Generation Software/ Correspondence Examination Automation Support (RGS/CEAS) system, it prevents premature issuance of subsequent notices. Moreover, procedures are in place to allow taxpayers every opportunity to resolve cases at the lowest level, such that Correspondence Examination continues to accept and consider taxpayer responses even after issuance of statutory notices of deficiency.

IRS balance due and examination notice processes have taxpayer response times built in which reduces the chances for premature issuance of subsequent notices. In this regard, the National Taxpayer Advocate cites a November 28, 2007, letter from the NAEA as an example of a situation where the IRS was issuing statutory notices of deficiency without first considering taxpayer replies to earlier notices. In its response to a 2008 Most Serious Problem[44] where the National Taxpayer Advocate cited this same 2007 NAEA letter, the IRS noted that it works with the NAEA and others in the practitioner community to solicit this kind of feedback in order to identify improvement opportunities. In this particular instance, the IRS promptly reviewed and adjusted the suspense dates for printing these notices, which served to address the NAEA's concerns.

44 National Taxpayer Advocate 2008 Annual Report to Congress 253.

Nonetheless, the IRS agrees there is a need to improve internal mail routing and control practices. To this end, multiple process improvement efforts are already underway. These include:

- In W&I Correspondence Examination, a Lean Six Sigma process for streamlining and rationalizing the handling of incoming mail was developed and successfully piloted at the Austin campus. The process resulted in a 70 percent reduction in the time to update examination cases to reply status after correspondence is received during peak processing. The procedures for this process, including a new centralized and standardized mail processing workstation, have been finalized. A rollout to all W&I Correspondence Examination campuses (except Andover, which is moving) will be completed before the end of FY 2011. Small Business/Self-Employed (SB/SE) is piloting the process in Cincinnati with a tentative rollout to other SB/SE campuses also planned for 2011. In addition, requirements for an Exam Mail Tool (EMT) that will automate and reduce the time needed for many aspects of the correspondence update process have been finalized. Included in this EMT tool are enhanced reports that will track the time correspondence was received by the IRS, received in Examination, as well as updated to a mail status on the Audit Information Management System to better monitor the timeliness of taxpayer correspondence. The tool is also scheduled for testing and initial rollout during 2011.
- In SB/SE, two Lean Six Sigma projects currently underway focus on improving the identification and handling of misrouted mail in SB/SE and W&I. These two projects are collectively known as the Misrouted Mail Initiative. Project sponsorship and teams have been developed to include all major operational representation from both SB/SE and W&I compliance organizations, including IMF and BMF sites, as well as related mail handling operations such as Submission Processing, Receipt & Control, and Campus Support. The expected outcomes are to understand and identify lessons learned from current mail routing operations and to identify tools available to accurately direct mail to the proper function.
- In AM, team members assigned to work with the SB/SE Misrouted Mail Initiative described above are currently visiting Submission Processing campuses and Campus Support in AM to identify improvement opportunities. These efforts specifically include evaluating use of a consolidated, enterprise-wide Mail Routing Guide as a replacement for the locally developed, non-standard guides currently used by the campuses to direct tax forms and correspondence to the appropriate functions.

With regard to the National Taxpayer Advocate's preliminary recommendations, we offer the following comments:

1) Track and assess the timeliness and accuracy of mail routing to each campus operation.

   As previously discussed, each IRS function currently has correspondence timeliness measures in place. In addition, multiple efforts are already underway to improve internal mail routing.

2) Revise timeframes for automated assessment processes so they provide sufficient time for the IRS to receive taxpayer responses and update its systems.

   IRS Collection and Examination systems already have built in uniform and sufficient notice suspense timeframes for the IRS to receive and consider taxpayer responses. For example, in Correspondence Examination RGS/CEAS automatically populates the suspense period whenever a case is updated into a new letter status. Also in this regard, IRS works closely with the tax practitioner community, such as the NAEA, to identify and implement specific improvement opportunities. Based on such feedback, IRS systems have been modified to generate letters to acknowledge receipt of taxpayer correspondence, as well as to adjust notice suspense timeframes. In addition, once mail is received and entered into IRS systems, the taxpayer's account is updated, which prevents the case from automatically moving to the next processing step and ensures IRS considers the taxpayer's response prior to sending the next notice. Further, SB/SE Research recently conducted a study for Examination regarding suspense timeframes and found that of those taxpayers who reply, between 68 percent and 77 percent do so by the due date of the suspense period. This research also found that a change in the suspense period would not materially affect these response rates.

3) Test the use of technology such as Intelligent Bar Coding on envelopes to enable easier routing of incoming mail.

   The IRS is already studying the benefits of using intelligent mail bar coding (IMBC). We believe utilization of IMBC will provide the greatest initial use and benefit for outgoing IRS mail that is undeliverable. While we agree that IMBC also has the potential to improve the routing of incoming mail, any effort to test the viability of IMBC for this purpose will be a longer term effort that depends on the outcome of the current IMBC study, available funding and programming resources, as well as the results of other mail-related efforts outlined above.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS agrees there is a need to improve internal mail routing and control practices, and believes the process improvement efforts already underway are a good first step. One effort includes evaluating use of a consolidated, enterprise-wide Mail Routing Guide as a replacement for the locally developed, non-standard guides now used by the campuses to direct tax forms and correspondence to the appropriate functions. The National Taxpayer Advocate applauds this effort. She also commends the IRS for studying the benefits of using IMBC to perfect outgoing mail and urges the IRS to continue analyzing the potential to improve the routing of incoming mail. However, with all due respect, the National Taxpayer Advocate does not consider the IRS correspondence timeliness measures to be adequate, and believes the IRS needs service-wide measures to track the timeliness and accuracy of correspondence processing.

The IRS states that measures such as timeliness and days to close are in place to monitor and manage correspondence inventory in each of the responsible IRS functions. However, these measures do not capture the timeliness of all correspondence but only the correspondence assigned to the specific function and controlled on one of the automated systems. Further, many existing IRS measures do not consider timeliness from the taxpayers' perspective. For example, CSCO measures overage status and days in inventory from the CSCO-received date, not from the IRS-received date. The Embedded Quality Timeliness measures use attributes that measure the timeliness and effectiveness of employee actions and adherence to IRS timeframes, which is important and commendable, but do not measure whether those actions were timely for the taxpayer.[45] To a taxpayer awaiting a reply, even the established timeframe of 14 days may seem excessive simply to move a letter from the mailroom to the correct function within a campus, particularly when there is no immediate acknowledgement of receipt.[46]

In response to TAS requests for information on the amount of time it takes to receive correspondence into the computer system, the IRS replied that the information was not available. In its response for this Most Serious Problem, however, the IRS states that 89 percent of AM correspondence was loaded within the 14 days. The IRS provided no data source or other citation for that statement. The IRS previously indicated that for all FY 2009 AM correspondence cases, the average time from the original IRS-received date to the date cases were scanned and assigned to AM was between 15 and 30 days. Even if we accept the IRS's assertion that AM controls 89 percent of its correspondence timely, the remaining 11 percent amounts to over 260,000 pieces of untimely processed correspondence. By not

45 EQRS User Guide, Chapter 5, June 15, 2010, http://sbse.web.irs.gov/eq/SysCorner/EQRS_UserGuide/docs/Chapter5.doc - 2010-06-15; Student Guide Effective Inventory Monitoring and Control Training 25977-102 (2-2008) Catalog Number 20146R, *available at* http://core.publish.no.irs.gov/trngpubs/pdf/20146b08.pdf (last visited Dec. 17, 2010).

46 IRM 5.19.1.1 (May 10, 2010); IRM 21.5.4.1.2.2 (Aug. 31, 2010). Most functions require that correspondence be loaded to automated systems, such as CIS, AMS, or RGS/CEAS, within five days of the functional received date or 14 days of the IRS received date. Generally, correspondence is not acknowledged upon receipt by the IRS except for mail sent Certified Return Receipt Requested.

processing correspondence timely, the IRS delays resolving taxpayers' account issues, creating additional burden for taxpayers and work for the IRS.

Accounts Management is just one function that receives taxpayer correspondence. IRS data show that over 75 percent of mail at two Compliance Services Collection Operation sites took longer than 14 days to process, and nearly 40 percent of collection correspondence took more than 30 days.[47] While TAS acknowledges that this data reflects only the CSCO work at two campuses, it illustrates the need for additional, servicewide measures to monitor the accuracy and timeliness of correspondence processing.

The IRS indicates that misrouting is the usual reason that correspondence is not controlled within 14 days. Yet the IRS does not measure or track the volume of misrouted or unassigned correspondence. Misrouted correspondence is sent to the wrong function, which then forwards it to a different function or incorrectly loads it into its own inventory. For example, a letter from a taxpayer attempting to resolve a correspondence examination case may be incorrectly sent to AM and placed in its inventory. This could have serious consequences, because the function awaiting the correspondence would assume the taxpayer failed to reply, would not update its automated systems, and instead would proceed to the next step, issuing additional notices, assessing taxes, and taking collection action. Even if the function receiving the case inputs computer codes to suspend further action, it may not stop additional actions on the taxpayer's accounts because many IRS systems do not communicate with each other.

The IRS states that AM, Collection, and Examination systems already have built-in uniform and sufficient notice suspense timeframes to receive and consider taxpayer responses. However, in response to a TAS inquiry the IRS replied that AUR, Examination, ACS, ACS Support, Document Matching, and CSCO do not track the number of days from the IRS-received date to the functional received and control dates.[48] This data is critical to the overall time allowed for processing correspondence. The IRS references a recent study by SB/SE Research regarding Examination suspense timeframes. However, this study cited focused solely on taxpayers' responses to the IRS correspondence examination *report*. It did not consider any other correspondence submitted by taxpayers, and cannot be generalized to all taxpayer correspondence related to correspondence examinations.[49]

The National Taxpayer Advocate suggests that the IRS perform additional studies to verify that the timeframes in automated processes provide adequate time for taxpayer correspondence to be received and processed. Because timely, accurate handling of incoming correspondence directly affects taxpayers and the efficiency of IRS functions, the IRS needs

47 CCA 4243 Reports for Memphis and Brookhaven, October 1, 2008 – September 30, 2009. For a full explanation of the methods used to analyze the date, see *supra* note 15.

48 IRS responses to TAS research requests (June 18, 2010, and June 23, 2010).

49 SB/SE Research, Detroit/Milwaukee, Project DET0088, *Timeliness of Taxpayer Responses to Correspondence Examination Reports* (March 2010). Clarification obtained from a telephone conversation with author on December 16, 2010,

to have one servicewide operation responsible for mail activities to maintain consistency for such an important function of tax administration.[50]

Recommendations

The National Taxpayer Advocate makes the following recommendations:

1. The IRS should establish one servicewide operation responsible for mail activities to provide consistent guidance for such an important function of tax administration, and to track and assess the timeliness and accuracy of mail routing servicewide.
2. The IRS should further evaluate and revise timeframes for automated assessment processes to provide sufficient time for the IRS to receive taxpayer responses and update systems so that taxpayers who reply to the IRS timely are not adversely affected.
3. The IRS should continue to pursue the use of technology such as Intelligent Bar Coding on notices and envelopes to make it easier to route incoming mail.

50 For more discussion of the need to centralize oversight of mail responsibilities, see Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers, supra.*

MSP #18 The IRS Should Accurately Track Sources of Balance Due Payments to Determine the Revenue Effectiveness of its Enforcement Activities and Service Initiatives

RESPONSIBLE OFFICIALS

Chris Wagner, Commissioner, Small Business/Self-Employed Division
Richard E. Byrd Jr., Commissioner, Wage & Investment Division
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DEFINITION OF PROBLEM

The IRS is required by law to properly record and account for the money it receives in order to prepare reliable financial and statistical reports to the President, Congress, and the American public,[1] and to measure tax enforcement results.[2] IRS procedures generally require employees to code the source of balance due tax payments to determine the revenue effectiveness of specific activities.[3] However, the IRS failed to record the payment code indicator on payment vouchers in over 81 percent of all tax payments received in calendar year (CY) 2009.[4] The National Taxpayer Advocate has identified several additional problems with IRS payment coding processes and procedures, which contribute to the widespread practice of coding payments as miscellaneous or not coding them at all, including:

- A lack of meaningful transaction codes to identify payments received;
- Deficient Internal Revenue Manual (IRM) guidance; and
- Insufficient training and oversight of IRS employees and vendors involved in coding received payments.

As a result, despite its declared commitment to a data-driven approach, the IRS's failure to accurately code and track the source of payments defeats the purpose of having a coding system.[5] It precludes the IRS from drawing meaningful conclusions about the

1 *See generally* 31 U.S.C.A. §§ 3512, 3513; 31 U.S.C.A. § 3302(e).

2 *See* The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), §§ 1201 and 1204, Pub. L. No. 105-106, 112 Stat. 685, 715-716, 722 (providing rules for establishment of a balanced performance measurement system by the IRS); 31 U.S.C.A. § 3515; IRS Statement of Procedural Rules, Internal Revenue Practice, Balanced System for Measuring Organizational and Employee Performance Within the Internal Revenue Service, 26 C.F.R. §§ 801.1 – 801.6; IRM 5.1.2.8.1.3 (July 13, 2010). *See also* The National Defense Authorization Act for Fiscal Year 1996 (The Clinger-Cohen Act of 1996), Pub. L. No. 104-106, 110 Stat. 186, 679; The Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285; The Chief Financial Officers Act of 1990, Pub. L. No. 101-576, 108 Stat. 2838.

3 *See, e.g.,* IRM 5.1.2.8.1 (July 13, 2010); IRM 3.11.10.5.10 (July 2, 2010); IRM 4.4.24.4(5) (Oct. 30, 2007); IRM 21.3.4.7.1.3 (Oct. 1, 2009). These two-digit numeric codes are called Designated Payment Codes (DPCs). The IRS uses DPCs to help identify payments, indicate application of payment to a specific liability, and identify the event that resulted in a payment.

4 IRS, Compliance Data Warehouse (CDW), Individual Masterfile (IMF) Transaction History Table, Transaction Codes 600-899, Transaction File Cycle 201032, Transaction Dates from Jan. 1 to Dec. 31, 2009.

5 IRS Strategic Plan 2009-2013, Goal 2, Objective 4, 19, 22, *available at* http://www.irs.gov/pub/irs-pdf/p3744.pdf (last visited Aug. 26, 2010). *See also* Department of Treasury, *Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance* (July 8, 2009), Component 2: Make a Multiyear Commitment to Research, *available at* http://www.irs.gov/pub/newsroom/tax_gap_report_-final_version.pdf.

effectiveness of its activities, and making data-driven policy decisions about service, enforcement, and resource allocation.[6]

ANALYSIS OF PROBLEM

Background

The IRS receives payments from a variety of sources and methods. Some payments are voluntary while others result from compliance activities or payment alternatives.[7] Various statutory and regulatory provisions require the IRS to measure the results of its operations, and prepare reliable financial and statistical reports to the President, Congress, and the public.[8] To fulfill these requirements, the IRS has established a balanced performance measurement system, composed of three elements: customer satisfaction, employee satisfaction, and business results.[9] Business results consist of both qualitative and quantitative measures of tax enforcement results.[10] The IRS uses data, statistics, compilations of information or "other numerical or quantitative recordations" of tax enforcement results for forecasting, financial planning, resource management, and formulation and development of methodologies and algorithms for its policies and procedures.[11]

The IRS has established two-digit Designated Payment Codes (DPCs) for taxpayer payments received after a tax has been assessed.[12] The IRS assigns a DPC to each subsequent, post-assessment payment it receives to identify the source (*e.g.*, a manually monitored installment agreement (MMIA), offer in compromise (OIC), levy, or seizure and sale of an asset).[13] A DPC serves a three-fold purpose. The code:

- Facilitates identification of payments designated to trust fund or non-trust fund employment taxes;
- Indicates application to a specific liability when a civil penalty includes a Trust Fund Recovery Penalty (TFRP) and other penalties; and

6 The IRS Oversight Board asserted that "[m]aking more data-driven decisions across the full range of IRS activities, from service to enforcement, will enable the IRS to better serve taxpayers who want to comply and more effectively enforce the law with those who do not." IRS Oversight Board, *Annual Report to Congress 2009* 6 (Apr. 2010), *available at* http://www.treas.gov/irsob/reports/2010/IRSOB%20Annual%20Report%202009.pdf.

7 For example, IRM 5.1.2.4 (July 13, 2010) requires that a Form 795/795A, *Daily Report of Collection Activity*, be prepared each day that payments or returns are secured, or as soon as possible, not later than the next business day.

8 *See* RRA 98, 715-716, 722 (providing rules for establishment of a balanced performance measurement system by the IRS); 31 U.S.C.A. § 3515; Treas. Reg. §§ 801.1 – 801.6; IRM 5.1.2.8.1.3 (July 13, 2010). *See also* The Clinger-Cohen Act of 1996, 679; The Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285; The Chief Financial Officers Act of 1990, Pub. L. No. 101-576, 108 Stat. 2838.

9 Treas. Reg. §§ 801.1, 801.2.

10 Treas. Reg. § 801.6. Examples of tax enforcement results include a lien filed, a levy served, a seizure executed, the amount assessed, the amount collected, and a fraud referral. Treas. Reg. § 801.6(d)(1).

11 Treas. Reg. § 801.6(d)(2). Records of tax enforcement results are data, statistics, and compilations of information or other numerical or quantitative recordations of the tax enforcement results reached in one or more cases.

12 These are generally balance due payments. Other payments, such as Estimated Tax Payments, Federal Tax Deposits, and payments with filed returns are designated by the nature of the payment, whether received in paper or electronic form.

13 *See* IRM 5.1.2.8.1 (July 13, 2010). *See also* IRM 3.11.10.5.10 (July 2, 2010); IRM 4.4.24.4(5) (Oct. 30, 2007); IRM 21.3.4.7.1.3 (Oct. 1, 2009).

- Identifies the event that resulted in payment.[14]

Although IRS procedures require employees to code the sources of payments received when certain transaction codes (TCs) apply, DPCs are not mandatory in all other situations.[15]

The National Taxpayer Advocate addressed the IRS's inability to accurately track sources of tax payments in the 2009 Annual Report to Congress.

In her 2009 Annual Report, the National Taxpayer Advocate raised concerns about the IRS's inability to accurately track the source of tax payments received on past due accounts.[16] TAS reported on a research study that, in part, attempted to assess whether the IRS is filing liens effectively to collect revenue. This analysis of IRS payment data revealed that, in approximately 67 percent of all payment transactions attributable to a statistically representative sample of taxpayers,[17] the IRS coded the payments as "Miscellaneous" or did not code them at all.[18] This means the IRS cannot determine whether any particular collection action (or none at all) was effective in generating tax payments for the liabilities incurred.

The National Taxpayer Advocate recommended that the IRS immediately implement a quality review of payment coding.[19] The IRS later agreed to this recommendation, with anticipated completion date of October 15, 2011.[20]

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14 IRM 5.1.2.8.1.3 (July 13, 2010).

15 IRM 5.1.2.8 (July 13, 2010); IRM 3.11.10.5.10 (July 2, 2010); IRM 4.4.24.4(5) (Oct. 30, 2007); IRM 21.3.4.7.1.3 (Oct. 1, 2009). The use of a DPC on all posting documents/vouchers is mandatory when the following Transaction Codes (TC) are involved: "640" Advance Payment of Determined Deficiency or Underreporter Proposal; "670" Subsequent Payment; "680" Designated Payment of Interest; "690" Designated Payment of Penalty; "694" Designated Payment of Fees and Collection costs; and "700" Credit Applied. For other TCs (*e.g.*, "610" Remittance with Return; "611" Dishonored Remittance with Return; "612" Correction of TC 610 Processed in Error; "641" Dishonored Advance Payment), DPCs are not required. Transaction codes are numeric codes for all system actions on the IRS Integrated Data Retrieval System (IDRS). IRS Document 6209, *IRS Processing Codes and Information* (2010), 8-1 - 8-42.

16 National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS's Use of Notices of Federal Tax Lien*).

17 TAS reviewed 1,886,683 transactions from 270,399 individual taxpayers who first incurred new balance due liabilities during tax year 2002 (and who had no previous unpaid balances due at that time), and against whom Notices of Federal Tax Lien (NFTLs) were filed in subsequent years. For a more detailed discussion and description of this lien analysis and methodology, including payment allocation, see National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS's Use of Notices of Federal Tax Lien*).

18 IRS, CDW, IMF Transaction File Cycle 200913. Of the 1,886,683 total payment transactions, only 629,158 transactions had the DPC code assigned. 1,257,525 transactions or about 67 percent were designated "miscellaneous" or "DPC indicator not present." Of the 1,257,525 transactions, 283,091 had a refund offset transaction code; leaving 974,434 payments (or 51.6 percent) as unaccountable. Thus, 912,249 payments (or 48.4 percent) had meaningful DPCs or could be identified as refund offsets. The IRS does not conduct a quality review of the payment information by DPC. IRS response to TAS research request (Oct. 6, 2009).

19 National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*, Recommendation No. 1).

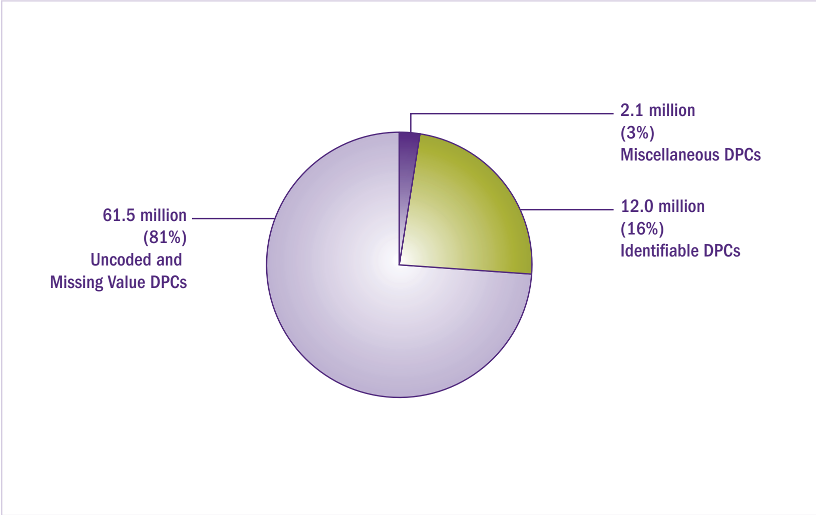
20 Department of Treasury Joint Audit Management Enterprise System (JAMES) tracking system (last visited Oct. 1, 2010).

The IRS has no way to accurately track the effectiveness of its enforcement activities and measure the benefits of its service initiatives.

The IRS Oversight Board has called for the IRS to make more data-driven decisions across the full range of its activities, from service to enforcement.[21] The IRS Strategic Plan also states the agency's commitment to use data and research servicewide to make informed decisions and allocate compliance resources.[22]

However, TAS's analysis of IRS payment source data revealed the payment code indicators were missing on payment vouchers in over four of five (or about 81 percent) tax payments received in CY 2009.[23] As shown on Chart 1.18.1 below, while about three percent of payments were coded as miscellaneous, only about 16 percent of all payments were identifiable by a DPC.

FIGURE 1.18.1, CY 2009 Number of Payments with Designated Payment Codes for Major Transaction Codes[24]



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21 IRS Oversight Board Annual Report to Congress 2009 6 (Apr. 2010), *available at* http://www.treas.gov/irsob/reports/2010/IRSOB%20Annual%20Report%202009.pdf.

22 IRS Strategic Plan 2009-2013, Strategic Foundations, Objective 4, 30, *available at* http://www.irs.gov/pub/irs-pdf/p3744.pdf (last visited Aug. 26, 2010).

23 IRS, CDW, IMF Transaction History Table, Transaction Codes 600-899, Transaction Dates from Jan. 1 to Dec. 31, 2009. The IRS received a total of 298.8 million payments on balance due accounts in CY 2009. TAS Research analyzed a subsegment of 75.6 million of the total 298.8 million (or approximately 25 percent) of those payments. These 75.6 million payments represented subsequent or balance due payments for major Transaction Codes that both require and do not require a DPC.

24 TAS research used a combination of major transaction codes that both require and do not require a DPC. IRS, CDW, IMF Transaction File Cycle 201032. DPC Code "99" indicates a miscellaneous payment. DPC Code "00" indicates a designated payment indicator is not present on posting voucher. Identifiable codes are DPCs with a value other than "00," "99," or missing.

While about 26 percent of CY 2009 payments had identifiable sources where the use of DPCs was mandatory, less than one percent of payments not requiring a DPC had identifiable sources, as shown on Charts 1.18.2 and 1.18.3 below.[25]

FIGURE 1.18.2, CY 2009 Number of Payments with Transaction Codes Where Use of a DPC Is Required[26]

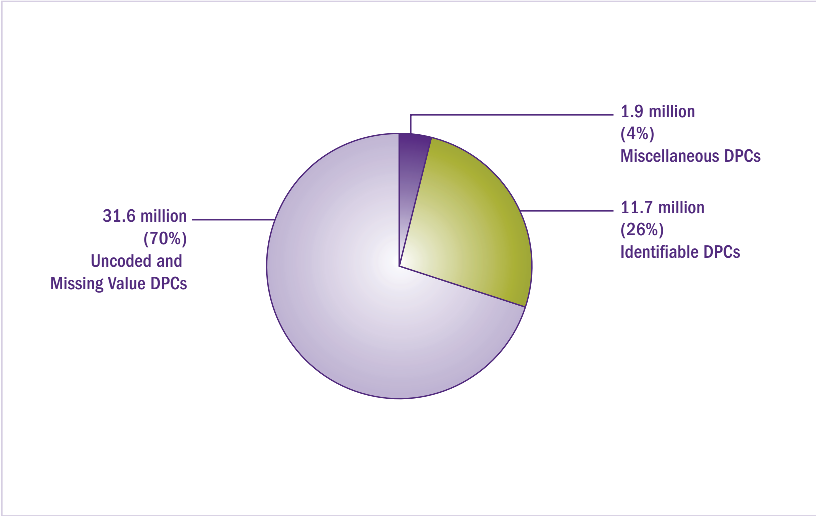
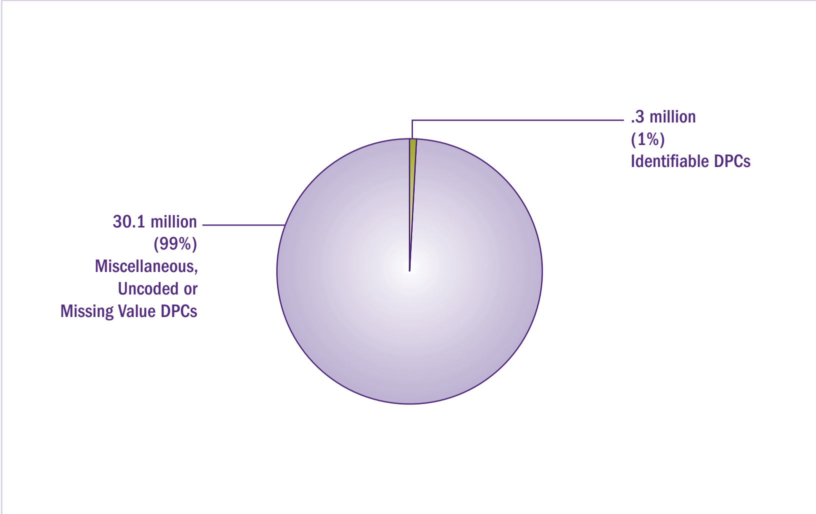


FIGURE 1.18.3, CY 2009 Number of Payments with Transaction Codes Where Use of a DPC Is Not Required[27]



25 IRS, CDW, IMF Transaction File Cycle 201032.

26 *Id.*

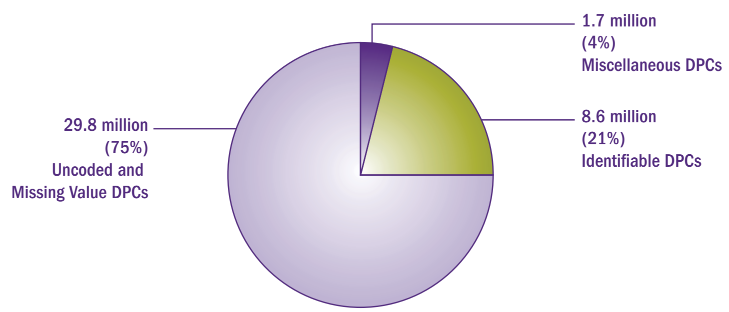
27 IRS, CDW, IMF Transaction File Cycle 201032. DPCs are not required for all other transaction codes. TAS Research analyzed the total of 30.4 million payments for non-mandatory DPCs.

Although statutory and regulatory provisions require the IRS to measure the costs and benefits of its various collection and enforcement efforts, the IRS does not use DPCs to formulate its collection policy or to evaluate the effectiveness of enforcement and taxpayer service activities.[28] The IRS's failure to accurately code and track the source of payments prevents the IRS from drawing meaningful conclusions about its own activities, and may mislead the American public, including policymakers, academia, researchers, and taxpayers.[29]

The IRS lacks meaningful transaction codes to identify payments received.

Even with transaction codes that require DPCs, the IRS is still unable to accurately assess the effectiveness of activities resulting in post-assessment or subsequent payments. The TC with the highest volume of posting documents was TC 670 "Subsequent Payment" (a mandatory TC) which accounted for 89 percent (40.1 million of 45.2 million) of all postings in CY 2009 and 94.5 percent of revenue ($80.3 billion of $85 billion) collected. This TC does not allow the IRS to distinguish what action caused the payment (*e.g.*, an enforcement action, a response to an IRS notice, or a voluntary payment). The DPC is critical in identifying the action that initiated the TC 670. As shown on Chart 1.18.4 below, about 74 percent (29.8 million of 40.1 million) of all TC 670s had no DPC and defaulted to a DPC of "00" that indicates "undesignated payment." This equates to about 93 percent of subsequent payments collected ($75 billion of $80.3 billion) in CY 2009.[30] Thus, in most cases the IRS does not know what event or action has resulted in a subsequent payment on a past due account.

FIGURE 1.18.4, CY 2009 Coding of DPCs for TC 670 "Subsequent Payment"



28 *See* Treas. Reg. §§ 801.1(a)(2); 801.6(d)(2). W&I, SB/SE, and CFO do not use DPC data or assess program effectiveness based on the use of the DPC data. IRS response to TAS research request (Sept. 20, 2010). TAS is also concerned that actions related to "service initiatives" are not generally represented in DPCs.

29 The performance measures that comprise the balanced measurement system will, to the maximum extent possible, be stated in ***objective, quantifiable, and measurable*** terms and will be used to measure the overall performance of various operational units within the IRS. Treas. Reg. § 801.2 (emphasis added).

30 IRS, CDW, IMF Transaction File Cycle 201032.

The significance of this finding cannot be overstated. *Neither the IRS nor policymakers know the true impact of IRS collection activities on delinquent accounts in the absence of a meaningful DPC or TC.* As a result, they may implement policies that unnecessarily harm taxpayers, and most importantly, adversely affect future compliance.[31] Therefore, the IRS should require its employees to use a meaningful DPC that indicates the source of payment.

Deficient IRM guidance and insufficient training and oversight of employees and vendors contribute to the IRS coding payments as miscellaneous or not coding them at all.

Taxpayers generally remit payments to lockbox depositories operated by outside vendors.[32] These vendors process remittances and send tapes containing remittance data, all vouchers, documents, and correspondence to the IRS for additional handling and input to databases.[33] Thus, the IRS can review the coding entered by the vendor and verify that each payment has the proper DPC.[34] However, the IRS generally allows the use of "00" (undesignated payment) and "99" (miscellaneous) DPCs for all TCs.[35] The IRMs for the Collection, Examination, and Accounts Management functions provide the same basic references regarding DPC entry and no further guidance.[36] Although the IRS Submission Processing function is ultimately responsible for coding received payments, the overall process lacks quality review of the accuracy of payment coding.[37]

We applaud recent IRS efforts to improve payment coding accuracy. The IRS revised the Customer Account Services (CAS) IRM to require CAS employees to research the payment source using all available data sources before entering a "00" or "not coded" DPC.[38] However, this IRM change does not apply to all IRS functions and outside vendors, and

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31 *See* Status Update: *The IRS Has Been Slow to Address the Adverse Impact of Its Lien Filing Policies on Taxpayers and Future Tax Compliance, infra. See also* National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*).

32 IRM 3.0.230 (Apr. 8, 2010); IRM 3.0.230.2.1 (Jan. 1, 2010); IRM 3.0.273 (Jan. 1, 2010). The Secretary of the Treasury under 12 U.S.C. §§ 90 and 265 permits certain financial institutions to act as a fiduciary of Treasury to process federal tax payments on behalf of IRS. The IRS lockbox network is comprised of three financial agents (Bank of America, US Bank, and JPMorgan Chase) with eight individual lockbox locations that process more than $400 billion annually (or about 17 percent of gross collections in FY 2009) and perform sorting, handling, and shipping of tax returns and other tax correspondence. IRS Data Book, 2009; IRS response to TAS research request (Sept. 20, 2010). About 75 percent of all payments processed by the lockbox network are either estimated tax payments or payments with filed returns. These payments are voluntary and are designated by the nature of the payment. IRS response to TAS (Nov. 1, 2010).

33 IRM 3.0.273.14 (Jan. 1, 2010).

34 For example, implementation of a Full Service Intelligent Bar Code for return mail or voucher/return mail labels can substantially improve payment coding. A meaningful DPC could easily be programmed into the bar code. *See also* Most Serious Problem: *Existing Mail Procedures Fail to Deliver Vital Taxpayer Responses Timely*; Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers, supra*.

35 *See, e.g.*, IRM 3.11.10.5.10 (July 2, 2010).

36 IRM 3.11.10 (Jan. 1, 2010); IRM 3.8.44, IRM 4.4.24 (Jan. 1, 2010); IRM 3.24.133.2 (Jan. 1, 2010); IRM 4.4.24 (Oct. 1, 2007); IRM 5.1.2.8 (July 13, 2010), IRM 21.1.7.9 (Oct. 1, 2010); IRM 21.1.1.4 (Oct. 1, 2007); IRM 21.3.4.7.1.2 (Mar. 22, 2010); IRM 21.3.4.7.1.3 (Oct. 1, 2009).

37 IRS response to TAS research request (Sept. 20, 2010). Submission Processing Campuses conduct quality reviews in the Receipt & Control Operation before the payments are posted. Quality Reviewers follow instructions in IRM 3.30.28. However, quality reviews standards do not include the accuracy of DPC coding and quality reports are not currently generated.

38 Acting on National Taxpayer Advocate's recommendation, the IRS revised IRM 21.3.4.7.12.3(5) (June 17, 2010). Paragraph 5 now reads: "If you are inputting a payment and the Designated Payment Code (DPC) is not present on the 809 receipt, research the payment source using all available data sources and if no information is available use DPC 00." SEPR Alert 100953 (June 17, 2010).

does not eliminate the use of the "00" DPC, which accounts for over 81 percent of all payments.[39] The IRS should take a servicewide approach to revising and consolidating DPC-related IRM guidance. This effort should involve the IRS operating divisions' embedded research functions, as well as TAS Research and Analysis, in developing better codes, because these codes can ultimately be used to evaluate the effectiveness of enforcement actions and service initiatives. The IRS also should immediately implement quality reviews of the accuracy of payment coding, generate periodic quality review reports, and annually train all IRS and vendor employees involved in entering DPCs on payments.

CONCLUSION

The IRS Oversight Board recently stated that one of the most serious challenges for the IRS is the more effective use of data, noting that the IRS "must increase its ability to use data more effectively in making service, enforcement, and resource allocation decisions."[40] Without accurately coding all the payments it receives, the IRS cannot fully meet its statutory and regulatory requirements to measure its business results.[41] It also cannot meet its strategic objective of developing a data-driven approach to allocating resources and making effective service, enforcement, and resource allocation decisions.[42] Finally, internal and external stakeholders are unable to accurately assess the effectiveness of IRS enforcement activities and service initiatives, and make reasonable, data-driven policy decisions.

The National Taxpayer Advocate offers these preliminary recommendations:

1. Revise IRM guidance and Lockbox Processing Guidelines for lockbox facilities to require the entry of specific designated payment codes on all received payments and require Submission Processing employees to verify the presence of an appropriate DPC on those payments.
2. Provide clear and specific guidance under what limited circumstances a miscellaneous DPC may be used.[43]
3. In consultation with TAS and IRS Research function, review and revise current DPCs and TCs to link each payment to specific IRS enforcement activities and service initiatives.

39 IRS, CDW, IMF Transaction File Cycle 201032. *See also* Figure 1.18.1, *CY 2009 Number of Payments with DPCs for Major Transaction Codes, supra*.

40 IRS Oversight Board, *Annual Report to Congress 2009* 31 (Apr. 2010), *available at* http://www.treas.gov/irsob/reports/2010/IRSOB%20Annual%20Report%202009.pdf. *See also* IRS Oversight Board, *FY 2011 IRS Budget Recommendation Special Report* 10 (Mar. 2010), *available at* http://www.treas.gov/irsob/reports/2010/IRSOB%20FY11%20BUDGET%20REPORT.pdf ("The IRS needs to evolve into a more data-driven organization. Such a transformation is essential for the IRS for two reasons: it offers the potential to create major efficiency gains in IRS business processes while simultaneously reducing taxpayer burden.").

41 *See, e.g.*, Treas. Reg. § 801.6(d)(1).

42 IRS Strategic Plan 2009-2013, Goal 2, Objective 4, 19, 22, *available at* http://www.irs.gov/pub/irs-pdf/p3744.pdf (last visited Aug. 26, 2010). *See also* U.S. Department of Treasury, *Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance* (July 8, 2009), Component 2: Make a Multiyear Commitment to Research, *available at* http://www.irs.gov/pub/newsroom/tax_gap_report_-final_version.pdf.

43 Eliminate use of DPC 00 "undesignated payment" and limit use of DPC 99 "miscellaneous" to situations where after a thorough inquiry no information is available to code the payment.

4. Implement a quality review of payment coding and provide for disciplinary action against employees who do not follow the procedures.

IRS COMMENTS

Background

Designated Payment Codes are intended to identify payments received from specific collection activity on accounts in Taxpayer Delinquent Account status. The purpose of DPCs is not to identify the source of all payments the IRS receives, nor are they intended to track taxpayer behavior subsequent to IRS enforcement actions or other service initiatives. They serve a useful purpose in enabling IRS to better understand the motivational factors that cause taxpayers to make a payment on a delinquent tax account and are useful in assessing the cost/benefit and effectiveness of certain collection work streams. In this regard, IRS agrees that the potential exists to improve the accuracy of the coding on subsequent payments and has already initiated a study of this issue.

However, it is important to understand that DPCs have nothing to do with the IRS's ability to account for the revenue, allocate payments to the proper taxpayers' accounts, or prepare reliable financial statements as required by United States Code (USC) Title 31. Nor are DPCs required, or even used, in the IRS's system of balanced measures as required by the IRS Restructuring and Reform Act of 1998 (RRA 98).

IRS procedures require employees to use DPCs to code the sources of payments received only when one of six Transaction Codes apply. Transaction Codes are numeric codes used for all systemic actions on the Integrated Data Retrieval System used by IRS employees to access and update taxpayer accounts. Examples include manually monitored installment agreements, offers in compromise, levy, or seizure and sale of an asset (IRM 5.1.2.8.1 (July 13, 2010)). DPCs are not mandatory in any other situations (IRM 5.1.2.8 (July 13, 2010); IRM 3.11.10.5.10 (July 2, 2010); IRM 4.4.24.4(5) (Oct. 30, 2007), and IRM 21.3.4.7.1.3 (Oct. 1, 2009)).[44]

Payments received with a filed tax return or estimated tax payments are not subsequent payments and are not subject to DPC coding. Furthermore, the IRS estimates that less than one percent of the payments submitted by individuals that are processed by the lockbox network require DPCs. Thus, it is not surprising for the National Taxpayer Advocate to report that "IRS failed to record the payment code indicator on payment vouchers in over 81 percent of all tax payments received in CY 2009."

The IRS strongly disagrees with the allegation that it is unable to properly record and account for the money it receives in order to prepare reliable financial and statistical reports to the President, Congress, and the American public as required by Title 31, or measure tax

[44] The use of a DPC on all posting documents/vouchers is mandatory only when the following Transaction Codes (TC) are involved: "640" Advance Payment of Determined Deficiency or Underreporter Proposal; "670" Subsequent Payment; "680" Designated Payment of Interest; "690" Designated Payment of Penalty; "694" Designated Payment of Fees and Collection costs; and "700" Credit Applied.

enforcement results as required by RRA 98. The IRS also believes it is incorrect that "(t) he IRS's failure to accurately code and track the source of payments prevents the IRS from drawing meaningful conclusions about its own activities, and may mislead the American public, including policymakers, academia, researchers, and taxpayers."

Regulatory and Legal Requirements – Balanced Measures

The National Taxpayer Advocate cites Treasury Regulations that require the IRS to evaluate the effectiveness of its operations as the basis for implying that DPCs are essential to meeting the balanced measures requirements of RRA 98.[45] As part of its implementation of RRA 98, a framework was developed by the IRS requiring a balanced system for measuring organizational and individual performance. The IRS sets performance goals for organizational units and measures the results achieved by those units with respect to those goals. The balanced performance measurement system is composed of three elements: Customer Satisfaction Measures; Employee Satisfaction Measures; and Business Results Measures. For example, for our Collection function, the IRS fulfills the requirements under RRA 98 by monitoring various collection measures such as dollars collected, closures, cycle time, age of inventory, enforcement activity, employee satisfaction, taxpayer satisfaction, and quality.

The IRS supplements the balanced measures it has established in accordance with RRA 98 and the implementing Treasury Regulations with past and current statistically valid research projects. DPCs were not created for and generally are not used for this purpose. In fact, the IRS usually already knows the reasons for taxpayer payments.[46] In only a small number, approximately seven percent, the IRS has not properly coded the payment and is unable to determine the reason for payment based on the Masterfile status of the account.[47]

Simply measuring and reporting on trends in collection activity and dollars collected through DPCs would fail to account for other variables critical to analyzing the effectiveness of collection actions. For example, changes to economic conditions, the inventory mix, and collection business practices and structure all can influence dollars collected through the various enforcement work streams. To credit the influence of collection actions only to those payments with transactions directly resulting from use of collection tools (*i.e.*, lien, levy, and seizure) does not provide a complete picture. Taxpayer actions, such as paying the liability in full, making installment payments, or filing an offer in compromise, may be motivated by the anticipation of, as well as the utilization of, IRS collection tools. Given these limitations, relying solely on DPC data to study or report externally on collection actions would provide an unrealistic and unreliable estimate of the amount collected as a result of various IRS collection actions.

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45 Treas. Reg. §§ 801.1(a)(2); 801.6(d)(2).

46 In FY 2009, approximately 58 percent from notices; 18 percent related to installment agreements; and 16 percent in TDA status that contain DPCs. *See* IRS, Collection Activity Report NO-5000-07; IRS, Collection Activity Report NO-5000-08.

47 IRS, Collection Activity Report 5000-07; IRS, Collection Activity Report 5000-09.

Further, IRS performance goals and measures, as well as its compliance with RRA 98, have been the subject of numerous reviews by the IRS Oversight Board, the Treasury Inspector General for Tax Administration, the Government Accountability Office (GAO), and the Congress, among others. In its Annual Report for 2007, the IRS Oversight Board stated: "It is now almost a decade since the enactment of the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98) and the IRS Oversight Board is pleased to report that the *IRS has made steady progress in meeting the letter and spirit of that landmark legislation* (emphasis added).[48] None of these external oversight functions have reported the IRS to be in violation of the balanced measures requirements of RRA 98.

Nothing in RRA 98 and the implementing regulations, or the external oversight reviews referenced above, requires the use of DPCs, or even mentions them as a part of the IRS's balanced measures process. As a result, the IRS does not agree with the statement in this report that "(w)ithout accurately coding all the payments it receives, the IRS cannot meet its statutory and regulatory requirements to measure its business results."

Regulatory and Legal Requirements – Financial Management

The report also takes the position that a DPC is essential to IRS financial management and implies that the IRS is not in compliance with the law (USC Title 31). The IRS disagrees. In fact, the IRS accurately records information on the revenue it collects in its financial systems and in the Enforcement Revenue Information System (ERIS), built to report on IRS enforcement activities.

Each year the IRS also prepares audited financial statements in compliance with the Statement of Federal Financial Accounting Standard No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.[49] The GAO has issued an unqualified opinion on the IRS financial statements for eleven consecutive years, stating that the financial statements are presented fairly, in conformity with Generally Accepted Accounting Principles and the principles and standards required by 31 USC § 3513.

In its annual financial statements, the IRS reports the tax revenues it collects including supplemental information showing the tax class and tax year of the collection in accordance with federal accounting standards. The IRS also provides GAO evidence that the revenue can be traced between the taxpayer accounts, sub-ledger and general ledger through Trace ID numbers. Reporting on DPCs is neither required nor useful for this purpose and the IRS is unaware of any external requirements to report on collected revenue by DPC.

48 *See also* Hearing on Status of IRS Efforts to Implement the IRS Restructuring and Reform Act of 1998, Senate Committee on Finance (Feb. 2, 2000); GAO, GGD-007-71R, (Feb. 28, 2000); TIGTA, Ref. No. 2007-10-140, *The Development of Specific Long-Term Measures and Targets Improved the Internal Revenue Service's Strategic Plan (2005-2009)* (Aug. 23, 2007); TIGTA, Ref. No. 2010-IE-R007, *The Internal Revenue Service Restructuring and Reform Act of 1998 Was Substantially Implemented but Challenges Remain* (Mar. 1, 2010).

49 The CFO Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990) and codified in relevant part, as amended, at Title 31 USC § 3521(g) and under the authority of 31 USC § 3515.

Measuring Enforcement Results

This report states that the absence or inaccuracy of DPCs "precludes the IRS from drawing meaningful conclusions about the effectiveness of its activities, and making data-driven policy decisions about service, enforcement, and resource allocation." The IRS believes that this statement is inaccurate. As noted above, DPCs are used strictly to code subsequent payments resulting from certain collection actions and do not measure the effectiveness of IRS services. More importantly, ERIS tracks and analyzes enforcement activities across all the enforcement functions from the day a case starts to the day it closes. ERIS reports enforcement revenue collected by the function that made the assessment or by where in the collection stream a case was when the dollars were collected. By using additional data elements captured in ERIS, such as the assessing function (*e.g.*, Examination, Substitute for Return, Information Return Program, etc.), the system can report on the effectiveness of IRS enforcement programs at the program level and has been used to make decisions in the past.

The IRS also maintains a cost module in the Integrated Financial System (IFS) that contains five years of cost information available to business units to determine the costs of its programs. The IRS managerial cost accounting system consists of IFS, ERIS, and multiple business-unit workload and production management systems. Since 2008, the IRS has completed numerous cost/benefit studies on enforcement programs where the IRS was able to match IFS cost information to the tax revenue data from ERIS and workload and production data from various business unit management systems to measure and report on the cost of IRS products and services. For example, studies in the following were provided to both the Business Operating Divisions and GAO in the past three years: AUR, EITC Exam/EITC AUR, Field Exam, Correspondence Exam, ACS, Field Collection, and ASFR. In fact, in FY 2009, GAO agreed the IRS has demonstrated it has the ability to effectively cost its programs, although it remains a management challenge.[50]

As referenced above, the IRS does agree that if the entry of DPC information were improved it would assist IRS in performing additional analyses and breakouts below the summary program levels. However, the absence of this information does not preclude the IRS from meeting its regulatory and statutory requirements for reporting on tax revenues collected or making data-driven policy decisions about its enforcement programs and resource allocations.

Ongoing Study of Potential DPC Coding Improvements

The National Taxpayer Advocate raised the issue of DPC coding in the 2009 Annual Report to Congress.[51] In response the IRS agreed to conduct a review of its payment coding process. IRS is currently in the process of conducting that review and will be exploring a range of potential improvement opportunities. This review is scheduled for completion by October 15, 2011.

50 GAO, GAO-10-176, *IRS's Fiscal Years 2009 and 2008 Financial Statements* (Nov. 2009).

51 National Taxpayer Advocate 2009 Annual Report to Congress (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*).

Response to Preliminary Recommendations

With regard to the National Taxpayer Advocate's recommendation to revise IRM guidance and lockbox processing guidelines, these instructions already correctly specify when DPCs are required and provide the appropriate codes to be used when coding designated payments. However, as noted above, IRS is already conducting a review of the DPC coding process to identify potential improvement opportunities. As part of that process, IRS will study the need for improving IRM or lockbox payment processing procedures.

With regard to the National Taxpayer Advocate's recommendation to improve guidance on when the "miscellaneous" DPC may be used, this will be considered as part of the currently ongoing DPC process review.

For the reasons outlined above, including the fact that DPCs are not required for every payment received by the IRS, we do not agree with the recommendation to review and revise current DPCs to link each payment to specific IRS enforcement activities and service initiatives.

The National Taxpayer Advocate also recommends that IRS implement a quality review of payment coding and provide for disciplinary action against employees who do not follow the procedures.

With regard to the quality review recommendation, this recommendation was also included in the National Taxpayer Advocate's annual report for 2009. In response, the IRS stated that it recognizes the need to ensure the consistent and appropriate use of DPCs by employees and agreed to review IRM guidance on this subject for clarity to ensure employees understand the need to properly code payments received and to conduct a review to assess appropriate use of these codes. That study is ongoing. The IRS has not agreed to implement a DPC quality review process at this point but is considering the need for such a system as part of its ongoing study.

With regard to the National Taxpayer Advocate's recommendation to provide disciplinary action against employees who do not follow the procedures, the IRS does not agree there is a need for any such punitive measures. The IRS does not believe that DPC coding issues are a result of employee malfeasance or misconduct. Rather, IRS believes existing employee performance management tools are more than adequate to address employee conformance with IRM requirements. However, as previously stated, the clarity and adequacy of these IRM requirements, as well as the need for a dedicated quality review process, will be assessed as part of the DPC process review currently underway and scheduled for completion in October 2011.

Taxpayer Advocate Service Comments

For the second consecutive year, the National Taxpayer Advocate raises concerns about the IRS's inability to accurately track the source of *subsequent, post-assessment* tax payments received on past due accounts.[52] The IRS, however, seems to have missed the point of our concerns. The IRS response discusses financial accounting and accurate posting of tax payments to proper taxpayer accounts. The National Taxpayer Advocate, on the other hand, identifies the material weaknesses in the IRS's measurement of the revenue effectiveness of its various activities. She is not implying that the IRS does not substantially comply with the statutory and regulatory requirements. She instead provides actionable recommendations to improve "the balanced performance measurement system" in terms of revenue generated by a particular enforcement activity or service initiative targeting past due accounts.

The Federal Managers' Financial Integrity Act of 1982 codified under Title 31 U.S.C. § 3512(c) requires that "revenues and expenditures applicable to agency operations [be] recorded and accounted for properly so that accounts and reliable financial and statistical reports may be prepared…."[53] The IRS Restructuring and Reform Act of 1998 and implementing regulations requires the IRS to establish a balanced system for measuring organizational and individual performance.[54] The IRS has substantially complied with these requirements by establishing a "balanced performance measurement system."[55] The regulations further contemplate that "the balanced measurement system will, to the maximum extent possible, be stated in *objective*, *quantifiable*, and *measurable* terms."[56] The IRS may use the records of tax enforcement results, for example "a lien filed, a levy served, a seizure executed, the amount assessed, the amount collected, and a fraud referral,"[57] "for purposes such as forecasting, financial planning, resource management, …the formulation of case selection criteria, …[and] to develop methodologies and algorithms for use in selecting tax returns to audit."[58]

While the law does not specifically require the use of DPCs, the Treasury Regulations provide that the IRS use "data, statistics, compilations of information or other numerical or quantitative recordations of the tax enforcement results" in measuring its performance.[59]

52 Most pre-filing, voluntary payments are already identifiable from their source, *e.g.*, payments with return (TC 610); federal tax deposits (TC 650); estimated tax payments (TC 660), etc.

53 31 U.S.C. § 3512(c)(1)(C).

54 RRA 98, § 1201(a)(2)(A) (requiring "establishing goals or objectives for individual, group, or organizational performance (or any combination thereof)…). *See also* Treas. Regs. §§ 801.1; 801.6.

55 Treas. Reg. § 801.1(a)(2). The balanced performance measurements system is composed of three elements: Customer Satisfaction Measures; Employee Satisfaction Measures; and Business Results Measures. *Id.* Business results measures consist of the quality and quantity measures, including "records of tax enforcement results." Treas. Reg.§ 801.6(d)(2).

56 Treas. Reg. § 801.2 (emphasis added).

57 Treas. Reg. § 801.6(d)(1).

58 Treas. Reg. § 801.6(d)(2).

59 *Id*.

The IRS's own internal guidance interprets that DPCs are "*congressionally mandated* and will be accumulated on a national basis to *determine the revenue effectiveness of specific collection activities*."[60]

DPCs are designed to provide the IRS and outside stakeholders with meaningful information regarding the revenue outcomes of IRS compliance activities. DPCs are also very important for gauging the IRS's performance in *objective*, *quantifiable*, and *measurable* terms. The IRS's use of the DPCs, however, does not provide good data for use in this manner. A TAS analysis of IRS payment source data has found that the DPC is not present on payment vouchers in 81 percent of all post-assessment tax payments received in 2009. Even with transaction codes that require DPCs, about 75 percent of all entries either had no DPC or defaulted to DPCs of "00" (undesignated payment) or "99" (miscellaneous). Thus, in most cases, the IRS does not know and cannot determine what event or action prompted the subsequent payment on a past due account. Accordingly, the IRS lacks critical data that would improve its ability to make meaningful policy decisions, assess programs, and effectively allocate resources.

The National Taxpayer Advocate respectfully disagrees that the Integrated Financial System, Enforcement Revenue Information System, and multiple business-unit workload and production management systems provide adequate cost-outcome and revenue effectiveness measurements of enforcement activities. The IRS's use of balanced measures tend to evaluate the performance of "organizational units," rather the IRS as a whole, or even key compliance activities such as liens, levies, and seizures, without analyzing the revenue impact of those actions.[61] The IRS acknowledges that "[e]xisting data structures in ERIS and CDW make it difficult to easily extract data needed to assess the effectiveness of collection programs, and only the few power users who understand the systems and data can extract critical information."[62] Several GAO reports dating back to 2002 have cited the need for "outcome-oriented performance measures."[63] The IRS continuously experiences challenges with respect to "developing and routinely using cost-based (and, where appropriate, enforcement revenue-based) performance metrics to measure the results of its efforts

60 IRM 5.1.2.8.1.3, *Identify the Event That Resulted in a Payment* (Aug. 15, 2008) (emphasis added).

61 The IRS acknowledges that existing reports do not track assessment dollars as they enter various collection streams to determine process effectiveness. Often, data are not captured or are counted inconsistently among systems, and there are no reports showing assessments, collections, and abatements in one report. The data are scattered and must be manually extracted from different systems, including ERIS, Collection Activity Reports (CAR), and CDW. IRS, PowerPoint presentation, *Improving the Collection Process* (May 5, 2010) (on file with the National Taxpayer Advocate).

62 IRS, PowerPoint presentation, *Improving the Collection Process* (May 5, 2010) (on file with the National Taxpayer Advocate).

63 *See, e.g.*, GAO, GAO-09-119, *Financial Audit of IRS's Fiscal Years 2008 and 2007 Financial Statements* (Nov. 2008); GAO, GAO-10-176, *Financial Audit of IRS's Fiscal Years 2009 and 2008 Financial Statements* (Nov. 2009); GAO, GAO-11-142, *Financial Audit of IRS's Fiscal Years 2010 and 2009 Financial Statements* (Nov. 2010).

and assist in allocating resources."[64] The GAO further commented that the IRS had to rely on "a resource-intensive statistical sampling process" to compensate for these deficiencies and estimate these amounts.[65] The GAO believes that "[t]hese issues also lead to increased taxpayer burden."[66]

The National Taxpayer Advocate also disagrees that DPCs are not designed to track taxpayer behavior and future compliance. To the degree that taxpayer behavior is represented by payments, the DPCs are intended to track that behavior. The DPC is not the be-all or end-all measurement, but is another useful tool to track the impact of IRS actions taken to motivate post-assessment, balance due payments, as well as the cost effectiveness of these actions.[67] And right now, because of the manner in which it is being applied, this tool is completely ineffective.

The National Taxpayer Advocate is pleased that the IRS is already reviewing the DPC coding process to identify potential improvement opportunities and has committed to study the payment coding process. However, she is disappointed that the IRS disagrees with the recommendation to review and revise current DPCs to link each payment to specific enforcement activities and service initiatives. The IRS also declines to implement a DPC quality review process, citing the need for additional study.

The National Taxpayer Advocate is baffled by the IRS's inflexible approach to payment coding and its resistance to changes that would improve its "balanced measurement system." It is clear that measuring specific enforcement activities and service initiatives, by using meaningful DPCs and TCs, would enable the IRS to give stakeholders a more accurate and complete picture of activities that cause the taxpayer to pay on balance due accounts and the costs associated with those activities.[68] The use of meaningful DPCs would also

64 GAO-09-119 at 24-25 (Nov. 2008) (stating "[the] IRS has limited ability to develop performance measures or related goals and to compare the relative effectiveness of its programs or activities....In addition, developing and tracking performance goals against actual performance would assist the IRS in evaluating the effectiveness of its various programs and activities in achieving IRS's mission."). *See also* GAO-11-142 *at* 6 (Nov. 2010) (pointing out a "material weakness in [IRS's] internal control over unpaid tax assessments.... [as a result of] ....a continuing deficiency in IRS's ability...to trace amounts reported in its financial statements and required supplementary information through its general ledger back to underlying *source* documents on a *transaction-by-transaction basis*" (emphasis added)).

65 GAO-11-142 *at* 6 (Nov. 2010).

66 GAO, GAO-11-142, *Financial Audit of IRS's Fiscal Years 2010 and 2009 Financial Statements* 6 (Nov. 2010).

67 *See* Status Update: *The IRS Has Been Slow to Address the Adverse Impact Its Lien Filing Policies Have on Taxpayers and Future Tax Compliance, infra*. While the IRS increased NFTL filings by about 550 percent from 1999 to 2010, the collected revenue (in 2010 dollars) has essentially remained flat. The IRS estimates that a lien filing costs between $25 and $100 plus labor costs. IRS Collection Process Study (CPS) 122 (Sept. 30, 2010). The IRS spends up to $109 million in lien filing costs annually, not including labor costs, based on 1,096,376 NFTLs filed in FY 2010. IRS, *Fiscal Year 2010 Enforcement Results, available at* http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf.

68 One important example of nebulous "data, statistics, compilations of information" is the Statistics of Income (SOI) reports between 2007 and 2008, where the IRS had "lost" about $32 billion in collection revenue for FYs 2005, 2006, and 2007. Since 2008 the IRS revised the SOI data with minimal explanation. IRS, *IRS Data Books, Table 16, Delinquent Collection Activities, 2005-2008*. The IRS originally reported revenue yield for FY 2005-2007 as (in thousands, respectively): $37,113,036, $40,813,309, and $43,318,830, but corrected these figures in the 2008 IRS Data Book and subsequent reports (in thousands, respectively) to $27,615,348, $29,172,915, and $31,952,399. *See also* National Taxpayer Advocate 2009 Annual Report to Congress viii-ix.

yield better "data-driven" decisions like those anticipated by the IRS Oversight Board.[69] The National Taxpayer Advocate believes the IRS should not delay the implementation of meaningful payment coding of all subsequent payments and link each payment to specific IRS enforcement activities and service initiatives, and should include TAS in the "ongoing study" of payment coding.

Finally, the National Taxpayer Advocate agrees that miscoding of subsequent payments does not stem from employee misconduct. Rather, it results from a lack of training and from IRS procedures that allow coding subsequent payments as "miscellaneous" or not coding them at all. Therefore, she would not recommend disciplinary action against employees not following procedures at this time. Instead, she insists that the IRS provide clear and specific guidance about the limited circumstances under which employees can use a miscellaneous DPC and implement a quality review of payment coding.

Recommendations

That National Taxpayer Advocate offers the following recommendations:

1. Revise IRM guidance and guidelines for lockbox facilities to require the entry of specific designated payment codes on all balance due payments, and require Submission Processing employees to verify the presence of an appropriate DPC on those payments.
2. Provide clear and specific guidance about the limited circumstances under which employees can use a miscellaneous DPC.
3. Implement a quality review of payment coding.
4. In consultation with TAS and IRS Research functions, review and revise current DPCs and TCs to link each subsequent payment to specific IRS enforcement activities and service initiatives.

69 IRS Oversight Board, *Annual Report to Congress 2009* 31 (Apr. 2010), *available at* http://www.treas.gov/irsob/reports/2010/IRSOB%20Annual%20Report%202009.pdf. *See also* IRS Oversight Board, FY 2011 IRS Budget Recommendation Special Report 10 (Mar. 2010), *available at* http://www.treas.gov/irsob/reports/2010/IRSOB%20FY11%20BUDGET%20REPORT.pdf.

MSP #19 The IRS Has Been Reluctant to Implement Alternative Service Methods that Would Improve Accessibility for Taxpayers Who Seek Face-to-Face Assistance

RESPONSIBLE OFFICIAL

Richard E. Byrd Jr., Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

Taxpayer Assistance Centers (TACs) are the IRS's main vehicle for providing face-to-face customer service available to taxpayers from the IRS. Although the IRS maintains 401 TACs, more than 30 percent of taxpayers do not live within a 30-minute drive of any of them.[1] Thus, tens of millions of taxpayers cannot easily obtain face-to-face service from the IRS. Additionally, TACs remain out of reach for many rural taxpayers, as most TACs are located in more populous areas[2] and only 55 percent are open 36 to 40 hours per week.[3] In 2008, the IRS convened the Geographic Coverage Initiative (GCI) to examine the placement of TACs and determine if the current TACs met the needs of the public. The GCI worked with a computer model to map the location of TACs in relation to the taxpaying population in general, as well as with regard to certain segments of the population, such as low income taxpayers or those who speak English as a second language. Using this model, the IRS should make more effective use of its limited resources to reach a greater percentage of the taxpaying population with alternative face-to-face service options. The IRS could achieve additional geographic coverage with solutions such as mobile vans or telepresence.[4]

ANALYSIS OF PROBLEM

Background

Some segments of the taxpaying population need or prefer to receive services face-to-face from the IRS.[5] The National Taxpayer Advocate has addressed the coverage and services provided by TACs in several Annual Reports to Congress, recommending that the IRS

1 IRS, *Taxpayer Assistance Blueprint (TAB): Phase 2*, 116, 194 (Apr. 17, 2007). The *Taxpayer Assistance Blueprint* reported a coverage rate of 60 percent of taxpayers within a 30-minute drive time of TACs. In response to a research request from TAS, the IRS provided the "*Field Assistance Geographic Coverage Initiative Executive Briefing January 2010*" and reported a 68.2 percent face-to-face coverage rate within a 30-minute drive of TACs. The coverage gains are due to changes in the underlying assumptions on travel time and are less conservative than the TAB estimates. Regardless of which assumptions are accepted as accurate, the IRS reports that at a minimum, nearly one-third of taxpayers (31.8 percent) do not have ready access to face-to-face services.

2 *See* http://www.irs.gov/localcontacts/index.html (last visited Oct. 5, 2010).

3 IRS, *Contact My Local Office, Face-to-face Tax Help, available at* http://www.irs.gov/localcontacts/index.html (last visited Oct. 5, 2010).

4 Cindy Waxer, *Telepresence: Current and Future*, VOIP-News, Making VoIP Connections, *available at* http://www.voip-news.com/feature/telepresence-current-futureapps-051507/ (May 15, 2007).

5 *See* IRS Oversight Board, *Taxpayer Customer Service and Channel Preference Survey Special Report* (Nov. 2006); National Taxpayer Advocate 2006 Annual Report to Congress vol. 2, 1-15 (*Study of Taxpayers Needs, Preferences, and Willingness to Use IRS Services*).

increase face-to-face service through increased TAC hours, the ability to make appointments at the TACs, vans, telepresence, and sharing space with local and state agencies.[6]

Brick and Mortar TACs May Not Reach the Right Populations.

The low income taxpayer population tends to be more transitory than other taxpayer groups, with more than 26 percent of the low income population moving in 2009 compared with approximately 15 percent of the general public.[7] This population may shift to areas where migratory work is available or may move more rapidly as the economy of an area changes, placing the taxpayers in and out of range of a TAC. The low income population is also less likely to have access to online assistance and may therefore be more in need of face-to-face service than other population segments.[8] Currently, the IRS reports approximately 67 percent coverage for taxpayers with incomes below $39,000.[9] The remaining 33 percent of taxpayers below this threshold cannot access reasonable face-to-face service and may be better served by alternatives to brick and mortar TACs.

Increase Face-to-Face Service Using Innovative Solutions

Brick and mortar TACs are not the only way to bring face-to-face service to taxpayers. The IRS should pilot a program using mobile vans to reach taxpayers in underserved areas. A van is a particularly good solution in states such as Montana, where towns and cities are very spread out. Employees based in one location could easily drive 50 to 75 miles from their home base each day and serve ten different locations in a two-week period. A 75-mile trip would not only provide service to taxpayers in that particular location, but to all those within a 30-minute drive of the location.

For example, in Montana, six brick and mortar TACs provide coverage within a 30-minute drive time to 59 percent of the taxpayers.[10] Placing a mobile TAC in various additional locations in the state could significantly increase face-to-face coverage to taxpayers. For example, if the IRS had a mobile van in Ramsay, Montana, one day a week an additional five percent of Montana taxpayers would have access to face-to-face coverage, while a day

6 *See* National Taxpayer Advocate 2008 Annual Report to Congress 95-113 (Most Serious Problem: *Taxpayer Service: Bringing Service to the Taxpayer*); National Taxpayer Advocate 2007 Annual Report to Congress 162-182 (Most Serious Problem: *Service at Taxpayer Assistance Centers*); National Taxpayer Advocate 2004 Annual Report to Congress 8-25 (Most Serious Problem: *Taxpayer Access – Face-to-Face Interaction*).

7 U.S. Census Bureau, *American FactFinder, 2009 American Community Survey 1-Year Estimates, Table, B07012, available at* http://factfinder.census.gov/servlet/DTTable?_bm=y&-geo_id=01000US&-ds_name=ACS_2009_1YR_G00_&-_lang=en&-redoLog=true&-mt_name=ACS_2009_1YR_G2000_B07012&-format=&-CONTEXT= (last visited Oct. 25, 2010).

8 PEW Internet & American Life Project, *Internet, Broadband, and Cell Phone Statistics* (Jan. 5, 2010) *available at* http://www.pewinternet.org/Reports/2010/Internet-broadband-and-cell-phone-statistics/Report.aspx. Only 60 percent of Americans with incomes below $30,000 a year use the Internet, compared with 94 percent of Americans with incomes over $75,000. Broadband Internet, providing faster access and making online tasks easier to complete, is adopted at even lower rates by those with lower incomes. Only 42 percent of American Internet users with incomes below $30,000 have access to broadband, compared to 84 percent of households with incomes of $75,000 or more.

9 IRS, Field Assistance Geographic Coverage Executive Briefing (July 2010).

10 IRS response to TAS research request (Nov. 3, 2010).

in Corvallis, Montana would cover another three percent.[11] By using mobile vans as an alternative solution to provide face-to-face service, the IRS could increase face-to-face service in Montana significantly.

In West Virginia, seven TACs provide face-to-face coverage for 62 percent of the state's taxpayers.[12] The IRS could work with the West Virginia government to identify walk-in state government office sites where the IRS could offer service one day per week. If the IRS rotated through state offices in the five to ten cities in West Virginia with no TACs, face-to-face service coverage would again increase significantly. For example, placing an account resolution employee in a state office one day a week in Newburg or in Independence, West Virginia would each cover an additional six percent of West Virginia taxpayers.[13]

Vans also have the advantage of being able to respond quickly to population changes and disasters. In states where a transient low income population follows seasonal work, such as California, a van provides the flexibility necessary to keep up with the migratory needs of this population, which a brick and mortar TAC cannot do. When a disaster strikes, such as the recent Gulf Coast oil spill, the vans could be sent immediately to the area where taxpayers need help without the IRS having to find temporary work space. Having mobile vans on site at disaster areas would allow taxpayers to quickly obtain the information they need, such as tax transcripts, to apply for benefits.

Because many TACs are in populous areas and are inaccessible to taxpayers in more remote towns,[14] the IRS needs a strategy to assist those who cannot easily reach a walk-in site. Previously, the National Taxpayer Advocate recommended the use of telepresence sites to provide service to remote areas of the country.[15] In the United States, doctors have used videoconferencing and telemedicine capabilities to remotely interact with patients who otherwise could not consult a medical professional in a timely manner.[16] The IRS could use similar technology to provide an interactive face-to-face experience for taxpayers. Taxpayers could bring documents and show them through the video screen to the assistor and receive all the benefits of a TAC, including tax preparation, tax law assistance, and account services.

11 IRS response to TAS research request (Nov. 3, 2010). The five most populous cities not currently covered by TACs are Ramsay, Warm Springs, Butte, Corvallis, and Hamilton. However, the populations of several of these locations overlap, so the IRS would need to determine which non-overlapping areas would provide the greatest overall coverage increase to test a mobile van program.

12 IRS response to TAS research request (Nov. 4, 2010).

13 *Id*.

14 *See* http://www.irs.gov/localcontacts/ (last visited Oct. 5, 2010).

15 National Taxpayer Advocate 2008 Annual Report to Congress 95-113 (Most Serious Problem: *Taxpayer Service: Bringing Service to the Taxpayer*).

16 Linda Lou, *Dr. Robot Is on Call, Interactive Tool Can Make Rounds*, The San Diego Union Tribune, Aug. 15, 2008, *available at* http://www.signonsandiego.com/news/northcounty/20080815-9999-1m15robodoc.html.

The IRS Made Efforts to Expand Face-to-Face Service in Fiscal Year 2010.

The National Taxpayer Advocate commends the IRS's efforts to provide more face-to-face service options to taxpayers. In fiscal year (FY) 2010, the IRS continued to test a program to locate IRS employees at Volunteer Income Tax Assistance (VITA) sites to help taxpayers who may need more than just tax preparation. The IRS tested this program at 27 sites and served over 5,300 taxpayers during the filing season.[17] Plans to continue this program in FY 2011 include expansion to a total of 30 VITA sites.[18] The IRS also continued to provide assistance at one VITA site in Minnesota through the end of September, 2010.[19]

In FY 2010, the IRS also tested a series of "Saturday Service" days where TACs across the country opened from 9:00 am to 2:00 pm.[20] The Taxpayer Advocate Service (TAS) participated in the Saturday events by providing telephone assistors to take in cases that met TAS criteria and sending Local Taxpayer Advocates to assist at several of the open TACs. The IRS opened 200 TACs at two Saturday events and 99 at a third event, serving over 35,000 taxpayers.[21] Additionally, the IRS offered Saturday Earned Income Tax Credit (EITC) assistance at 170 TACs and offered help on Saturday, July 17 at seven Gulf Coast TACs for taxpayers impacted by the oil spill.[22]

The IRS also made efforts to extend service hours at TACs, expanding hours on weekdays and Saturdays at 16 TACs during the 2010 filing season.[23] The IRS provided Saturday service at seven TACs throughout the filing season, with the exception of April 3.[24] Due to taxpayer response, the IRS plans to offer expanded service during filing season 2011 as well.[25]

Minimal Barriers Exist to Implementing Pilot Programs.

While some costs exist in implementing pilot programs, these costs should be minimal. Leasing or purchasing a van to test a mobile TAC program would be inexpensive and could serve to increase face-to-face coverage significantly. Partnering with state tax agencies to provide additional services to the citizens of those states will not involve costly or long-term investment in real estate for the IRS. The IRS would only need to negotiate the use of minimal space to provide TAC services to taxpayers one day a week. The largest cost would be associated with setting up a pilot telepresence program, which would require the IRS to invest in technology and space.

17 IRS response to TAS research request (Oct. 13, 2010).

18 *Id.*

19 *Id.*

20 *See* http://www.irs.gov/localcontacts/article/0,,id=220631,00.html (last visited Oct. 1, 2010).

21 IRS response to TAS research request (Oct. 13, 2010).

22 *Id.*

23 *Id.*

24 *Id.*

25 *Id.*

Maintaining the Status Quo of Face-to-Face Service Is Not an Option.

While the IRS made efforts to add face-to-face services in FY 2010, these solutions are not permanent. Additionally, most VITA sites only operate during filing season, while taxpayers need face-to-face service year-round. Saturday Service days are not held often enough or scheduled at optimal locations.

Unless the IRS tries new solutions, over 30 percent of taxpayers will not have ready access to face-to-face service, the same rate since the IRS completed opening its 401 TACs.[26] Those who need this service most include low income taxpayers, the elderly, and the disabled.[27] Studies have shown that these taxpayers have less access to the Internet and prefer to receive service face-to-face.[28]

CONCLUSION

Face-to-face assistance is essential to effective tax administration. Certain segments of the taxpaying population will always require face-to-face assistance.[29] The IRS could significantly increase the reach of face-to-face services through mobile vans, collaborating with state and local agencies, telepresence, and other innovative solutions. In addition to maintaining brick and mortar TACs where there are stable populations of taxpayers with face-to-face requirements, the IRS should also become flexible in providing face-to-face service to other fluctuating populations and areas with varying needs.

In conclusion, the National Taxpayer Advocate offers these preliminary recommendations:

1. Test a program using mobile vans to increase face-to-face service;
2. Pilot a program to work with state and local agencies to increase the IRS's face-to-face presence; and
3. Test telepresence in remote areas.

IRS COMMENTS

We appreciate the National Taxpayer Advocate's review of the IRS's customer service to taxpayers, as well as the acknowledgement of the Geographic Coverage Initiative that examines the placement of TACs and determines if the current TACs meet the needs of taxpayers.

The IRS recognizes the continual need to provide taxpayers with increased face-to-face services. Since the creation of the GCI in 2008, the IRS has taken several steps to increase its

26 IRS, *Taxpayer Assistance Blueprint: Phase 2*, 116, 194 (Apr. 17, 2007). Or a slightly higher 68.2 percent using estimates that assume taxpayers are able to travel more quickly than those used in the TAB study. IRS response to TAS research request (Oct. 13, 2010).

27 National Taxpayer Advocate 2006 Annual Report to Congress vol. 2, 1-15 (*Study of Taxpayer Needs and Preferences*).

28 *See* IRS Oversight Board, *Taxpayer Customer Service and Channel Preference Survey Special Report* (Nov. 2006); National Taxpayer Advocate 2006 Annual Report to Congress vol. 2, 1-15 (*Study of Taxpayers Needs, Preferences, and Willingness to Use IRS Services*).

29 National Taxpayer Advocate 2006 Annual Report to Congress vol. 2, 1-15 (*Study of Taxpayers Needs, Preferences, and Willingness to Use IRS Services*).

partnerships with volunteer sites and other IRS organizations and expand the TAC hours of service to meet the face-to-face needs of taxpayers.

In 2009, IRS employees worked at nine VITA locations assisting taxpayers with account issues, transcripts, Individual Taxpayer Identification Numbers (ITIN), and answering tax law questions. Over 1,300 taxpayers received service. During 2010, the IRS provided assistance at 27 volunteer locations and assisted over 5,300 taxpayers. The IRS plans to staff approximately 30 volunteer locations in 2011.

Also during 2010, the IRS held two EITC Awareness Saturday events to bring awareness of EITC and prepare returns for those who qualify. These EITC events were held in 170 TACs where the IRS assisted over 9,500 taxpayers and prepared over 4,000 tax returns.

The IRS sponsored nationwide Open House events in 2010, in at least one TAC in each state.[30] The Open House events convened various IRS organizations, including TAS, Small Business/Self-Employed; Large Business and International; Chief Counsel; Tax Exempt and Government Entities; Governmental Liaison; Stakeholder, Partnerships, Education and Communication; Automated Collection System; and outside partners who worked together to resolve taxpayer issues. Although the events provided assistance to all taxpayers who came to the TAC, some of the events had special themes and reached out to specific taxpayers, such as small businesses, the disabled, veterans, and taxpayers who were struggling due to the economic downturn. These events were very successful and well attended, over 35,000 taxpayers were assisted and 8,600 tax returns were prepared.

For 2011, the IRS will continue to offer EITC Saturday service and Open House events in partnership with many of the IRS organizations mentioned above. Four Open House events are planned during the filing season at nearly 100 TACs and two after the filing season at approximately 50 TACs. The IRS will continue to partner with community organizations to increase our services for taxpayers and looks forward to continuing its partnership with TAS during these events.

The IRS also provided expanded service hours during 2010. Sixteen TACs across the country opened before 8:30 a.m. and after 4:30 p.m. on weekdays and Saturdays. The expanded service hours resulted in 6,272 walk-in taxpayers through the week of April 15, 2010. As a part of this initiative, the IRS analyzed data and solicited feedback from both taxpayers and employees to evaluate the success of the expanded hours of operations at select TACs. Based on this feedback, the IRS is planning to offer similar expanded hours of service during the 2011 filing season in select TACs where existing staff can effectively accommodate taxpayers.

The IRS recognized the potential need for taxpayers impacted by the Gulf of Mexico oil spill and initiated the Gulf Coast Assistance Day at seven TACs located throughout the Gulf

30 Those events were conducted on February 20th, March 27th, May 15th, June 5th, and September 25th.

Coast area on Saturday, July 17. A total of 168 taxpayers received assistance to resolve a variety of federal tax-related issues.

PRELIMINARY RECOMMENDATIONS:

Test a program using mobile vans to increase face-to-face service.

The IRS has tested this option in the past and received low taxpayer interest and turnout. For example, the IRS conducted a mobile Tax Tour in North Dakota using alternative locations. Despite efforts to promote the IRS's availability in the mobile locations through radio announcements, newspaper ads, and local flyers, the number of taxpayers served was 76 in 2008, 12 in 2009, and 13 in 2010. Based on these tests, we have observed that taxpayers do not come to sites that are not established and staffed on a regular basis.

Pilot a program to work with state and local agencies to increase the IRS's face-to-face presence.

The IRS currently partners with state and local agencies to increase IRS's ability to directly provide service to taxpayers. We currently prepare returns for 27 states through 263 TACs across the country. Eight additional states (Kentucky, Michigan, Minnesota, Nebraska, New Jersey, Ohio, Pennsylvania, and Virginia) will be brought online in 2011 and six additional six states, plus the District of Columbia, will be considered in subsequent years.

In addition, we have co-located with state tax agencies, such as the State of Utah, to offer a full range of TAC-related services including return filing, resolution of account issues, transcripts, and tax law assistance. During 2010, the TAC in Charleston, West Virginia partnered with the State of West Virginia to provide IRS staffing at the state's office on selected days to assist taxpayers with heavy vehicle use taxes. The IRS is interested in pursuing other opportunities to collaborate with state tax agencies on an as needed basis. However, there are resource challenges as some states are requesting monetary assistance.

The IRS is utilizing the GCI Model to increase the coverage rate by exploring the use of alternative locations and increasing partnerships by establishing an increased IRS presence at the volunteer sites during the filing season. By staffing volunteer sites with IRS employees from offices within the commuting area, IRS is able to provide additional service and enhance coverage. IRS employees provide services not currently offered at these volunteer sites such as accounts, transcripts, and tax law questions.

Test telepresence in remote areas.

The IRS agrees with the National Taxpayer Advocate's recommendation that a telepresence in remote areas may be a potential option. We are currently working on technical and bandwidth issues at existing TAC locations to optimize computer applications that are used to access taxpayers' accounts. Once these issues have been resolved, the IRS will consider the telepresence option.

The Facilitated Self Assistance (FSA) kiosks, which are another form of virtual presence, were used at 49 TACs for the 2010 filing season. FSA allows the IRS to expand its service and outreach to taxpayers by providing assistance through computer workstations that taxpayers can use to connect to IRS.gov and conduct their tax-related business and share feedback about their experience. Approximately 9,700 taxpayers used FSA to file their tax returns electronically, apply for an Employer Identification Number, print current and prior year forms and publications, and enroll in Electronic Federal Tax Payment System (EFTPS). Dated equipment and structure has delayed further deployment of FSA. However, IRS Field Assistance is working on a viable solution for kiosks in the TACs and will continue to provide FSA in 2011.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS acknowledges the potential of telepresence as a method of serving taxpayers in areas where TACs are not in reasonable driving distance. The National Taxpayer Advocate continues to encourage the IRS to explore this option and implement a pilot program to test its effectiveness. In fact, the Taxpayer Advocate Service will be testing this approach by establishing a telepresence site for taxpayers seeking TAS assistance in at least two states. We will share our progress and results with the IRS. We also commend the IRS's efforts to expand service in current TAC locations by offering weekend service and longer hours on weekdays.

However, the focus of this issue is the large number of taxpayers with no access to face-to-face service. While offering additional services at existing TACs is also critical, the National Taxpayer Advocate is concerned that the IRS is not expanding service to underserved areas. Open houses and EITC Awareness Days are very important, but take place at current TAC locations. Neither these events nor increasing hours can deliver face-to-face coverage to taxpayers who live beyond a reasonable driving distance of a TAC.

The National Taxpayer Advocate is surprised by the IRS response to the recommendation that the IRS test a program of using mobile vans to expand face-to-face service to taxpayers. Twice, the IRS replied to TAS requests for information by saying it does not own mobile vans.[31] The IRS did not respond at all to the National Taxpayer Advocate's recommendation in her 2008 Annual Report that it test a van program.[32] However, in its response for this year's report, the IRS states that it has been testing a Mobile Tax Tour in North Dakota since 2008. Despite requests for information about how the IRS has expanded face-to-face service to taxpayers, the IRS has not previously mentioned this program.[33] Thus, we have had no opportunity to explore the parameters of the Mobile Tax Tour. For example, the IRS provided no information about the dates or locations of the tour in North Dakota, the hours the vans were available or how frequently they went to sites, or the methods of publicizing and promoting the service. The National Taxpayer Advocate is unable to evaluate from the IRS response whether this program meets the recommendation of testing a mobile TAC program. The National Taxpayer Advocate encourages the IRS to share more information regarding this program with TAS.

In its response to a TAS research request, the IRS also failed to mention partnering with state tax agencies,[34] yet in the response to this Most Serious Problem the IRS states it collaborated with the tax agencies in Utah and West Virginia to provide, respectively, a full range of TAC services and services related to heavy vehicle use taxes. The National

31 IRS response to TAS research requests (Oct. 21, 2010, and Nov. 3, 2010).

32 *See* 2008 National Taxpayer Advocate Annual Report to Congress 95-113.

33 IRS response to TAS research request (Oct. 21, 2010).

34 *Id.*

Taxpayer Advocate is pleased that the IRS is working with state agencies, but again cannot evaluate this program based on the information provided. The National Taxpayer Advocate encourages the IRS to share further information regarding this program with TAS.

Successful pilots of van and co-location programs must contain several key elements. The programs must be consistent; that is, taxpayers must be able to expect that certain services will be available on certain days in certain locations. Haphazardly advertising a mobile van program through print and advertising, holding the program for one day, and then declaring it was unsuccessful because only a few taxpayers availed themselves of the service does not reflect a well-structured pilot program. It will take time for taxpayers to realize and trust that a mobile TAC will be in their area every other Thursday offering full-scale IRS services. A one-day trial, even with advertising, will not give the IRS useful information about the extent to which taxpayers use the program. Programs must also be advertised to taxpayers most likely to need face-to-face services, through channels they are likely to use. Simply informing the public of an event via the IRS website will not reach those segments of the population that are most likely to need face-to-face service, as those taxpayers are less likely to use the Internet.[35]

Tax agencies in other countries have had significant success with mobile van units, and even use them to supplement brick-and-mortar assistance centers in populous areas as well as more remote or rural ones. In November, 2010, the National Taxpayer Advocate visited with Chilean Servicio de Impuestos Internos (SII – the tax agency or "IRS") officials and observed both stationary and mobile assistance centers. There are four such centers in Santiago, the most populous city in Chile. Notwithstanding these four centers, the tax agency utilizes vans to visit various communities in Santiago. The Chilean SII believes that having a presence among taxpayers and making it easier to obtain assistance increases voluntary tax compliance.[36]

The National Taxpayer Advocate suggests that the IRS work with TAS to evaluate the programs referenced in its response, to determine if they are effective tests of mobile TACs and co-locations and to develop a strategy for a successful van program. Additionally, the National Taxpayer Advocate recommends that the IRS focus on expanding face-to-face service to underserved taxpayers in addition to expanding services at current TACs. Maintaining the status quo of brick and mortar TACs as the main vehicle for face-to-face service leaves more than 30 percent of taxpayers without reasonable access to this service. The IRS needs to explore further options to reach these taxpayers.

35 *See* IRS Oversight Board, *Taxpayer Customer Service and Channel Preference Survey Special Report* (Nov. 2006); National Taxpayer Advocate 2006 Annual Report to Congress vol. 2, 1-15 (*Study of Taxpayers Needs, Preferences, and Willingness to Use IRS Services*).

36 Conversations between the National Taxpayer Advocate and Chilean SII officials, November 22 – 24, 2010.

Recommendations

The National Taxpayer Advocate recommends that the IRS work with the Taxpayer Advocate Service to design and:

1. Test a program that uses mobile vans to increase face-to-face service;
2. Pilot a program to work with state and local agencies to increase the IRS's face-to-face presence; and
3. Test telepresence in remote areas

MSP #20 The S Corporation Election Process Unduly Burdens Small Businesses

RESPONSIBLE OFFICIALS

Chris Wagner, Commissioner, Small Business/Self-Employed Division
William J. Wilkins, Chief Counsel

DEFINITION OF PROBLEM

Subchapter S corporations are the most common corporate entity in the tax system.[1] S corporation status is highly desirable because in addition to traditional corporate attributes such as limited liability and transferable ownership, these corporations "pass-through" profits or losses to shareholders who report the income and receive the tax benefit of any losses on their individual returns.[2]

While the IRS rarely denies S corporation status for failure to meet the election criteria, many S corporation returns remain unprocessed for years because of missing or late elections, internal IRS errors in recognizing or processing a valid election, and an absence of effective relief procedures. In processing year (PY) 2009 alone, about 24 percent of all new S corporation returns could not be processed as filed.[3] The IRS does not provide examples of scenarios that meet the criteria for reasonable cause relief in its published guidance, nor does the IRS always fully inform taxpayers of their options for relief under five available Revenue Procedures.[4] These shortcomings impose undue burdens on small business taxpayers and may create significant re-work for the IRS. The National Taxpayer Advocate has identified the following challenges in the S election process:

- Despite increased IRS outreach, some taxpayers still overlook the requirement to file an S election;
- Administrative relief procedures for a late S corporation election are complex and burdensome for taxpayers;
- Retroactive relief via a Private Letter Ruling (PLR) is lengthy, complicated, and cost-prohibitive for many small businesses;

1 In FY 2009, 4.5 million S corporation returns were filed, accounting for about 64 percent of all corporate returns. IRS, *Data Book 2009*, Table 2, 4.

2 Internal Revenue Code (IRC) § 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under §1362(a) is in effect for such year. A small business corporation must make an election to be an S corporation by filing a completed Form 2553, *Election by a Small Business Corporation*. Treas. Reg. § 1.1362-6(a)(2).

3 IRS, Compliance Data Warehouse (CDW) for PY 2009 (June 2010). In PY 2008 and 2009, nearly 17 percent and nearly 24 percent, respectively, of all new S corporation filings were unpostable. If there is no election on file, the information cannot "post" to the IRS Master File; hence the return becomes "unpostable."

4 A taxpayer may obtain relief for certain late S corporation and late corporate classification elections by following the procedures in Rev. Proc. 2007-62, 2007-2 C.B. 786; Rev. Proc. 2004-49, 2004-2 C.B. 210; Rev. Proc. 2004-48, 2004-2 C.B. 172; Rev. Proc. 2003-43, 2003-1 C.B. 998; or Rev. Proc. 97-48, 1997-2 C.B. 521.

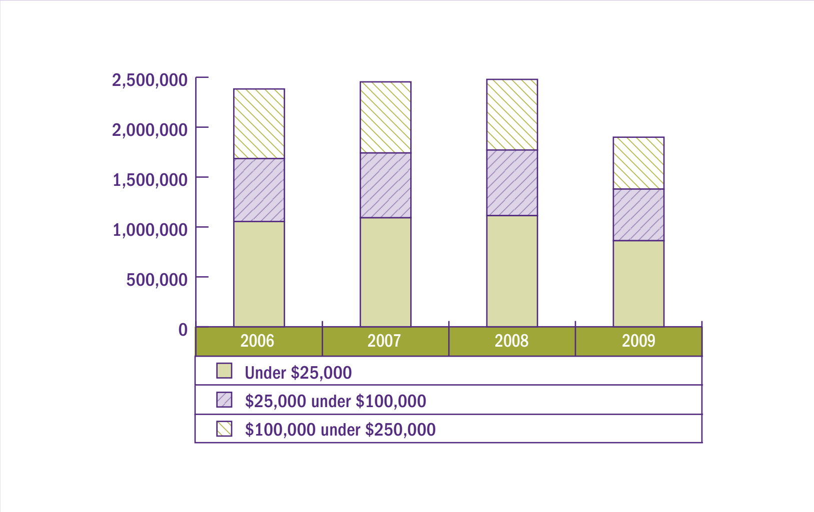
- The IRS's inability to verify the receipt of S corporation election applications increases taxpayer burden; and
- The conversion of S corporation returns to regular, taxable corporate returns imposes downstream burdens on S corporation shareholders and may have violated the law in the past.

ANALYSIS OF PROBLEM

Background

In tax year (TY) 2009, S corporations accounted for about 64 percent of all corporate returns, with 45 percent of S corporation returns reporting gross receipts under $100,000 and 63 percent reporting gross receipts under $250,000.[5] As Chart 1.20.1 illustrates, returns with gross receipts of under $250,000 comprised about 60 percent of all S corporation returns from TY 2006 to TY 2008. In TY 2009, approximately 419,000 small business taxpayers elected to be treated as S corporations.[6]

CHART 1.20.1, S Corporation Filings Stratified by Gross Receipts, TY 2006 – TY 2009



For a business to be treated as an S corporation, the entity must file Form 2553, *Election by a Small Business Corporation,* on or before the 15th day of the third month of the tax

5 IRS, CDW, Business Returns Transaction File (Tax Year 2009).

6 Business Master File (BMF) Extract for TYs 2006-2009 for Transaction Codes 090-095 (Sept. 2010). TY 2009 figures reflect partial year data through Sept. 2010.

year for which the election is to be in effect.[7] The IRS rarely denies S corporation elections for failure to meet the election criteria.[8] In PY 2009, only 615 of approximately 419,000 elections were denied on this basis.[9] It is not rare, however, for S corporation returns to remain unprocessed for several years because of missing or late elections or IRS errors in recognizing or processing a valid election. In PYs 2008 and 2009, there were 81,431 and 97,823 unpostable S corporation returns – or nearly 17 and nearly 24 percent, respectively, of all new S corporation filings.[10] Prior IRS research reports revealed approximately 20 percent of these returns remain unpostable for multiple years.[11]

Despite increased IRS outreach, some taxpayers still overlook the requirement to file an S election.

The IRS cannot process Form 1120S, *U.S. Income Tax Return for an S Corporation*, until it approves the S corporation election and determines an effective date of the S corporation status. It is this two-step, two-form, filing process in the first year that businesses often overlook. Even though the IRS uses several methods to educate taxpayers, many corporations only become aware of this pre-filing requirement after they attempt to file their first tax returns.[12]

The IRS could and should do more to help small business owners identify the requirement to file Form 2553. Typing the phrase "starting a new corporation" into the search box on www.irs.gov provides a link to Publication 583, *Starting a New Business and Keeping Records*. While this publication mentions S corporations as a form of business, describes the value of an S corporation, and directs the reader to Form 2553 (and the related instructions) for further information, it never explains that a business **must** file Form 2553 to become an S corporation. Form 2553 is conspicuously missing from the "Which Forms Must I File?" section and filing Form 2553 did not make the list as one of the "Top Six Tips for Taxpayers Starting a New Business." While the SB/SE Examination function maintains an excellent website that explains applicable S corporation laws and procedures, this site is not referenced in any IRS publications.[13]

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7 The S corporation election must be made at any time during the preceding taxable year, or at any time during the taxable year on or before the 15th day of the third month of the taxable year. IRC § 1362(b)(1); Treas. Reg. § 1.1362-6(a)(2). When an S corporation election is made after the 15th day of the third month of the taxable year and on or before the 15th day of the third month of the following taxable year, the election is treated as made for the following taxable year. IRC § 1362(b)(3). When Congress created the S corporation in 1958, the election was made by simply sending the request in writing to the IRS. The first official Form 2553, *Election by Small Business Corporation*, was issued in October 1968.

8 The election criteria are short and straightforward. Under IRC § 1362, in order to be considered an S corporation, a business must meet the criteria of a "small business corporation" as defined in IRC § 1361(b)(1) (a domestic corporation which is not an ineligible corporation and which does not 1) have more than 100 shareholders, 2) have as a shareholder a person who is not an individual, 3) have a nonresident alien as a shareholder, and 4) have more than one class of stock). *See also* Treas. Reg. § 1.1361-1(2)(b).

9 BMF Extract for Tax Years 2006-2009 for Transaction Codes 090-095 (Sept. 2010).

10 BMF from the CDW for PYs 2007-2009 (June 2010). If there is no election on file, the return information cannot "post" to the IRS Master File, and the return becomes "unpostable."

11 IRS, SB/SE Research report, Profile Taxpayers with Unpostable Initial 1120S Returns (May 2007).

12 For example, the IRS provides information about the need to file Form 2553 to elect S corporation status on its website, when applying for an employer identification number (EIN), and even on the face of the Form 1120S.

13 *See* http://www.irs.gov/businesses/small/article/0,,id=98263,00.html (last visited June 3, 2010).

Administrative relief procedures for a late S corporation election are complex and burdensome for taxpayers.

When an S corporation return cannot be processed because an S election is not on file, the IRS sends a letter requesting evidence of a valid election. If the taxpayer has no evidence or simply did not make a timely election, the IRS has the authority to treat the S election as timely for the taxable year if there was reasonable cause for the failure to make the election.[14] The IRS only provides reasonable cause relief for a late S corporation election under one of five Revenue Procedures, or through a letter ruling request discussed below.[15] The IRS does not provide examples of acceptable scenarios that meet criteria for reasonable cause relief in its published guidance,[16] nor does the IRS always inform taxpayers of all their options under the Revenue Procedures.[17] Moreover, the IRS does not provide routine reasonable cause relief through its campus employees and has no administrative appeal process to address S corporation election denials.

The current Form 2553 includes space for an explanation of reasonable cause based on the latest retroactive relief provision in Revenue Procedure 2007-62. Under this procedure, a company that fails to timely file Form 2553 can request relief by filing Form 2553 with its first Form 1120S as long as the return is filed within six months of the original due date (excluding extensions).[18] The hope expressed in the National Taxpayer Advocate's 2007 Annual Report to Congress – that Revenue Procedure 2007-62 would reduce the number of unpostable returns and ease taxpayer burden – has not been fully realized. After an initial dip in the number of unpostables in processing year 2008, unpostable returns continue to rise, even though the total number of S corporation elections has decreased about 23

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14 IRC § 1362(b)(5) provides that if (A) an election under § 1362(a) is made for any taxable year (determined without regard to § 1362(b)(3)) after the date prescribed by § 1362(b) for making the election for the taxable year or no election is made for any taxable year, and (B) the IRS determines that there was reasonable cause for the failure to timely make the election, the IRS may treat the election as timely made for the taxable year (and § 1362(b)(3) shall not apply).

15 A taxpayer may obtain relief for certain late S corporation and late corporate classification elections by following the procedures in Rev. Proc. 2007-62, 2007-2 C.B. 786; Rev. Proc. 2004-49, 2004-2 C.B. 210; Rev. Proc. 2004-48, 2004-2 C.B. 172; Rev. Proc. 2003-43, 2003-1 C.B. 998; or Rev. Proc. 97-48, 1997-2 C.B. 521. For letter ruling procedures, see Treas. Reg. § 301.9100-1; Rev. Proc. 2010-1, 2010-1 I.R.B. 1.

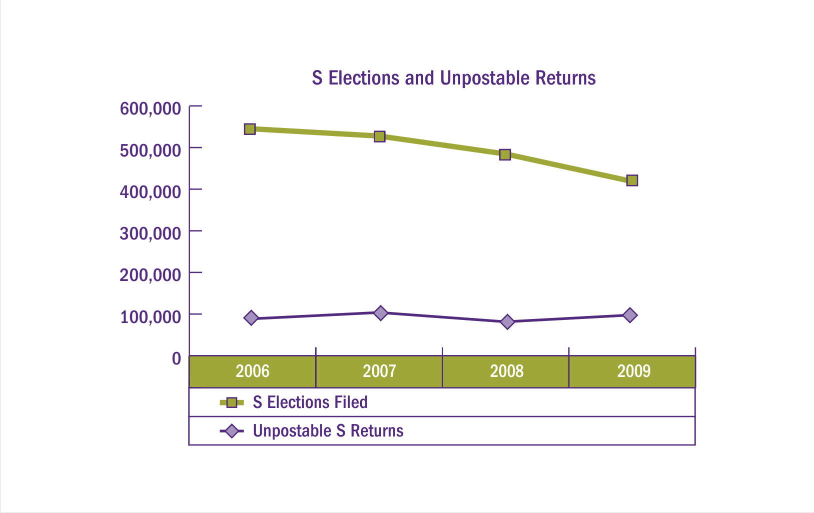
16 There is, however, a listing of common reasonable cause criteria in Internal Revenue Manual (IRM) 3.13.2.22.5 related to the application of Rev. Proc. 2003-43.

17 The IRS letter requesting evidence of a valid and timely S corporation election is generated by the IRS Correspondex system, which allows the IRS to insert various explanatory paragraphs. Depending on the employee processing the election, a taxpayer may not be informed of Revenue Procedures specific to its situation.

18 Revenue Procedure 2007-62 provides that an entity may request relief for a late S corporation election if all of the following requirements are met: 1) The entity fails to qualify for its intended status as an S corporation on the first day that status was desired solely because of the failure to file a timely Form 2553 with the applicable campus; 2) The entity has reasonable cause for its failure to file a timely Form 2553; 3) The entity seeking to make the S corporation election has not filed a tax return for the first taxable year in which the election was intended; 4) The application for relief is filed under this revenue procedure no later than six months after the due date of the tax return (including extensions) of the entity seeking to make the election for the first taxable year in which the election was intended; and 5) No taxpayer whose tax liability or tax return would be affected by the S corporation election (including all shareholders of the S corporation) has reported inconsistently with the S corporation election on any affected return for the year the S corporation election was intended.

percent between PY 2006 and PY 2009, from nearly 545,000 elections to nearly 419,000, as shown in Chart 1.20.2 below.[19]

CHART 1.20.2, Comparison of S Corporation Filings and Unpostable Returns, PY 2006 – PY 2009



The IRS could simplify administrative relief procedures for late S corporation elections and avoid confusion by consolidating the five revenue procedures into one, and by including a simple guide to the relief process in letters to taxpayers who did not make a timely election.

Retroactive relief via the Private Letter Ruling process is lengthy, complicated, and may be cost-prohibitive for many small businesses.

A small business entity that does not meet the requirements for relief, or is denied relief under a revenue procedure, is taxed as a C corporation for at least one year and may face the challenge of requesting relief by means of a PLR.[20] The IRS charges a user fee for a PLR ranging from $625 to $14,000 per request.[21]

According to a recent report by the Treasury Inspector General for Tax Administration, the IRS Office of Chief Counsel issued 226 PLRs for late S corporation elections under

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19 IRS, SB/SE Research report, *Profile Taxpayers with Unpostable Initial 1120S Returns* (May 2007) for PY 2006, and CDW BMF for PYs 2007-2009 (June 2010). With the exception of a dip in unpostable returns in 2008, unpostable returns continue to rise. The total number of unpostable Forms 1120S from PY 2006 to PY 2009 was as follows: PY 2006 – 88,672, PY 2007 – 103,762, PY 2008 – 81,431, PY 2009 – 97,823, IRS Master File Transaction Code (TC) data for Form 1120S. The total number of S elections filed from PY 2006 through 2009 was as follows: PY 2006 – 544,917, PY 2007 – 527,644, PY 2008 – 484,595, PY 2009 – 418,567. *See* BMF Extract for TYs 2006-2009 for Transaction Codes 090, 093, and 094 (Aug. 2010).

20 For a discussion of the PLR process specific to S corporation rulings, see National Taxpayer Advocate 2004 Annual Report to Congress 392. *See also* Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2010-10-106, *Chief Counsel Can Take Actions to Improve the Timeliness of Private Letter Rulings and Potentially Reduce the Number Issued* (Sept. 10, 2010).

21 A PLR may cost up to $14,000 per ruling request. Treas. Reg. § 301.9100-1; Rev. Proc. 2010-1, 2010-1 I.R.B. 1. However, a reduced user fee of $625 is available to taxpayers with gross income of less than $250,000 and $2,100 to taxpayers with gross income of less than $1,000,000. *See* Rev. Proc. 2010-1, Appendix A, (A)(3) – (4) and (B)(1).

IRC § 1362 from fiscal year (FY) 2007 to FY 2009.[22] Although the Office of Chief Counsel is aware of the need for guidance in the S corporation election area and issued numerous Revenue Procedures of which five are still active,[23] this guidance did not eliminate or reduce the need for letter rulings in connection with S corporation elections.[24]

The National Taxpayer Advocate is concerned about the increasing burden imposed on small business taxpayers by the need to seek relief via a lengthy, complicated, and often cost-prohibitive PLR process when the taxpayer is ineligible for relief under the existing revenue procedures.[25] Small business taxpayers need easy-to-follow published guidance providing retroactive relief for the failure to make a timely S corporation election.[26]

The IRS's inability to verify the receipt of election applications and acceptance of S corporation returns increases taxpayer burden.

In addition to reasonable cause, most of the relief procedures also require proof of timely and consistent filing of the S corporation and shareholder returns. In the past, it has been difficult to prove the existence of timely filed S corporation returns because the IRS filed unprocessable returns without cross-referencing them to the Employer Identification Number of the entity.[27] Unless a taxpayer had correspondence from the IRS with a Document Locator Number (DLN), it was nearly impossible to locate these unprocessable returns and prove timely filing. Since PY 2009, these returns have been transcribed to the Master File. We are pleased to report that the IRS can now verify proof of timely and consistent filing from its Master File, and has updated IRM procedures to require employees to research this readily available information before denying relief. While these enhancements will be very helpful from now on, they do not help resolve old, unpostable accounts.

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22 TIGTA, Ref. No. 2010-10-106, *Chief Counsel Can Take Actions to Improve the Timeliness of Private Letter Rulings and Potentially Reduce the Number Issued* 7 (Figure 2, Issue Code 1362.01-03) (Sep. 10, 2010). *See also* IRS, *IRS Written Determinations, at* http://www.irs.gov/app/picklist/list/writtenDeterminations.html (last visited Sept. 30, 2010). IRS Written Determinations are documents the IRS is required to make "…open to public inspection…" pursuant to the provisions of IRC § 6110.

23 Rev. Proc. 2007-62, 2007 -2 C.B. 786; Rev. Proc. 2004-49, 2004-2 C.B. 210; Rev. Proc. 2004-48, 2004-2 C.B. 172; Rev. Proc. 2003-43, 2003-1 C.B. 998; Rev. Proc. 97-48, 1997-2 C.B. 521.

24 In response to a TIGTA recommendation, the Office of Chief Counsel agreed that it "should identify common issues in letter ruling requests, and, when possible and beneficial, issue published guidance that eliminates or reduces the need for taxpayers to request letter rulings in connection with these identified issues." TIGTA, Ref. No. 2010-10-106, *Chief Counsel Can Take Actions to Improve the Timeliness of Private Letter Rulings and Potentially Reduce the Number Issued* (Sept. 10, 2010).

25 For letter ruling procedures, see Treas. Reg. § 301.9100-1; Rev. Proc. 2010-1, 2010-1 I.R.B. 1. *See also* TIGTA, Ref. No. 2010-10-106, *Chief Counsel Can Take Actions to Improve the Timeliness of Private Letter Rulings and Potentially Reduce the Number Issued* (Sept. 10, 2010). TIGTA determined that Chief Counsel personnel did not always make the initial contact with taxpayers to discuss the taxpayers' issues within 21 calendar days after case assignment, and did not always meet Counsel's internal target date of 120 calendar days to issue a PLR.

26 The IRS Office of Chief Counsel plans to issue guidance under IRC § 1362. Department of the Treasury, 2009-2010 Priority Guidance Plan (Nov. 24, 2009) and First Periodic Update of the 2009-2010 Priority Guidance Plan (Mar. 16, 2010), *at* http://www.irs.gov/newsroom/article/0,,id=215792,00.html.

27 In 2002, TIGTA reported that first-time filers of Form 1120S encountered a cumbersome, ineffective verification process for unpostable returns. TIGTA, Ref. No. 2002-30-186, *The Internal Revenue Service Needs to Simplify Filing Requirement and Clarify Processing Procedures for Small Business Corporate Returns* 1-3 (Sept. 2002).

Some S corporation elections are filed timely, but are not properly received, controlled, and processed by the IRS.[28] The IRS acknowledged these problems in 2002 and promised to improve electronic filing for corporate returns.[29] These changes have not been fully implemented. The IRS still does not allow Forms 2553 to be filed electronically as a stand-alone form or record any information about faxed or mailed Forms 2553 upon receipt, and therefore cannot verify the receipt of filed elections.[30] While taxpayers should and do bear the burden of showing that their elections are timely filed, the IRS could and should ease that burden by tracking the receipt of S elections, regardless of the filing method. Doing so will reduce the burden to both taxpayers and the IRS.

The conversion of S corporation returns to regular, taxable corporate returns imposes downstream burdens on S corporation shareholders and may have violated the law in the past.

The IRS converts S corporation returns without proof of a valid, timely election to Form 1120, *U.S. Income Tax Return for a Corporation,* where income is taxed at the corporate level. This conversion is reflected on the IRS Master File system. However, often the IRS does not assess any tax at the corporate level, and therefore does not issue a Statutory Notice of Deficiency (SNOD), leaving taxpayers with the incorrect assumption that the IRS accepted their 1120S returns as filed.[31] S corporation shareholders may then report the Form 1120S income or loss on their Forms 1040, or claim other expenses or credits attributable to the corporation. Years later, these shareholders may find themselves in an audit situation with large proposed assessments.

In some instances prior to 2004, the IRS converted S corporation returns to C corporation taxable returns and assessed the tax liability without issuing a SNOD. A TIGTA audit in 2002 identified about 3,700 instances where unclear IRS procedures may have violated taxpayer rights, as the IRS assessed taxes on an estimated $6.7 million in taxable income without sending the taxpayers a SNOD.[32] Although Chief Counsel determined in 1999 that the IRS "may not assess tax liability without following deficiency procedures specified under IRC §§ 6212 and 6213," the IRS continued this practice through tax year 2003.[33] TAS continues to resolve old cases where the IRS's Submission Processing, Accounts

28 BMF Extract for Tax Years 2006-2009 for Transaction Code 093 (Sept. 2010). There were 12,372 timely filed but unprocessed and unresolved elections in TY 2006, 8,768 in TY 2007, 6,848 in TY 2008, and 6,275 in TY 2009.

29 TIGTA, Ref. No. 2002-30-186, *The Internal Revenue Service Needs to Simplify Filing Requirement and Clarify Processing Procedures for Small Business Corporate Returns* 4 (Sept. 2002).

30 The IRS tracks S elections by inputting certain transaction codes on IDRS. IRS Document 6209, *IRS Processing Codes and Information* (2010). However, Transaction Code 093, *Application for Small Business Election*, only goes on the module 30 days after receipt.

31 Memorandum from Assistant Chief Counsel (Field Service) to District Counsel, Pennsylvania District, Ref. No. 199929036 (May 20, 1999). In a nonprecedential opinion, the IRS Office of Chief Counsel concluded that the IRS may process unpostable Form 1120S returns by transferring line item information to other forms that are postable (*i.e.*, Forms 1120). However, these postable forms do not constitute the taxpayers' returns but are merely a processing mechanism.

32 TIGTA, Ref. No. 2002-30-186, *The Internal Revenue Service Needs to Simplify Filing Requirements and Clarify Processing Procedures for Small Business Corporate Returns* (Sept. 23, 2002).

33 Memorandum from Assistant Chief Counsel (Field Service) to District Counsel, Pennsylvania District, Ref. No. 199929036 (May 20, 1999).

Management, and Examination support and processing functions assessed tax at the corporate level without issuing notices of deficiency.[34]

CONCLUSION

The cumbersome S corporation election procedures unduly burden small businesses and waste valuable IRS resources in resolving unpostable S corporation accounts where the income has most likely already been reported on the shareholders' individual returns. The IRS should refocus its efforts and assist small business owners who are trying to elect S corporation status by simplifying the late election relief process and updating publications and the IRS website with the simplified procedures.

In conclusion, the National Taxpayer Advocate offers these preliminary recommendations:

1. Consolidate the five revenue procedures providing relief for late S corporation elections into one.
2. Include a simple guide to the relief process in letters to taxpayers that did not make a timely election.
3. Publish guidance providing retroactive relief where reasonable cause exists for the failure to make a timely S corporation election at any time without the need to request a letter ruling and delegate authority to provide reasonable cause relief. The guidance should provide examples of what constitutes reasonable cause.
4. Enhance systems to allow electronic filing of Form 2553 at any time during the tax year, up to and including with the first S corporation return filing.
5. Update publications, forms, correspondence, and the IRS website with instructions for making the S election and how to seek relief to correct late elections.
6. Develop an administrative appeal process for taxpayers whose elections are denied.
7. Identify and correct old conversion cases where the IRS assessed tax without issuing a statutory notice of deficiency or denied effective elections because of lost returns or other errors.

IRS COMMENTS

As part of Congress' enactment of Subchapter S in 1958, qualified businesses are allowed the option of electing tax treatment as an S corporation. The benefits allowed to S corporations include avoidance of double taxation, as can be the case with C corporations, while preserving the limited liability features that can be lost in the case of some partnerships.

[34] A review of 318 of 2,332 TAS cases involving S corporation election issues uncovered 32 (approximately ten percent) accounts where tax was assessed without a statutory notice of deficiency for tax years prior to 2003. Cases were selected from the Taxpayer Advocate Management Information System (TAMIS) using issue code 440 for the period June 1, 2006, through September 30, 2010. Cases were selected for review based on a convenience sample.

The IRS continues to attempt to ease taxpayer burden and appreciates the National Taxpayer Advocate's analysis of the S corporation election process, its impact on small business taxpayers, and recognition of the valuable IRS resources dedicated to resolving related discrepancies.

Chief Counsel Passthroughs and Special Industries (CC:PSI) has included an item in their 2009-2010 Priority Guidance Plan entitled "Guidance under § 1362" which will carry over to the 2010-2011 Priority Guidance Plan. This project will look at superseding most or all of the existing relief revenue procedures and combining them into a single source which will facilitate taxpayer understanding.

As noted in the National Taxpayer Advocate's report, the IRS has taken several steps to educate taxpayers regarding the S corporation election process. For example:

- When taxpayers apply for an EIN and indicate the new entity is a corporation or S corporation, they receive an EIN confirmation notice[35] which includes text entitled "Important Information for S Corporation Election."
- When taxpayers apply for EINs for S corporations using the Modernized Internet EIN application, they are presented with several pages of instructions concerning the requirements for making an S Corporation election.
- Instructions for Form 2553, *Election by a Small Business Corporation*, page 2, includes guidance on the late election relief provisions.
- Letter 3853 is issued to taxpayers who file an S corporation with no election in effect to notify the taxpayers of late election relief provisions.
- Using the search term "S corporation" on www.irs.gov results in a top link to "S corporations." This leads to the website which defines S corporations, explains the requirements to elect S corporation status, and states the requirement to submit Form 2553 signed by all the shareholders.
- Since tax year 2007, the Form 1120S warns taxpayers not to file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation. It also reiterates this requirement on a line G by asking for the Form 2553 to be attached if this is the first year of S corporation status, if it was not already filed.
- From 1993 through 2006, Form 1120S stated not to file this form unless the corporation has filed Form 2553 to elect to be an S corporation.
- The Form 1120S Instructions discuss the need to have an accepted election in effect and references Form 2553 and related instructions.

The National Taxpayer Advocate's report indicates that in the past, it has been difficult to prove the existence of timely filed S corporation returns. As the report recognizes, the IRS processes have improved as we now have the ability to capture rejected returns in Master File.

35 CP 575A.

The IRS campus provides relief for late S elections when taxpayers file requests for relief pursuant to one of the current safe harbor revenue procedures and the procedural requirements of the revenue procedure are satisfied. The procedures that previously converted S corporation returns to taxable C corporation returns were discontinued prior to 2004. Currently, when an S corporation return is filed which rejects in processing, the IRS provides the corporation Letter 3853C which informs the taxpayer that no election, Form 2553, has been accepted. The letter requests a completed Form 2553 and explains late election relief provisions. It also advises the taxpayer the correct form to be filed and that the shareholder(s) should be advised of the tax consequences. If no response is received from the taxpayer, the S corporation is processed as a C corporation. The conversion process does not result in tax assessment. Although the taxpayer will not receive a Statutory Notice of Deficiency, the taxpayer is appropriately notified they do not have a valid S election.

The National Taxpayer Advocate makes seven preliminary recommendations to improve the S corporation election process. The IRS is taking or has taken the following actions with respect to these recommendations.

The IRS agrees with the merits of the National Taxpayer Advocate's preliminary recommendation to consolidate the five relief revenue procedures. As previously noted, Chief Counsel Passthroughs and Special Industries (CC:PSI) has a project on the 2009-2010 Priority Guidance Plan entitled "Guidance under § 1362" which will be carried over onto the 2010-2011 Plan. This project is currently in progress and was expanded earlier this year to supersede most or all of the existing relief revenue procedures, offering a single source for this relief, consistent with the National Taxpayer Advocate's recommendation.

The National Taxpayer Advocate's report indicates that IRS misses opportunities to educate taxpayers and preliminarily recommends that the IRS provide a simple guide to the relief process in letters to taxpayers that did not make a timely election. The IRS understands the importance of providing taxpayer education and outreach. IRS will continue to review and update instructions, correspondence, and other communications in order to educate the taxpayer. We note that we may be able to better educate taxpayers as to the relief process after the issuance of the combined late election relief revenue procedure.

The National Taxpayer Advocate recommends the IRS publish guidance, with examples, providing retroactive relief where reasonable cause exists for the failure to make a timely S corporation election at any time without the need to request a letter ruling and delegate authority to provide reasonable cause relief. The determination of "reasonable cause" is factual and must be applied to the facts and circumstances of a particular case. It would be difficult to provide specific examples of what constitutes reasonable cause "at any time." For example, it could necessarily implicate years in which the statute of limitations is closed for the corporation or its shareholders. As previously discussed, if taxpayers file requests for relief for late S elections pursuant to one of the current safe harbor revenue procedures, and the procedural requirements of the revenue procedure are satisfied, the Campus routinely provides relief for late S elections.

The National Taxpayer Advocate preliminarily recommends that IRS enhance systems to allow electronic filing of Form 2553 at any time during the tax year, up to and including with the first S corporation return filing. The IRS currently allows for the Form 2553 to be filed as an attachment to an electronically filed Form 1120S. The IRS has no plans at this time to expand the use of electronic filing to allow Form 2553 to be processed as a stand-alone form. The due date for the Form 2553 cannot be extended under current law. IRC § 1362(b) provides that an election for a given taxable year may be made at any time during the preceding taxable year or at any time during the taxable year and on or before the 15th day of the 3rd month of the taxable year. Therefore, the Form 2553, whether paper or electronic, cannot allow elections to be effective up to and including the return filing date without a statutory change. There have been legislative proposals in the past which would permit taxpayers to make the S corporation election with the first S corporation return.

The National Taxpayer Advocate's report also suggests the IRS update publications, forms, correspondence, and the IRS website with instructions for making the S elections and how to seek relief to correct late elections. As stated previously, the IRS already has many communication vehicles alerting taxpayers of the rules for S elections. The IRS will continue to review and update instructions, correspondence, and other communications in order to educate taxpayers. We note that it may be easier to communicate the relief process to taxpayers after the issuance of the combined late election relief revenue procedure.

The National Taxpayer Advocate's report proposes that the IRS develop an administrative appeal process for taxpayers whose initial elections are denied. Taxpayers currently have several processes available when their initial elections are denied. Late S election relief is presently available under the safe harbor revenue procedures. Taxpayers denied relief under the safe harbor revenue procedures may request late S election relief through the Private Letter Ruling process. If Chief Counsel reaches a tentatively adverse determination to the PLR, taxpayers have the right to a conference and to submit additional information supporting their request.

The National Taxpayer Advocate's report indicates the IRS converted S corporation returns to C corporation taxable returns and assessed the tax liability without issuing a Statutory Notice of Deficiency. Although the report recognized that the IRS changed this procedure prior to 2004, the report recommends that the IRS identify and correct old conversion cases where tax was assessed without issuing a SNOD or denied effective elections because of lost returns or other errors. While the IRS does not disagree with the value of the recommendation, the IRS lacks the systemic ability to isolate the assessments made to these converted returns. Identifying such cases would be an extremely high resource-intensive undertaking. It should be noted that previous assessments were often abated (either at the corporate or shareholder level) after taxpayers contacted the campus to resolve their late election issue.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased the IRS considers updated guidance under IRC §1362 a priority, and is encouraged to know this guidance will supersede most or all of the existing revenue procedures, and therefore offer a single source for late S corporation election relief. With thousands of S corporation returns remaining unpostable year after year, many taxpayers continue to experience unnecessary burdens and downstream consequences of the conversion of S corporation returns to regular, taxable corporate returns. The National Taxpayer Advocate encourages the IRS to expedite the release of the new, consolidated late election relief revenue procedure. The guidance should provide easy-to-follow examples of what constitutes reasonable cause, which can be applied fairly and consistently by IRS processing units. The National Taxpayer Advocate looks forward to consulting with Chief Counsel in developing this guidance and examples.

The National Taxpayer Advocate commends the IRS for improving systems to document rejected returns and increasing outreach to new S corporation filers. However, the National Taxpayer Advocate remains concerned that these efforts are not providing the desired result, as evident from the increasing number of unpostable returns. Although we agree with the IRS that "it may be easier to communicate the relief process to taxpayers after the issuance of the combined late election relief revenue procedure," we also believe the IRS should not delay improvements in its outreach, especially for taxpayers whose returns are not accepted and converted into taxable entity returns. IRS correspondence to taxpayers, including Letter 3853C, should include a simple, complete guide to the relief process.[36] In addition, the IRS website should be a one-stop resource for taxpayers making the S election and seeking relief to correct late elections.

The National Taxpayer Advocate agrees that allowing a small business corporation to elect S corporation status at the time it timely files its first S corporation return requires a legislative change. She recommended such action in the past and reiterates her proposal in this report.[37] Nonetheless, the electronic filing of an S corporation election as a stand-alone form, or at a minimum scanning the document into the Correspondence Imaging System, would allow the IRS to instantly verify the receipt of filed elections. Most importantly, it would reduce the burden to both taxpayers and the IRS.

The National Taxpayer Advocate also believes that creating an administrative appeal process for taxpayers whose elections were denied will alleviate taxpayer burden and ensure that IRS errors in reasonable cause determinations are addressed. When the IRS directs taxpayers to amend prior-year unpostable returns, and they do not qualify for relief

36 For example, none of the explanatory paragraphs available for Notice 3853C include information pertaining to the most recent Revenue Procedure 2007-62.

37 *See* Legislative Recommendation: *Extend the Due Date for S Corporation Elections to Reduce the High Rate of Untimely Elections, infra*. *See also* National Taxpayer Advocate 2004 Annual Report to Congress 390; National Taxpayer Advocate 2002 Annual Report to Congress 246.

under one of the revenue procedures, their only option is to seek late election relief through a PLR, which may cost up to $14,000. If the business cannot afford the PLR user fee, it will not be treated as an S corporation until the following taxable year. The business also may be subject to certain special corporate-level taxes,[38] and carry on certain C corporation attributes such as retained earnings that may be taxable to shareholders as a dividend upon distribution, or be limited in the use of any net operating losses arising during the period it was a C corporation.[39] Given these significant consequences, it is effective tax administration to develop an administrative appeal process for late elections. This process will serve two purposes – (1) ensure that IRS errors in reasonable cause determinations will be addressed with minimal taxpayer burden, and (2) free up the Office of Chief Counsel resources for other, more substantive PLR requests.

Finally, the National Taxpayer Advocate rejects the IRS's rationale for not correcting illegal corporate assessments because "identifying such cases would be an extremely high resource-intensive undertaking." These assessments, made in violation of the deficiency procedures under IRC §§ 6212 and 6213, abridge a taxpayer's right to due process and should be systemically identified and abated. TAS offers its assistance in identifying and correcting these cases.

Recommendations

The National Taxpayer Advocate offers the following recommendations:

1. In consultation with TAS, expedite the issuance of a consolidated revenue procedure for late S corporation elections to supersede existing revenue procedures and offer a single source for relief. The guidance should contain easy-to-follow examples of what constitutes reasonable cause under each aspect of the procedure.
2. Immediately identify and correct old conversion cases where the IRS assessed tax without issuing a statutory notice of deficiency or denied effective elections because of lost returns or other errors.
3. Update IRS publications, forms, correspondence, and websites to include a simple and complete guide to the late election relief process.
4. Develop an administrative appeal process for taxpayers whose elections are denied.
5. Allow electronic filing of Form 2553 as a stand-alone form with an instant verification of filing provided to taxpayers.

38 *See generally* IRC §§ 1374 and 1375.

39 IRC §§ 1368(c); 1374(a) and (b)(2). IRC § 1374(b)(2) generally provides an exception, allowing certain carryover losses to be used against the built-in gains tax of IRC § 1374(a). If the business has C corporation retained earnings and receives too much of its income in future taxable years from certain passive investment activities, its S corporation election may terminate under IRC § 1362(d)(3).

MSP #21 The Combined Annual Wage Reporting Program Continues to Impose a Substantial Burden on Employers

RESPONSIBLE OFFICIAL

Chris Wagner, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

The purpose of the Combined Annual Wage Reporting (CAWR) program is to ensure that employers pay and withhold the proper amount of tax. The program accomplishes this task by comparing the data on wage and information reporting forms submitted to the Social Security Administration (SSA) with the amounts reported on IRS employment tax forms.[1] This process enables the IRS and SSA to identify potentially missing or incorrect tax and wage data. The IRS then contacts employers to resolve any discrepancies.

The National Taxpayer Advocate has raised concerns about the CAWR program in prior Annual Reports to Congress.[2] Although the IRS has improved the program in some respects, the National Taxpayer Advocate remains concerned that it still does not respond to employers' correspondence in the timeframes the IRS has set. In May 2010, almost 87 percent of correspondence was not worked within the established period of 45 days from receipt.[3] The IRS has since reduced that percentage to 44.7 percent, which is a marked improvement, but it remains the case that nearly half of all CAWR correspondence was not worked within the established timeframe.[4] Failure to timely resolve correspondence increases taxpayer burden.

The IRS recently issued more restrictive guidance on abatement of the Failure to Timely File Information Returns penalty and the Intentional Disregard penalty.[5] As a result, taxpayers are now far less likely to have such penalties abated. In fact, the Failure to Timely File Information Returns penalty dollars abated fell from 82 percent in fiscal year (FY) 2008 to 71 percent in FY 2010. The Intentional Disregard penalty dollars abated dropped even more drastically, from 85 percent in FY 2008 to 61 percent in FY 2010.[6] The IRS's reluctance to abate penalties in CAWR cases may impose an unnecessary financial burden

1 Wage and information reporting forms include Forms W-2, W-3, W-2C, W-3C, 1099-R, and W-2G. Employment tax forms include Forms 941, 943, 944, 945, and Schedule H filed with 1040/1040X.

2 National Taxpayer Advocate 2008 Annual Report to Congress 316 (Most Serious Problem: *Inefficiencies in the Administration of the Combined Annual Wage Reporting (CAWR) Program Impose Substantial Burden on Employers and Waste IRS Resources*); National Taxpayer Advocate 2003 Annual Report to Congress 220 (Most Serious Problem: *Combined Annual Wage Reporting (CAWR) Reconciliation*).

3 Small Business/Self-Employed Division (SB/SE) response to TAS information request (June 21, 2010).

4 SB/SE response to TAS information request (Oct. 22, 2010).

5 Internal Revenue Manual (IRM) 4.19.4.6.1 (Sept. 28, 2008).

6 IRS, Business Master File Transaction History from Compliance Data Warehouse (Oct. 2010). Percentage of tax periods receiving a full or partial abatement divided by the number of tax periods where abatement was requested.

on businesses without addressing the underlying account problem or achieving increased voluntary compliance, which is the purpose of civil penalties.[7]

IRS systems limitations may cause taxpayers to provide late responses, thereby incurring the penalty. The IRS's Business Master File (BMF) system, which is the repository for name and address information for all business entities in the United States, can record only one address per entity. This limitation contributes to misrouted IRS mail, potentially leading to penalties and collection action.[8] This is a significant problem for large entities with multiple divisions, which may have different addresses and pay different taxes, such as corporate income tax or employment taxes. Every time one of these divisions files a return, the address on the BMF is changed.[9] This may cause notices to go to an inappropriate division (*e.g.*, an employment tax notice is sent to the corporate tax division), causing the corporation to miss the due date for responding to the employment tax notice.

ANALYSIS OF PROBLEM

Background

Since the National Taxpayer Advocate last reported on this issue, the Small Business/Self-Employed Division has made systemic and procedural improvements to the CAWR program.[10] The National Taxpayer Advocate acknowledges SB/SE's efforts to improve service in resolving wage and tax reporting discrepancies. However, CAWR still ranks as the number one issue in TAS cases involving large and mid-size businesses, tax-exempt organizations, and government entities.[11] CAWR also remains one of the top ten issues in TAS receipts from small business and self-employed taxpayers.[12]

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7 *See* National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 2 (A Framework for Reforming the Penalty Regime).

8 Information Reporting Program Advisory Committee Report, Burden Reduction Subgroup (June 11, 2010). This report identified the BMF's inability to record more than one address for a corporation that has different divisions and the problems this inability causes for corporations, such as misrouted mail. The report recommended that the BMF be modified so it can record multiple addresses for one corporation.

9 The IRS will send correspondence to the taxpayer's last known address, which is defined as the address on the most recently filed and properly processed return. Treas. Reg. § 301.6212-2(a). For a discussion on last known address issues, see Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers, infra/supra*.

10 Such improvements include: (1) In 2008, the Late Reply inventory was added to the CAWR Automated Program (CAP) database along with the existing inventory. This provides better tracking and control of employers requesting reconsideration of their CAWR tax assessments. (2) In March 2010, SB/SE improved automated screening of potential CAWR cases, providing greater consistency in identifying cases where the IRS had internal information that resolved the potential discrepancy. (3) In 2010, SB/SE enabled the CAWR program to automatically send copies of the pre-assessment letters to the employers' representatives, including reporting agents. (4) SB/SE revised its procedures, implemented a tracking mechanism, and established designated points of contact to improve coordination with the Large Corporation Technical Unit (LCTU), which allows CAWR to resolve more large corporate case discrepancies without issuing notices. (5) The IRS provided new written guidance to assist clerical teams, managers, and coordinators conducting CAWR and FUTA (Federal Unemployment Tax) operations. This guidance explains the different types of reports and provides direction on their use. (6) The IRS worked with SSA to increase IRS employee access to an SSA database with information needed to resolve older cases. (7) The IRS reviewed and updated mail routing references for accuracy in an effort to decrease misdirected CAWR mail, and created a guide to assist mailrooms and other clerical functions in routing penalty notices. *See* SB/SE response to TAS information request (June 21, 2010).

11 *See* TAS, *Business Performance Review* (4th Quarter FY 2010).

12 *Id*.

The IRS Does Not Timely Resolve Correspondence from Employers.

A taxpayer attempting to resolve a case can be frustrated and confused when the CAWR program has delayed response to correspondence. When the IRS identifies potentially missing or incorrect tax and wage data, it issues a notice asking the taxpayer to provide information to resolve the discrepancy within 45 days.[13] If the taxpayer provides the information or verifies data, the IRS has 45 days to resolve the case.[14] However, according to SB/SE data, the IRS does not meet this timeframe in the vast majority of cases. For example, in May 2010, 87 percent of correspondence was not worked within 45 days, an increase of 19 percent over the same period in FY 2009.[15] When the IRS cannot resolve the correspondence within the 45 days, it should issue an interim letter to let the taxpayer know that it needs more time. However, IRS reviews in 2009 identified instances where each of the three CAWR sites was unable to locate requested cases, controlled cases incorrectly, or had not issued interim letters.[16] These defects adversely affect taxpayers. The IRS should evaluate its CAWR staffing level, which appears inadequate to handle its inventory.

IRS Policy Changes Have Caused a Substantial Decline in CAWR Penalty Abatements.

Overview of CAWR Penalties

The IRS can penalize employers when they fail to file information returns or file them after the due date.[17] Such penalties can be significant, with the amount varying according to when, if it all, the correct information is filed. The purpose of these penalties is to encourage employers to timely provide employees with the information necessary to comply with their tax obligations.[18]

The IRS may impose a harsher penalty if a taxpayer's failure to file an information return or provide a correct return is due to intentional disregard of the filing requirements.[19] Internal Revenue Code (IRC) § 6721(3) provides an uncapped penalty based on intentional disregard when the taxpayer knowingly or willfully failed to timely file the information returns.[20] For example, the intentional disregard penalty for late filing Form 1099 information returns is five percent of the aggregate amount of the items that must be reported.[21]

13 IRM 4.19.4.3.1(3)a (Apr. 1, 2010).

14 SB/SE defines unresolved correspondence in inventory of more than 45 days as aged work. SB/SE response to TAS information request (June 21, 2010).

15 SB/SE response to TAS information request (June 21, 2010).

16 *Id*.

17 Internal Revenue Code (IRC) § 6721(a).

18 Report of the Committee on the Budget, HR Rep. No. 247, 101st Cong., 1st Sess. 1383 (1989), reprinted in 1989 USCCAN 1906, 2853.

19 *See* IRC § 6721(e).

20 Treas. Reg. § 301.6721-1(f)(2).

21 *See* IRC § 6721(e)(2)(B).

Whether a taxpayer knowingly or willfully fails to timely file an information return is "determined on the basis of all the facts and circumstances in the particular case."[22] Some of the factors in the determination are stated in Treas. Reg. § 301.6721-1(f)(3) and include:

- Whether the failure to file timely is part of a pattern;
- Whether the taxpayer promptly made a correction upon discovery of the failure;
- Whether the taxpayer corrects the failure to file within 30 days of a written request from the IRS; and
- Whether the failure to timely file penalty is less than the cost of timely filing.

Recently, the IRS seems to have changed its approach to the abatement of penalties on CAWR cases. Previous guidance stated, "If the employer establishes a reasonable cause or due diligence, abate the penalty …"[23] In guidance issued in September 2008, SB/SE instructed employees to use "caution" when considering abatement requests for the Failure to Timely File Information Returns penalty and the Intentional Disregard penalty.[24] The revised guidance states:

> Prior to abating a CAWR penalty (Late Filing and/or Intentional Disregard), be aware of the numerous attempts made by both the Service and SSA to solicit the correct information from the employer. Failure to secure and properly credit the missing Forms W-2 will impact an individual's SSA earnings record and ultimately that individual's retirement benefits. Given the history of correspondence sent to the taxpayer by SSA and the CAWR unit, caution should be used in abating the penalty.[25]

This guidance shifts the focus from reasonable cause and willful neglect, a statutory standard set forth by IRC § 6724(a), to a standard that urges caution. The IRS now instructs its employees to focus on the number of attempts the IRS or SSA has made to contact the employer, rather than consider whether there is reasonable cause for the unresponsiveness or whether IRS processes and communications contributed to the lack of response. Since the IRS issued this revised instruction, the number of Failure to Timely File Information Returns and Intentional Disregard penalties abated has decreased significantly.

The tables below shows the percentages of tax periods assessed that were later abated in CAWR penalty cases.[26]

22 Treas. Reg. § 301.6721-1(f)(2).

23 IRM 4.19.4.6.1 (May 1, 2006).

24 IRM 4.19.4.6.1 (Sept. 28, 2008). This IRM was updated April 16, 2009, but this instruction was left unchanged.

25 *Id.*

26 IRS, Business Master File Transaction History from Compliance Data Warehouse (Oct. 2010). Percentage of tax periods receiving a full or partial abatement divided by the number of tax periods where abatement was requested.

TABLE 1.21.1, Failure To File Penalty Abatement Rates

FY of Abatement	Number of Abatements Requested	Number of Abatements	Percent of Tax Periods Abated
2006	45	41	91.11
2007	39	30	76.92
2008	84	69	82.14
2009	1,375	1,091	79.35
2010	1,677	1,187	70.78

TABLE 1.21.2, Intentional Disregard Penalty Abatement Rates

FY of Abatement	Number of Abatements Requested	Number of Abatements	Percent of Tax Periods Abated
2006	52,586	40,115	76.28
2007	48,876	39,477	80.77
2008	17,328	14,699	84.83
2009	46,078	27,871	60.49
2010	51,868	31,568	60.86

The IRS Should Expand Its First-Time Abatement Policy to Include Late Filing and Intentional Disregard Penalties.

The IRS has a policy of abating certain penalties for first-time offenders regardless of whether reasonable cause exists. This so-called "First-Time Abatement" policy is set forth in IRM 20.1.3.5.1, which states that this option will be available only for Failure to Deposit (FTD), Failure to File (FTF), and Failure to Pay (FTP) penalties, not for the Failure to Timely File Information Returns Penalty and the Intentional Disregard Penalty. The IRM provides that in cases where an FTD, FTF, or FTP penalty has been assessed, the First-Time Abatement relief option can be applied if a taxpayer has not been required to file a return previously or has not been assessed penalties in the past three years (with the exception of estimated tax penalties).[27] First-Time Abatement relief is a policy decision that the IRS has made, and is not governed by statute. As such, there is nothing in the law preventing the IRS from revising the IRM to extend this administrative relief to the Failure to Timely File Information Returns and the Intentional Disregard penalties.[28] Abating these penalties in certain situations would promote voluntary compliance.

IRS Systems Limitations Result in Penalties Being Assessed Unnecessarily.

The IRS may be able to reduce unnecessary penalty assessments by modifying its systems to ensure that taxpayers timely receive notices about employment tax issues. Because the BMF can record only one address per entity, IRS correspondence may be misrouted, particularly

27 IRM 20.1.1.3.6.1 (Dec. 11, 2009).

28 The IRS Office of Chief Counsel, in a recent memorandum, approved the revised guidance. This memorandum points out that no statute or regulation addresses the First Time Abatement penalty relief option. In other words, the IRS's application of this relief is entirely a policy decision. *See* IRS Chief Counsel, Chief Counsel Memorandum on First-Time Abatement Penalty Relief Option, POSTN-143178-09 (Dec. 7, 2009).

for large entities that have different divisions with separate addresses. Each division may have responsibility for paying just one type of tax, but every time a division submits a tax filing (*e.g.*, income tax, payroll, or information reporting), the last known address for that entity changes to the individual division's address on the BMF.[29] This makes it very difficult for businesses to know what address the IRS is using at any given time. Further, correspondence regarding employment taxes may be sent to a division that manages other tax filings, such as the corporate income tax division. This means the employment tax division may not find out about the notice until there is very little time left to respond, or even until after the deadline. By then, the IRS may have already assessed penalties, requiring the firm to attempt to convince the IRS to abate the penalty, which as noted above, has become increasingly difficult.[30] Businesses that cannot obtain abatements may be subject to liens or levies.

The Information Reporting Program Advisory Committee (IRPAC) raised this issue and recommended that the IRS immediately update its guidance on last known addresses related to business addresses.[31] Specifically, IRPAC recommended that Revenue Procedure 2010-16 be updated to separate last known address processes between businesses and individuals, and that the IRS accelerate development of a system that allows multiple addresses and contacts. However, the IRS's 2010-2011 Guidance Priority Plan did not include these recommendations.

CONCLUSION

The IRS has made some positive changes in the CAWR program, but it needs further analysis and improvement. The National Taxpayer Advocate is concerned that the IRS's delayed responses to taxpayer correspondence causes taxpayer confusion and frustration. These delays may result from inadequate staffing levels. Timely communication with taxpayers is an essential component of an effective program. Additionally, the National Taxpayer Advocate is concerned about the impact on businesses of the recent change in the IRS's guidance regarding abatement of penalties, particularly when IRS processes may contribute to late responses. For example, the IRS's inability to record different mailing addresses for corporate entities can result in late responses, unnecessary penalties, and possible collection action.

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29 IRM 3.13.36.27 (July 1, 2010). The IRS will send correspondence to the taxpayer's last known address, which is defined as the address on the most recently filed and properly processed return. Treas. Reg. § 301.6212-2(a).

30 IRM 4.19.4.2.1.1 (Feb. 1, 2008); IRM 4.19.4.3.36(1) (Apr. 1, 2010); IRM 4.19.4.4(7) (Apr. 1, 2010); IRM 21.7.1.4.11 (Oct. 3, 2007); IRM 21.7.1.4.10 (Jan. 1, 2007). The IRS has a Large Corporate Technical Unit (LCTU) that serves the needs of large entities, and each corporation has a dedicated representative/technician. Prior to any assessment of penalties, the CAWR unit is supposed to communicate with the LCTU technician so he or she can contact the corporation and attempt to resolve the issue. However, this process only applies to cases with a Large Corporation indicator or tax and penalties of $1 million or higher and relies heavily on communication between three different groups, increasing the risk of some taxpayers falling through the cracks. The process also attempts to address the problem after it happens, whereas modifying the BMF to record multiple addresses would prevent the problem from occurring (*i.e.*, the IRS will send notices to the correct corporate division).

31 IRPAC Report, Burden Reduction Subgroup (June 11, 2010). Revenue Procedure 2010-16 provides an explanation of how IRS is informed of a change of address.

In conclusion, the National Taxpayer Advocate offers these preliminary recommendations:

1. The IRS should evaluate CAWR staffing to determine if existing levels are adequate to handle its correspondence.
2. The IRS should expand the First-Time Abatement policy to include late filing and intentional disregard penalties.
3. The IRS should upgrade its systems to allow for multiple corporate addresses based on the type of tax.

IRS COMMENTS

The IRS agrees that timely communication with taxpayers is an essential function of tax administration and assists with voluntary compliance. The IRS continually strives to perfect the CAWR program to address overage and the quality of service through improved inventory management controls, inventory selection, and the use of various automated tools.

The IRS acknowledges that overage correspondence remains problematic due to continual increases in workloads and correspondence levels as stated in the Office of the National Taxpayer Advocate's report. As part of the FY 2011 work planning process, the IRS evaluated CAWR staffing and workload levels and adjusted the CAWR workload to better align with our resources.

Resolving taxpayer correspondence timely remains a top priority. Throughout FY 2010, IRS took action to allocate additional resources to the CAWR operations to reduce aged inventories. These efforts resulted in a significant improvement going from 87 percent overage to 45 percent from May 2010 to September 2010.[32]

Improving CAWR program effectiveness remains a priority and the CAWR staff continues to collaborate with the Modernization & Information Technology Services (MITS) organization to secure programming changes to provide improved inventory management functionality and promote program efficiency. Recent enhancements include auto-generation of Interim Letters[33] on cases with correspondence aged 25 days or more from the IRS received date, auto-generation of IRS CAWR notices, and providing copies of CAWR notices to authorized third parties.

In addition, forthcoming improvements for fiscal year (FY) 2011 include:

- Systemic uploads of assessment data, letters, and case updates from CAWR to Masterfile/IDRS;
- New status codes to define and track case results;
- Storage and tracking of case data to improve case selection and reduce burden; and

32 September 2010 COBR.

33 Letter 2645C or Letter 2644C is generated informing taxpayers that the IRS needs additional time to review their correspondence and they can expect a response within 60 days.

- New reports to improve inventory management.

Combined, these changes will reduce resources expended on manual processes and enable campuses to manage CAWR staffing and inventory levels more effectively.

Furthermore, a completely redesigned CAWR Automated Program (CAP) that will offer capabilities similar to the current Automated Underreporter (AUR) system is scheduled for deployment in FY 2014 as part of the Information Reporting Document Matching (IRDM) effort. The new system is expected to provide world class automation and technology upgrades to support data driven CAWR case creation and selection, TIN-level case management, embedded interest calculation capabilities, and various other inventory tracking and report generation functionality.

In her report, the National Taxpayer Advocate cites declines in CAWR penalty abatements between FY 2008 and FY 2010. The IRS does not dispute the decline in penalty abatements. The National Taxpayer Advocate states the reason for the decline in penalty abatements is due to an IRS change in its approach to the abatement of penalties on CAWR cases citing language from an update made to IRM 4.19.4.6.1, *Late Replies Addressing SSA-CAWR Penalties*, in September 2008 which encourages caution when abating the penalty. This language was taken directly from IRM 20.1, *Penalty Handbook*, which has been in place since at least 1998.[34] The September 2008 update to IRM 4.19.4 was made to include CAWR penalty guidance previously contained in the Penalty Handbook. No changes to intent or wording was made as part of this update as the language used in the update matches instructions previously contained in the Penalty Handbook.[35] Therefore, the IRS does not believe this guidance shifts the focus from reasonable cause and willful neglect to a standard that urges caution. Instead, the IRS believes this decrease is reflective of the actions IRS took to address prior National Taxpayer Advocate concerns contained in the 2008 Annual Report to Congress regarding inconsistent administration of CAWR penalties.[36] In response to the 2008 report, the IRS clarified IRM penalty application and abatement procedures and delivered additional penalty related training to campus technicians. In addition, the IRS took actions to improve outreach and education services to taxpayers by posting CAWR related communiqués on the www.irs.gov website and partnering with the payer agent liaison to stress the importance of timely addressing issues raised on CAWR notices with the practitioner community.

The IRS believes it exercises reasonable care and diligence when issuing CAWR notices to businesses. The IRS sends notices to the taxpayer's last known address, provides a copy of the notice to authorized third parties, allows recipients 45 days to respond (compared to 30

34 Refer to IRM 20.1.7.3.4.4(7)b and (8). The guidance shown has been in place since at least 1998.

35 As the National Taxpayer Advocate states, the 2008 CAWR IRM 4.19.4.6.1(1) was updated. The update incorporated language directly from the Penalty Handbook. IRM 20.1.7.3.4.4(7)b and (8) language was removed on Nov. 16, 2007. IRM 20.1.7.3.4 (4) and (5) now refers technicians to CAWR IRM 4.19.4 for guidance.

36 *See* National Taxpayer Advocate 2008 Annual Report to Congress 319 (Most Serious Problem: *Inefficiencies in the Administration of the Combined Annual Wage Reporting (CAWR) Program Impose Substantial Burden on Employers and Waste IRS Resources, Improper Assessment of Penalties Leads to Subsequent Abatement*).

days for individuals), and does not take subsequent actions on CAWR cases until at least 81 days after the initial notice has been issued. The National Taxpayer Advocate indicates that the CAWR program contacts the Large Corporate Technical Unit (LCTU) on cases that contain a large corporation indicator or penalties of $1 million and that some taxpayers still fall through the cracks.[37] Prior to assessment of penalties, CAWR technicians are instructed to contact the LCTU on any case with a Large Corporation indicator or tax and/or penalty assessment of $1 million dollars or more.[38] This coordination ensures penalty assertion on Large Corporation cases is appropriate and case processing is accurate. In an effort to further improve the process, a Large Corporation Tracking sheet has been instituted for the CAWR Program as well as the LCTU.

The National Taxpayer Advocate makes three preliminary recommendations to improve the CAWR Program. The IRS is taking, or has taken, the following actions with respect to these recommendations:

> The IRS has made great strides in reducing overage CAWR inventory over the last few months in FY 2010. Due to this steady decline in overage, coupled with the additional program enhancements already planned, the IRS does not believe further evaluation in CAWR staffing needs to be performed beyond what is regularly performed in our program areas as we make routine resource decisions.
>
> The late filing and intentional disregard penalties discussed in the National Taxpayer Advocate's report pertain to information return documents and are assessed against the payer, not the wage earner. This protects the individual taxpayer by encouraging employers to timely provide the taxpayer necessary information to comply with the taxpayer's tax obligations. Due to the nature of these penalties, and after careful consideration and input from Chief Counsel, the Office of Servicewide Penalties, and the 1998 Penalty Task Group findings, the IRS does not believe it is appropriate to apply the First-Time Abatement Penalty relief option for these late filing and intentional disregard penalties. However, if a taxpayer can demonstrate reasonable cause, abatement of these penalties will be fully considered.
>
> Through our current procedures, the IRS believes it exercises reasonable care and diligence when issuing CAWR notices to businesses. Issuing notices to multiple corporate addresses increases the risk of unauthorized disclosure, increases burden as multiple recipients will receive and spend time responding to the same notice, and campus correspondence and overage volumes would increase exponentially. For these reasons, the IRS does not agree it would be prudent to allow input into the Business Masterfile (BMF) for multiple corporate addresses.

37 IRM 4.19.4.2.1(4) (Feb. 1, 2008); IRM 21.7.1.4.11 (Oct. 3, 2007); IRM 21.7.1.4.10 (Jan. 1, 2007).

38 IRM 4.19.4.3.36(1) and 4.19.4.4(7).

Taxpayer Advocate Service Comments

The National Taxpayer Advocate commends the IRS for evaluating staffing and workload to better align CAWR resources for FY 2011 and for initiating additional programming enhancements to improve inventory management over the next two years. Due to this steady decline in aged correspondence and the enhancements already planned, the IRS states that no further evaluation in CAWR staffing is needed. However, even after significant improvement, almost half of the aged CAWR correspondence still could not be resolved within the established timeframes as of September 2010. The National Taxpayer Advocate urges the IRS to address this issue quickly by increasing staffing or adjusting workload.

The IRS recognizes the decline in penalty abatements but does not believe the decrease was related to the revised guidance issued in 2008. Although the National Taxpayer Advocate acknowledges that the revised guidance may not have been a change in policy, the revisions to the IRM, procedural guidance, and training materials did shift the focus of penalty administration to increased assessment of the Failure to Timely File Information Returns penalty and the Intentional Disregard penalty.[39] Regardless of the cause, the National Taxpayer Advocate remains concerned by the significant decline in Failure to Timely File Information Returns penalty dollars abated (from 82 percent in FY 2008 to 71 percent in FY 2010), for which the IRS has offered no explanation other than the IRM change. Even with respect to the Intentional Disregard penalty, a first-time waiver can be a corrective, educational opportunity.

The IRS states the penalty assessments protect individual taxpayers by encouraging employers to timely provide the taxpayers with the information they need to comply with tax obligations. However, the IRS has no data to verify that assertion of the penalties improves compliance. In 2008 the National Taxpayer Advocate urged the IRS to regularly collect and analyze more detailed penalty data, and conduct an empirical study to quantify the effect of each penalty on voluntary compliance.[40] Despite the lack of research on how penalties impact voluntary compliance, the IRS refuses to apply the First-Time Abatement Penalty relief option for these late filing and intentional disregard penalties. Thus, the IRS is potentially imposing unnecessary financial burdens on businesses without even knowing if the policy is achieving the desired result.

The IRS appears to have misunderstood the National Taxpayer Advocate's recommendations to modify its systems to record more than one address per BMF entity and did not address problems that large entities face (*i.e.*, they have different divisions that constantly deal with IRS correspondence that has been mailed to the wrong address). Both IRPAC and the National Taxpayer Advocate recommend that the IRS modify it systems so that notices relating to a specific type of tax (*e.g.*, employment taxes) are sent to the corporate office

39 IRM 4.19.4.6.1 (Sept. 28, 2008). This IRM was updated April 16, 2009, but this instruction was left unchanged.

40 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 2 (*A Framework for Reforming the Penalty Regime*).

that handles that tax. We are not suggesting that the IRS send multiple copies of notice to multiple corporate addresses. Under this approach, there should not be an increased risk of unauthorized disclosure and no increase in the number of notices issued by IRS campus correspondence units. To the contrary, the use of more accurate addresses should reduce penalty assessments, the need for abatements, and reopened cases.

Recommendations

The National Taxpayer Advocate offers these recommendations:

1. The IRS should conduct research to determine whether assessment of the Failure to Timely File Information Returns penalty and the Intentional Disregard penalty increases compliance with filing requirements.
2. The IRS should conduct a pilot to determine whether expansion of the First-Time Abatement policy to late filing and intentional disregard penalties undermines compliance with filing requirements.
3. The IRS should upgrade its systems to allow for multiple corporate addresses based on the type of tax.

Status Update: The IRS Has Been Slow to Address the Adverse Impact of its Lien Filing Policies on Taxpayers and Future Tax Compliance

RESPONSIBLE OFFICIALS

Richard E. Byrd Jr., Commissioner, Wage and Investment Division
Chris Wagner, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

The filing of a notice of federal tax lien (NFTL) can be a useful tool in a comprehensive and balanced strategy to increase tax compliance. However, as stated in the 2009 Annual Report to Congress, when used improperly, an NFTL can severely damage the financial welfare of the affected taxpayer, and reduce federal revenue and tax compliance for years to come.[1] Despite the National Taxpayer Advocate's specific concerns and actionable recommendations, the IRS has not altered its lien filing policies. It continues to disregard the potential adverse impact of an NFTL on a taxpayer's financial condition and files many liens automatically, without substantive human review or the exercise of discretion or judgment applied to the taxpayer's facts and circumstances. These policies continue to harm an increasing number of taxpayers. Among our findings:

- The IRS increased lien filings by approximately 14 percent over the prior year and about 550 percent from fiscal year (FY) 1999 despite scant evidence that liens generate commensurate tax revenue;[2]
- The IRS is now filing liens against nearly 1.1 million taxpayers a year, damaging their credit record in the midst of the worst economy in several generations, especially harming low income and minority taxpayers;[3]
- The total number of taxpayers harmed by IRS lien filing policies is much greater than 1.1 million because over five million liens filed in recent years continue to negatively affect taxpayers' credit for at least seven years from the date they pay off their debts;[4] and

1 National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS's Use of Notices of Federal Tax Lien*). *See also* National Taxpayer Advocate 2009 Annual Report to Congress 357-364 (Legislative Recommendation: *Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens*).

2 IRS, *Fiscal Year 2010 Enforcement Results, available at* http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf. During FY 1999-2009, when adjusted for inflation, the total dollars IRS collected actually declined by about seven percent from $29.4 billion to $27.2 billion (in terms of real dollars valued as of 2009). IRS, *Statistics of Income (SOI) Data Books, Table 16, Delinquent Collection Activities, 1999-2009. See also* Bureau of Labor Statistics, Dept. of Labor, *Consumer Price Index – All Urban Consumers (CPI-U), available at* http://www.bls.gov/CPI/.

3 IRS, *Fiscal Year 2010 Enforcement Results, available at* http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf. *See also* Fortune, *The IRS's Problem with Minorities* (Dec. 2, 2010) (citing study entitled *IRS Enforcement's Impact on Minority Communities*, exclusively conducted for Fortune by Thomas M. Evans, CEO of TaxLifeboat, a firm that advises taxpayers on resolving their problems with the IRS); and New York Times, *E.E.O.C. Sues Kaplan Over Hiring* (Dec. 21, 2010) (reporting that the Equal Employment Opportunity Commission sued Kaplan Higher Education Corporation alleging discrimination against black job applicants through the way it uses credit histories in its hiring processes).

4 The IRS filed 5,200,913 NFTLs during the past seven years. IRS, *Fiscal Year 2010 Enforcement Results, available at* http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf. A damaging notation remains on the taxpayer's consumer credit report for at least seven years from the date of lien release. The Fair Credit Reporting Act, § 605(a)(3), 15 U.S.C. § 1681c(a)(3).

- The IRS still has not undertaken studies to evaluate the effectiveness of its lien filing policies in terms of collected revenue and effect on future tax compliance.

In January 2010, the National Taxpayer Advocate issued two Taxpayer Advocate Directives (TADs) directing the IRS to implement specific improvements to its lien filing policies and procedures, and to grant relief to taxpayers harmed by automatic filing.[5] The IRS has not adequately addressed these concerns. As a result, NFTL filing practices continue harming millions of taxpayers, risk undermining future tax compliance, and cause millions of taxpayer dollars to be spent on potentially unnecessary lien filing fees.[6]

ANALYSIS OF PROBLEM

Background

The National Taxpayer Advocate thoroughly examined IRS lien filing policies in the 2009 Annual Report to Congress. She proposed several administrative and legislative steps to improve these policies and procedures, and to grant relief to taxpayers harmed by automatic filings.[7] Notwithstanding this compelling analysis, the IRS increased its lien filings by approximately 14 percent, from about 966,000 in FY 2009 to about 1.1 million in FY 2010.[8] Moreover, the IRS continues to file NFTLs early in collection cases, even though it cannot track the source of payments on past due accounts to measure the effectiveness of its collection actions.[9] The IRS has declined to change its automatic lien filing practices, which contradict its own longstanding policy.[10]

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5 Taxpayer Advocate Directives (TADs) 2010-1 and 2010-2 (Jan. 20, 2010). For copies of the TADs, see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix VIII, *available at* http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf.

6 The IRS estimates that a lien filing costs between $25 and $100, plus labor costs. IRS, *Collection Process Study* (CPS) 122 (Sept. 30, 2010). The IRS may spend up to $109 million in lien filing costs annually, not including labor costs, based on 1,096,376 NFTLs filed in FY 2010. IRS, *Fiscal Year 2010 Enforcement Results, available at* http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf.

7 National Taxpayer Advocate 2009 Annual Report to Congress 17-40; National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18. *See also* National Taxpayer Advocate 2009 Annual Report to Congress 357-364.

8 In FY 2010, the IRS filed 1,096,376 NFTLs. IRS, *FY 2010 Enforcement Results, available at* http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf.

9 *See* Most Serious Problem: *The IRS Should Accurately Track Sources of Balance Due Payments to Determine the Revenue Effectiveness of Its Enforcement Activities and Service Initiatives, supra*. NFTL filings have increased by over 550 percent in the past 11 years, from about 168,000 in FY 1999 to nearly 1.1 million in FY 2010. While FY 2010 SOI data are unavailable, TAS estimates that the inflation-adjusted collection revenue (in 2010 dollars) has essentially remained flat (it has increased by just four percent based on an alternative measure that the IRS has recently published), which is likely attributable to the IRS's efforts with curbing offshore tax evasion. IRS, *FY 2010 Enforcement Results, available at* http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf; Bureau of Labor Statistics, Dept. of Labor, Consumer Price Index – All Urban Consumers (CPI-U), *available at* http://www.bls.gov/CPI/ (last visited Oct. 10, 2009). *See, e.g.*, IRS, IRS Commissioner Doug Shulman's Statement on UBS/Voluntary Disclosure Program (Nov, 16, 2010) (estimating revenue effect of the program at about $3.6 billion dollars), *available at* http://www.irs.gov/newsroom/article/0,,id=231520,00.html; Reuters, *Deutsche Bank U.S. Tax Fraud Deal Opens Floodgates* (Dec. 22, 2010) (reporting Deutche Bank's $553.6 million and UBS's $780 million settlement with the IRS).

10 IRS Policy Statement 5-47 states: "…All pertinent facts must be carefully considered as the filing of the notice of lien may adversely affect the taxpayer's ability to pay and thereby hamper or retard the collection process." Internal Revenue Manual (IRM) 1.2.14.1.13 (Oct. 9, 1996). In the context of Collection Due Process hearings, Congress made clear that the IRS shall consider whether any proposed collection action "balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection be no more intrusive than necessary." IRC § 6330(c)(3)(C) (cross referenced by IRC §. 6320(c)). At present, IRS lien filing procedures do not do much balancing. They focus almost exclusively on tax collection without regard for the legitimate concern of affected persons that collection actions be no more intrusive than necessary.

On January 20, 2010, the National Taxpayer Advocate issued two TADs, directing the Commissioner, Wage and Investment (W&I) Division, and Commissioner, Small Business/Self-Employed (SB/SE) Division,[11] to:

- Immediately discontinue the automatic filing of NFTLs on Currently Not Collectible (CNC) hardship accounts with an unpaid balance of $5,000 or more, require employees to make NFTL filing determinations based on a meaningful review of the facts of each taxpayer's case, and require managerial approval for the filing of an NFTL in all cases where the taxpayer has no assets;[12]
- Allow, upon the request of a taxpayer, the withdrawal of an NFTL in situations where one of the statutory withdrawal criteria is satisfied, even if the underlying lien has been released;
- Include the complete TAS training video, *Taxpayer Rights: Collection Case Studies*, in the mandatory annual continuing professional education training about exercising judgment and discretion before and after NFTL filing for collection employees and managers in the Collection Field function (CFf); and
- In consultation with TAS, develop separate training on this topic for employees and managers in the Automated Collection System (ACS).[13]

The IRS responded by establishing a task force to undertake a comprehensive review of IRS collection practices, as well as to conduct a joint study with TAS Research of the utility of filing an NFTL on accounts deemed CNC. The National Taxpayer Advocate applauds the IRS's task force undertaking, in which TAS actively participated.[14] However, the IRS to date has not changed its current NFTL guidance.[15] On March 24, 2010, the Commissioners of SB/SE and W&I appealed TADs 2010-1 and 2010-2 to the Deputy Commissioner

11 *See* TAD 2010-1, *Immediately discontinue automatic lien filing on Currently Not Collectible (CNC) hardship accounts with an unpaid balance of $5,000 of more, require employees to make meaningful notice of federal tax lien (NFTL) filing determinations, and require managerial approval for filings of an NFTL in all cases where the taxpayer has no assets* (Jan. 20, 2010); TAD 2010-2, *Withdrawal of a notice of federal tax lien (NFTL) where the statutory withdrawal criteria are satisfied, even if the underlying lien has been released* (Jan. 20, 2010). For copies of the TADs see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix VIII, *available at* http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal..pdf.

12 *See* TAD 2010-1 (Jan. 20, 2010).

13 *See* TAD 2010-2 (Jan. 20, 2010).

14 TAS actively participated in the IRS CPS, an extensive overview of IRS collection processes, and the CPS Tools Assessment Team, which conducted a policy review and in-depth analysis of the various tools used by Collection, including determining the efficiency and appropriateness of liens for different categories of taxpayers. The Executive Director, Systemic Advocacy represents the National Taxpayer Advocate on the Collection Governance Council, and is a member of the CPS Advisory Board, which is overseeing the study and reviews its findings and recommendations.

15 The IRS Office of Chief Counsel has advised the IRS that its IRM is in compliance with the IRS Restructuring and Reform Act of 1998 (RRA 98). Memorandum dated Feb. 12, 2010, from Gary D. Gray, Deputy Associate Chief Counsel (Procedure and Administration) to Frederick W. Schindler, Director, Collection Policy (SB/SE). The memorandum characterizes the impact of a lien-filing on a taxpayer's financial viability as a "second-order hardship" and states rather clinically: "As an involuntary creditor not involved in the extension of credit, the Service is not in a position to evaluate these potential hardships and lacks the resources to effectively account for them in the large number of CNC hardship cases." The National Taxpayer Advocate fundamentally disagrees with the memorandum's conclusion that existing IRS procedures adhere to the policy underlying RRA 98. As described in the 2009 Annual Report, the intent of Congress in requiring managerial approval of lien filings for the first time was to provide additional taxpayer protections. Since RRA 98, the IRS has moved in the opposite direction. It has changed its policy in a wide swath of cases to require that liens be imposed unless an employee obtains managerial approval to refrain from making the filing. In our view, such a policy is clearly at odds with the intent of RRA 98.

for Services and Enforcement.[16] On March 31, 2010, the National Taxpayer Advocate supplemented and reissued TAD 2010-1 to the Deputy Commissioner for Services and Enforcement.[17] The National Taxpayer Advocate simultaneously issued an interim guidance memorandum to TAS employees, clarifying how they can best advocate for taxpayers affected by IRS automatic lien filing policies.[18] The memo advises employees to use sound judgment in evaluating relevant facts and circumstances with respect to the filing of an NFTL in cases involving installment agreements (IAs), offers in compromise (OICs), or CNC determinations.

Following subsequent meetings with the National Taxpayer Advocate, the Deputy Commissioner for Services and Enforcement issued a response to the TADs on June 10, 2010, which noted that:

> [t]he IRS fully appreciates the views and concerns expressed by the Office of the National Taxpayer Advocate. However, making significant fundamental changes to lien policies and procedures such as those directed in TAD 2010-1 have the potential to materially affect the revenue collected for the United States. Thus, any potential changes should be carefully considered and supported by clear and consistent data as to the effect of the changes including the rights and obligations of taxpayers, effective and efficient resource allocation and revenue collected or foregone. In order to consider the specific directives of TAD 2010-1, additional study is necessary.[19]

On September 30, 2010, the IRS completed the CPS study and issued recommendations to the Deputy Commissioner for Services and Enforcement.[20]

The IRS response to the National Taxpayer Advocate's concerns is inadequate and fails to address the potential harm its lien policies create for taxpayers and tax administration alike.

The CPS study recommended establishing nationwide pilots in ACS campuses and in the CFf to apply new lien filing criteria for taxpayers meeting revised income and other

16 Appeal of TAD 2010-1 (Mar. 24, 2010). The chief(s) of IRS function(s) subject to a TAD may appeal the proposed action within ten calendar days from the date on the TAD. *See* IRM 13.2.1.6.2, *TAD Appeal Process* (July 19, 2009). The National Taxpayer Advocate met with IRS executives on a number of occasions after the issuance of TADs and briefed them about her concerns and the results of the lien filing study published in Volume 2 of the National Taxpayer Advocate 2009 Annual Report to Congress.

17 In subsequent discussions, the SB/SE Commissioner and the National Taxpayer Advocate agreed to continue working on several of the concerns identified in TAD 2010-2, including an agreement to issue IRS guidance about NFTL withdrawal after lien release, the roll-out of the TAS training video on taxpayer rights to CFf employees, and the creation of a TAS-SB/SE-W&I team to develop similar training for ACS employees.

18 National Taxpayer Advocate, *Interim Guidance Memorandum*, Control No. TAS-13.1-0310-003 (Mar. 31, 2010). For a copy of this memorandum, see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix IX, *available at* http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal..pdf.

19 Memorandum for Nina E. Olson, National Taxpayer Advocate, from Steven T. Miller, on Taxpayer Advocate Directives 2010-1, 2010-2, and 2010-3 (June 10, 2010).

20 IRS, *Collection Process Study* (CPS) (Sept. 30, 2010).

criteria.[21] Except for this change, the recommendations anticipate the IRS would retain current guidance about lien filings.

The National Taxpayer Advocate is very concerned that, according to the IRS's own estimates, these suggested policy changes will reduce the IRS's 1.1 million annual lien filings by only 40,000 to 41,000, or about .3 percent.[22] At the same time, the IRS has increased lien filings by 130,758 NFTLs in FY 2010 compared to FY 2009.[23]

The IRS justifies its current and proposed policies based on the following arguments: 1) need to protect the government's interest; 2) need to establish priority in bankruptcy; and 3) need to establish priority in assets since the value fluctuates dependent on economic conditions.[24]

First, the IRS does not define these government interests, which may include not only the interest in the current debt, but also the interest in the financial viability of the taxpayer. A financially viable taxpayer with improved earning potential may generate an increased amount of tax revenue in the future and be able to pay the existing tax debt. The government also has a vested interest in cultivating a voluntarily compliant taxpayer who can pay future taxes.

Second, while it is true that the determination of secured status for an allowed claim of the government under Bankruptcy Code § 506(a) is dependent upon the filing of a tax lien, it does not mean that automatic filing of NFTLs on CNC (hardship) accounts with any unpaid balance threshold will necessarily protect the government's interest in the taxpayer's assets in bankruptcy. Under § 506(a) of the Bankruptcy Code, the claim of a creditor that is secured by the debtor's property is divided into secured and unsecured portions if the collateral is worth less than the face amount of the claim.[25] Thus, there are a secured claim equal to the value of the collateral and an unsecured claim equal to the deficiency.

When the IRS has filed an NFTL, all property of the debtor in which the estate has an interest subject to the lien must be valued in order to ascertain the lien's value. Internal Revenue Manual (IRM) 5.16.1.2.9(1) states that "generally, these [CNC hardship] cases involve no income or assets, no equity in assets or insufficient income to make any payment without causing hardship."[26] Hence, the IRS itself acknowledges that in CNC cases the

21 CPS *at* 121. The pilots are generally recommended for a three-month period. However, the CPS team also suggested that the new criteria remain in place after the initial three-month period ends rather then revert to the current criteria because "repeated changes to criteria would prove confusing for employees and minimize the impact of eventual implementation." *Id.*

22 CPS *at* 122.

23 IRS, *FY 2010 Enforcement Results, available at* http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf.

24 Appeal of TAD 2010-1, Memorandum for Nina E. Olson, National Taxpayer Advocate, from Christopher Wagner, Commissioner, SB/SE Division, and Richard Byrd, Commissioner, W&I Division (Mar. 24, 2010). *See also* Memorandum for Nina E. Olson, National Taxpayer Advocate, from Steven T. Miller, on Taxpayer Advocate Directives 2010-1, 2010-2, and 2010-3 (June 10, 2010); CPS *at* 121.

25 11 U.S.C. § 506(a).

26 IRM 5.16.1.2.9(1), *Hardship* (May 5, 2009).

amount of the secured claim in bankruptcy would be at or close to zero. Fiscal year 2010 data clearly support this premise: the IRS collected more in bankruptcy proceedings on unsecured priority claims than on secured claims.[27] Moreover, the statutory lien survives the bankruptcy for property excluded from the bankruptcy estate whether or not an NFTL has been filed.[28] Therefore, the IRS can sometimes collect discharged taxes after the bankruptcy even when an NFTL was not filed, if the statutory lien attaches to property excluded from the bankruptcy estate, such as a pension.[29]

Finally, the National Taxpayer Advocate is concerned that the IRS is substituting another automatic filing threshold for the exercise of discretion or judgment applied to the taxpayer's facts and circumstances, especially when it bases a lien filing determination on the *existence* of real property, not the *equity* in assets. During the current economic downturn, many taxpayers find the fair market value of their real estate is substantially less than they owe on their mortgages. In such situations, a lien filing based on the mere *existence* of real property will undoubtedly harm both the taxpayers and the government because the NFTL will not attach to any tangible interest in the property and will instead decrease the taxpayers' ability to obtain credit to repay tax debts. It is true that the general economic environment or individual financial circumstances of taxpayers suffering an economic hardship today or repaying liabilities pursuant to an IA may improve in the future, resulting in equity in assets. At that time, the government might reap some benefit from filing the NFTL. By analyzing internal sources, such as its own Information Returns Program (IRP) data (which provide verifiable third party documentation),[30] as well as Accurint to confirm real estate, business property, and motor vehicle records, the IRS can determine the existence of equity in assets to which a lien could attach.[31] The IRS can and should review the taxpayer's financial information on a regular basis, and make timely NFTL filing determinations, when economic conditions improve or the taxpayer acquires equity in assets. The IRS possesses or has access to a wealth of financial data pertaining to taxpayers. The IRS should utilize this data prudently to develop a balanced lien filing strategy.

While additional studies on the effectiveness and impact of lien filing policies may be helpful, the National Taxpayer Advocate respectfully disagrees with the IRS's position that

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27 IRS, Collection Activity Report NO-5000-31, *IMF Report of Bankruptcies* (Oct. 5, 2010), Total - All Chapters, line 2.1. In FY 2008, the total collection for all chapters showed $201,096,960 collected from unsecured priority claims and $47,374,751 collected from secured claims. The IRS also collected $31,752,097 from general unsecured claims. For definitions, see 11 U.S.C. §§ 506(secured claim); 507(a)(8) (priority claim).

28 SB/SE, *Interim Guidance for Insolvency Monitoring of Lien Releases*, Control No. SB/SE-05-1209-071 (Dec. 16, 2009).

29 IRC § 6321; 11 U.S.C. §§ 541(a) and (c)(2). *See also U.S. v. Rogers*, 558 F. Supp. 2d 774 (N.D. Ohio 2008) (holding statutory lien attached *in rem* to the retirement interest excluded from the bankruptcy estate).

30 IRM 2.3.35.1 (Aug. 1, 2003). The IRP allows IRS employees to request either online or hardcopy Information Returns Processing (IRP) transcripts from the Information Returns Master File (IRMF), *e.g.*, Form 1098, *Mortgage Interest Statement* (demonstrating home ownership) or Form 1099-INT, *Interest Statement* (demonstrating asset ownership).

31 Accurint is a service provided by Lexis-Nexis, with which the IRS has an unlimited annually renewable contract. *See* Accurint, http://www.accurint.com (last visited Sept. 25, 2010).

it cannot consider recommended actions until it completes the study and pilots.[32] TAS research studies have sufficiently demonstrated that current lien filing policies and practices actively and unnecessarily harm taxpayers. Particularly in the area of CNC taxpayer accounts, there is no sound policy or revenue basis for *automatically* filing liens based on an unpaid balance of assessment threshold.

TAS is actively advocating for taxpayers that experience harm from current NFTL filing policies and has issued Taxpayer Assistance Orders (TAOs) in some cases.[33] TAS is also conducting its own study of the impact of NFTL filings on future tax compliance.[34] The objectives of this study are: 1) to determine whether any amounts of payments are likely attributable to the NFTL; 2) to determine the effect of the NFTL on future payment compliance; 3) to determine the effect of the NFTL on future filing compliance; and 4) to determine whether the NFTL is associated with a decline in future income.[35] Upon issuance of this report, the National Taxpayer Advocate will elevate the TADs to the Commissioner of Internal Revenue for his review and action.

The IRS's delay in issuing guidance about NFTL withdrawals following lien releases unnecessarily harms taxpayers and may undermine future tax compliance.

The IRS Office of Chief Counsel issued an opinion on October 8, 2009, concluding "that as a legal matter, the IRS may file a certificate of withdrawal after a lien release."[36] However, the IRS has failed to change its procedures to conform to the opinion. In response to the TAD, the IRS committed to draft guidance to change its policy and implement the opinion by mid-July 2010.[37] The recently released Collection Process Study also recommended approving NFTL withdrawal requests after a lien is released, but limited such withdraws to few specific situations.[38] The scope of the proposed guidance did not fully address the

32 For a detailed discussion of IRS's inability to accurately measure the effectiveness of any of its collection actions because it cannot accurately track the sources of balance due payments, see Most Serious Problem: *The IRS Should Accurately Track Sources of Balance Due Payments to Determine the Revenue Effectiveness of Its Enforcement Activities and Service Initiatives, supra.*

33 *See* IRC § 7811(a). In FY 2010, the National Taxpayer Advocate, TAS Area Directors, and Local Taxpayer Advocates issued 26 Taxpayer Assistance Orders (TAOs) which involved lien issues. From October 1, 2010, to December 20, 2010, TAS issued additional six TAOs.

34 TAS Research will analyze a cohort of delinquent individual tax return filers (IMF) taxpayers, who had new unpaid tax liabilities in tax year (TY) 2002, to determine what impact exists from the imposition of NFTLs. TAS Research will study the payment activities and subsequent compliance behavior of these taxpayers. Particularly, this analysis will compare payment activity and compliance behavior for taxpayers with and without a NFTL. TAS Research will examine payment compliance and the overall compliance behavior on these taxpayers' TY 2002 to TY 2009 tax modules.

35 For a more detailed discussion of the design of this study, see *Estimating the Impact of Liens on Taxpayer Compliance Behavior: An Ongoing Research Initiative*, vol. 2, *infra*.

36 Memorandum from Branch 3 (Procedure and Administration) to Special Counsel (National Taxpayer Advocate), Ref. No. POSTN-133674-09 (Oct. 8, 2009). A lien that is "released" is reflected on the taxpayer's credit record for seven years from the date of the release. However, an NFTL that is "withdrawn" is treated as if it had not been filed and is removed from the record.

37 Memorandum for Nina E. Olson, National Taxpayer Advocate, from Steven T. Miller, Deputy Commissioner for Services and Enforcement, on TADs 2010-1, 2010-2, and 2010-3 (June 10, 2010); Appeal of TAD 2010-2 (Mar. 24, 2010). In addition, the CPS acknowledged that "[a]pproving lien withdrawal applications after lien releases could enhance taxpayers' financial viability and increase future tax revenue." CPS *at* 125.

38 CPS *at* 125-126. The CPS recommended that the IRS generally approve NFTL withdrawal requests for taxpayers who full pay and for liens resulting from substitute for return (SFR) assessments where subsequently filed returns resulted in the taxpayers owing no tax. It did not recommend approval of NFTL withdrawal requests when the lien is released due to expiration of the statute. In our view, these recommendations do not follow the criteria established by the statute for NFTL withdrawals. *See* IRC § 6323(j)(1).

National Taxpayer Advocate's concerns, nor did it provide appropriate relief in accordance with the statute. TAS substantially redrafted the guidance in consultation with the Special Counsel to the National Taxpayer Advocate. To date, the IRS has not provided the National Taxpayer Advocate with an updated draft of this guidance.

More than a year has passed since the Office of Chief Counsel issued its opinion regarding NFTL withdrawals after lien releases. The IRS has still not acted on this opinion. Because the IRS failed to issue appropriate NFTL withdrawal guidance, the current policy of disallowing NFTL withdrawals after a tax lien release continues to harm taxpayers.

The IRS should improve communications and processes associated with rectifying erroneous lien filings.

In May 2010, TAS opened an Immediate Intervention project concerning the release of federal tax liens when the filing of the NFTL was erroneous.[39] Under IRC § 6326(b) and the related regulations, if the IRS erroneously files an NFTL, the certificate of release must include a statement that such filing was erroneous.[40] In a number of TAS cases, the computer-generated Form 668(Z), *Certificate of Release of Federal Tax Lien*, did not contain this statutorily required language.[41] Thus, the consumer credit bureaus considered the releases to have been issued because the tax liability was satisfied or unenforceable under IRC § 6325(a) (rather than a release under IRC § 6326(b)). When this occurs, a damaging notation remains on the taxpayer's consumer credit report for at least seven years from the date of release.[42] Consequently, victims of erroneous NFTL filings incur the additional burden of proving to credit reporting bureaus that the filings were incorrect.

Even when the IRS provides the Letter of Apology (Letter 544) in these cases, it uses a fillable PDF form that prints out with gaps and extra spaces. According to an official with a major credit reporting agency, the credit bureau may reject the letter as suspicious when a taxpayer submits it to substantiate an erroneous NFTL filing.[43] The IRS has agreed to clarify and supplement IRM guidance regarding certificates of release for erroneously filed liens, and to fix the spacing in Letter 544.

CONCLUSION

The National Taxpayer Advocate will zealously advocate for the IRS to change its lien filing policies and practices until the IRS addresses her concerns and resolves the underlying

39 IRC § 6326(b); Treas. Reg. § 301.6326-1. An immediate intervention is an operational issue, identified internally or externally, which causes immediate, significant harm to multiple taxpayers and demands an urgent response. IRM 13.2.1.4.2.1 (July 16, 2009). The TAS analyst assigned to an immediate intervention must develop an action plan for resolution within five calendar days of assignment. IRM 13.2.2.4.1 (July 16, 2009).

40 IRC § 6326(b); Treas. Reg. § 301.6326-1.

41 IRC § 6326(b) and regulations require the IRS to expeditiously (and, to the extent practicable, within 14 days after such determination) issue a certificate of release of an erroneous lien which "shall include in such certificate a statement that such filing was erroneous." IRC § 6326(b); Treas. Reg. § 301.6326-1.

42 The Fair Credit Reporting Act, § 605(a)(3), 15 U.S.C. § 1681c(a)(3).

43 TAS teleconference with Experian Senior Vice President (Apr. 30, 2010).

issues. The National Taxpayer Advocate will keep working to improve IRS lien filing policies and processes in a manner that would benefit both taxpayers and the United States. Moreover, TAS employees will advocate on behalf of taxpayers in lien cases and issue TAOs where appropriate. The National Taxpayer Advocate expects the IRS will collaborate with TAS on these issues, and she will regularly report to Congress on the progress of this effort.

In conclusion, the National Taxpayer Advocate reiterates her recommendations that the IRS:

1. Immediately rescind its policy of automatically filing liens against accounts designated as "currently not collectible" due to economic hardship based on an unpaid balance threshold.
2. Require managerial approval for NFTL filings in all cases where the taxpayer has no significant equity in assets.
3. Revise the Internal Revenue Manual to base lien filing determinations on a thorough review of information including the taxpayer's assets, the taxpayer's income, and the value of the taxpayer's equity in the assets; and determine after weighing all the facts and circumstances whether (i) the lien will attach to property, (ii) the benefit to the government from the NFTL filing outweighs the harm to the taxpayer, and (iii) the filing will jeopardize the taxpayer's ability to comply with the tax laws in the future.
4. To reverse the damage to a taxpayer's credit rating, the IRS also should develop and issue guidance allowing, upon the request of the taxpayer, the withdrawal of an NFTL where the statutory withdrawal criteria are satisfied, even if the underlying lien has been released.

Status Update: The IRS Offer in Compromise Program Continues to be Underutilized

RESPONSIBLE OFFICIAL

Chris Wagner, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

For the past nine years, the National Taxpayer Advocate has identified the IRS offer in compromise (OIC) program as one of the most serious problems facing taxpayers.[1] The current economic climate has led to a nine percent increase in offer receipts.[2] However, the IRS accepts roughly one offer for every 290 taxpayers with a delinquent account.[3] Meanwhile, the IRS places over a million taxpayers' accounts into currently not collectible (CNC) status each year, which undermines revenue collection goals.[4] Moreover, the IRS generally files notices of federal tax lien (NFTLs) against taxpayers for balances exceeding $5,000 after offer acceptance, return, or rejection, which hampers taxpayers who are actively trying to pay their tax debts.[5]

To its credit, over the last year the IRS has conducted several significant studies of the OIC program, and revised procedures for processing some of the offers worked in the Centralized Offer in Compromise units (COIC).[6] If the IRS adopts and implements certain recommendations from these studies (discussed below), the IRS finally will have accepted and implemented its Policy Statement 5-100 and the IRS Restructuring and Reform Act of 1998's OIC directives, and made the offer program an integral part of its collection strategy. The IRS now has a roadmap to reinvigorate the OIC program—it just needs to do it.[7]

1 National Taxpayer Advocate 2009 Annual Report to Congress 196-216; National Taxpayer Advocate 2008 Annual Report to Congress 26-28; National Taxpayer Advocate 2007 Annual Report to Congress 374-387; National Taxpayer Advocate 2006 Annual Report to Congress 83-109, 507-519; National Taxpayer Advocate 2005 Annual Report to Congress 270-291; National Taxpayer Advocate 2004 Annual Report to Congress 226-245, 311-341, 433-50; National Taxpayer Advocate 2003 Annual Report to Congress 99-112; National Taxpayer Advocate 2002 Annual Report to Congress 15-24; National Taxpayer Advocate 2001 Annual Report to Congress 202-215.

2 IRS Small Business/Self-Employed Division (SB/SE), *OIC Executive Summary Report* (Sept. 2010). The current economic climate is evidenced by an unemployment rate of nearly ten percent, and one out of every 389 homes in foreclosure. Bureau of Labor Statistics, *Labor Force Statistics from the Current Population Survey, available at* http://data.bls.gov/PDQ/servlet/SurveyOutputServlet?data_tool=latest_numbers&series_id=LNS14000000 (last visited Dec. 6, 2010); RealtyTrac, National Real Estate Trends, http://www.realtytrac.com/TrendCenter/Default.aspx?address=&T= (last visited Dec. 6, 2010).

3 At the beginning of Fiscal Year (FY) 2010, there were 4,031,093 taxpayers with delinquent accounts. During FY 2010, the IRS accepted only 13,886 offers. SB/SE, Collection Activity Report NO-5000-2.

4 SB/SE, Collection Activity Report NO-5000-149, *Recap of Currently Not Collectable Report* (Oct. 1, 2010) (1,302,856 taxpayers were placed in currently not collectible (CNC) status from October 1, 2009, to September 30, 2010). The IRS will suspend collection activity by placing an account into CNC status when it has limited resources to collect the delinquent taxes, it is unable to locate the taxpayer, or the taxpayer is unable to pay.

5 Internal Revenue Manual (IRM) 5.8.4.13(5) (June 1, 2010). *See also* National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*).

6 *See* The MITRE Corporation, *Offer in Compromise Study* (Jan. 20, 2010); Siegel + Gale, *Offer in Compromise, Strategic Recommendations* (July 31, 2009); IRS, *Collection Process Study*, Final Report (Sept. 30, 2010); IRS, *COIC Streamline Processing Test Executive Briefing* (May 27, 2010).

7 IRM 1.2.14.1.18, *Policy Statement 5-100* (Jan. 30, 1992); IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206 (1998); H.R. Conf. Rep. 599, 105th Cong., 2d Sess., 289 (1998).

ANALYSIS OF PROBLEM

Background

An OIC is an agreement in which the government accepts less than the full amount owed in exchange for the taxpayer's promise to comply with tax laws for at least five years.[8] The IRS's offer program allows for the compromise of tax liabilities based upon doubt as to liability (DATL), doubt as to collectability (DATC), and effective tax administration (ETA).[9]

Most OIC applications fall into the DATC category.[10] IRS procedures allow for the acceptance of a DATC offer when the amount reflects reasonable collection potential (RCP), unless special circumstances exist.[11] The IRS calculates RCP as an amount equal to the value of all of the taxpayer's equity in assets, plus four, five, or more years' worth of future income (net of reasonable living expenses).[12]

IRS Policy Statement 5-100 provides that the success of the offer program will depend on taxpayers making offers consistent with their ability to pay. The policy further requires that offers will be accepted in the best interests of the government and the taxpayer to provide a fresh start towards compliance, in lieu of a protracted installment agreement (IA) or placing an account into CNC status.[13] Yet the IRS reported almost $29 billion as CNC in FY 2010, and maintains a CNC inventory of over $66 billion (representing almost 3.1 million taxpayers), and a large inventory of "inactive" cases in its queue.[14]

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8 Internal Revenue Code (IRC) § 7122.

9 IRC § 7122; Treas. Reg. § 301.7122-1, *et seq*.; Form 656, *Offer in Compromise* (Mar. 2009); Form 656-B, *Offer in Compromise Booklet* (Mar. 2009). The IRS accepts doubt as to liability (DATL) offers when the IRS has a legitimate doubt the taxpayer owes part or all of the tax liability; and doubt as to collectibility (DATC) offers when the IRS doubts the taxpayer could fully pay the tax liability within the statutory period for collection. The IRS accepts effective tax administration (ETA) offers when the taxpayer has no doubt the tax is correct and the IRS may collect the full amount, but "economic hardship" or "equity and/or public policy" conditions are present. IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206 (1998); H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess., 289 (1998); Treas. Reg. § 301.7122-1(b)(3). "Economic hardship" occurs when an individual is unable to pay reasonable basic living expenses. *See* Treas. Reg. § 301.6343-1.

10 In FY 2009, IRS Collection received 52,102 offers, of which two percent, or 1,041, were submitted as ETA offers, and the remaining 98 percent were submitted as DATC offers. The IRS also received 1,347 DATL offers in FY 2009, of which none were accepted. SB/SE, *OIC Executive Summary Report* (Sept. 2009). SB/SE response to TAS research request (July 15, 2010). SB/SE response to second TAS research request (Sept. 29, 2010).

11 IRM 5.8.1.1.3(3) (Mar. 16, 2010); IRM 5.8.4.3 (June 1, 2010). The IRS can accept a DATC offer if special circumstances exist that create an economic hardship and prevent a taxpayer from being able to pay the RCP.

12 IRM 5.8.1.1.3(1) (Mar. 16, 2010).

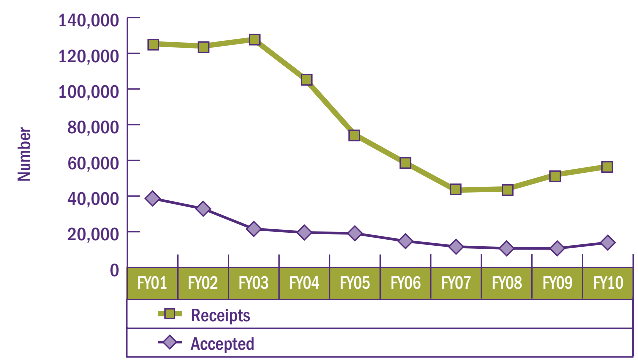
13 IRM 1.2.14.1.18 (Jan. 30, 1992).

14 IRM 5.16.1.1 (June 29, 2010). IRS Policy Statement P-5-71 provides the IRS authority to report an account as CNC for a variety of reasons (*e.g.*, unable to pay, unable to contact or locate, and death). This generally suspends collection actions but the liability is still due and owing; thus, penalties and interest continue to accrue until the statutory period of collection expires. IRS, Collection Activity Report NO-5000-149, *Recap of Accounts Currently Not Collectible Reports* (Oct. 1, 2010). The IRS Collection queue is an inventory of cases awaiting assignment to the Collection Field function. While these cases are considered to be "open" collection accounts, they remain inactive until assigned to a revenue officer. At the conclusion of FY 2010, the IRS reported 3,328,895 Taxpayer Delinquent Accounts (*i.e.*, balance due assessments) as residing in the Collection queue. IRS, Collection Activity Report NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Oct. 1, 2010).

The Current State of the OIC Program

As illustrated by Figure 1.23.1 below, the program has experienced a steady decline in offers received and accepted since FY 2001 with a slight improvement in FY 2010.[15]

FIGURE 1.23.1, FY 2001 – FY 2010 OIC Receipts and Acceptances



Offer receipts have increased by nine percent and acceptances have risen by 30 percent, yet the IRS accepted less than 14,000 offers while its collection inventory grew to almost 4.3 million taxpayers in FY 2010.[16]

IRS Consultants Confirm Deep-Rooted Problems in the Offer Program.

The MITRE Corporation's study of the offer program revealed continuing problems, centered on a lack of leadership and clear policy guidance to employees.[17] Further, MITRE found that offer examiners lack a consistent approach to identifying special circumstances.[18] Another firm, Siegel and Gale, observed that the "eight-step" process described in the OIC forms is misleading and unduly burdensome (and actually involves more than 100 steps) to taxpayers; the instructions are lengthy and detached from the forms; and debt information in the collection information statement, which is the centerpiece of the process, is overlooked by the IRS.[19]

15 IRS, Collection Activity Report NO-5000-108, *Monthly Report of Offer in Compromise Activity (FY 2001-FY 2010).*

16 The IRS received 56,539 offers in FY 2010; 4,437 more than in FY 2009. The IRS accepted 13,886 offers in FY 2010; 3,221 more than in FY 2009. SB/SE, *OIC Executive Summary Report* (Sept. 2010); IRS, Collection Activity Report NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Oct. 1, 2010).

17 *See* The MITRE Corporation, OIC Study, Executive Advisory Board Briefing (Mar. 4, 2010). MITRE noted that under current IRS procedures, taxpayers whose offers are accepted are usually wage earners, are most often represented by a power of attorney (POA), are more likely to have older tax liabilities, own a home with negative equity, and have experienced a life-changing event. The MITRE Corporation, *Offer in Compromise Study* 33 (Jan. 20, 2010).

18 The MITRE Corporation, *Offer in Compromise Study* 31-32, 34 (Jan. 20, 2010).

19 Siegel + Gale, *Offer in Compromise, Strategic Recommendations* 10-13 (July 31, 2009).

The National Taxpayer Advocate believes the IRS is taking a positive step by obtaining advice from MITRE and Siegel and Gale, but she does not agree with all of the consultants' recommendations. For example, MITRE recommended simplifying the application form due to concerns that the request for creditor information was confusing taxpayers because it was not used to calculate the offer.[20] We believe the IRS should be using this information to evaluate expenses and allowable living expenses (ALEs) to accept more offers (*i.e.*, it should allow payments on unsecured debt when calculating RCP).[21] Siegel and Gale believed there was too much emphasis on DATL and ETA offers and wanted to change the names of the offer forms.[22] However, because the title of the form and these types of offers are dictated by statute and regulations, the IRS should continue to provide these options to taxpayers.

The National Taxpayer Advocate believes the IRS should eliminate the lengthy forms and requirements for substantial amounts of information early in the process. The IRS has access to a significant amount of financial information about the taxpayer, beyond tax information, which it can use to construct an initial financial picture of the taxpayer.[23] The offer process should begin with the submission of a simple application and minimal attached documentation. The examiner would schedule an initial call with the taxpayer to discuss the process and the information needed to continue, which the IRS would document in a letter to the taxpayer. Once the IRS received the information, it would examine and decide whether to accept the offer.

In Improving the Offer Program, the IRS Must Not Lose Touch with Its Customers.

During a focus group conducted at the IRS Nationwide Tax Forums in 2009, one practitioner shared this opinion about the experience dealing with the IRS:

> The biggest thing that I see wrong is that the IRS employees have a chip on their shoulders and see the practitioners as the enemy and will not work with them to get the offer accepted. . . . When you get correspondence back regarding an offer and you call them back, no one knows who they are and you can't get a hold of them . . ..[24]

This practitioner's opinion mirrors the results of the most recent customer satisfaction surveys about the offer process.

20 The MITRE Corporation, *Offer in Compromise Study* 19, 23-24 (Jan. 20, 2010).

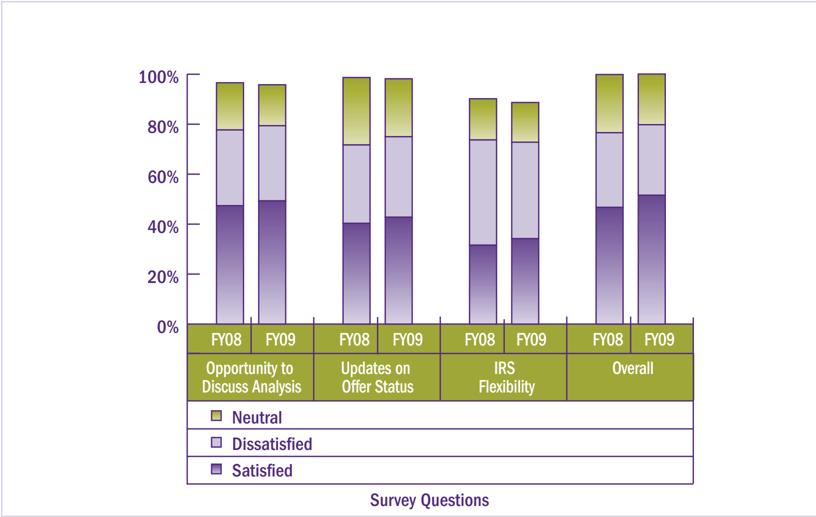
21 *See* Most Serious Problem: *The IRS Does Not Know the Impact of Ignoring Non-IRS Debt When Analyzing a Taxpayer's Ability to Pay an IRS Debt, supra*.

22 Siegel + Gale, *Offer in Compromise, Strategic Recommendations* 36 (July 31, 2009); Siegel + Gale, Form 656, *Offer in Compromise* (July 2009).

23 The COIC gathers Accurint (asset locator tool), DMV records, and internal sources to verify the fair market value of assets to build cases for offer consideration. IRM 5.8.3.4.2 (Mar. 26, 2010). The IRS also has various Internet resources, such as Smart.Alx (for credit bureau research) and LexisNexis (for legal research), and intranet resources. IRM 5.1.18.3 (Sept. 17, 2010).

24 IRS, 2009 Nationwide Tax Forums, OIC focus group conducted by TAS – San Diego (July 14, 2009).

FIGURE 1.23.2, FY 2008 and FY 2009 Combined OIC Field and COIC Customer Satisfaction Survey Results[25]



In 2009, taxpayers responding to the survey were satisfied with the opportunity to discuss analysis, updates on offer status, and IRS flexibility 49, 42, and 34 percent of the time, respectively. Many respondents felt the first consideration for the IRS is how to reject an offer.[26] One reason for the high levels of customer dissatisfaction may be how the IRS defines offer program "success." COIC quality measures include customer accuracy, professionalism, timeliness, and disposition time, but not whether offer examiners consider special circumstances or educate taxpayers about the offer process.[27]

The Results of the IRS Collection Process Study and Recent Changes to COIC Procedures May Begin the Revival of the Offer Program.

In May 2010, SB/SE briefed IRS executives on its plan to test new procedures to increase efficiencies and improve the quality of OIC case decisions. The procedures are designed to "streamline" the COIC process by eliminating non-value added actions, and reduce taxpayer burden by reducing documentation requirements and placing renewed emphasis on telephone contacts in lieu of standard written communication. The procedures also introduce more flexibility for case decisions made by COIC offer examiners by adjusting requirements for evaluating the equity in assets, and the value of payments the IRS may

25 SB/SE, *Offer in Compromise Customer Satisfaction Survey Results for FY09* 9 (June 30, 2010), SB/SE, *Offer in Compromise Customer Satisfaction Survey Results for FY08* 9 (June 30, 2009). The sum of the percents for some response choices does not equal 100 percent because "not applicable" responses are not shown.

26 SB/SE, *Offer in Compromise Customer Satisfaction Survey Results for FY09*, Brookhaven 51-15 ("rejection or returning of offers without the opportunity to provide additional information makes it seem like the agent is just trying to get rid of the offers"); Brookhaven 51-21 ("too many offer examiners are under pressure to "close" offers by rejection outright"); Memphis 52-3 ("it seems that a rejection is the first concern, rather than making the offer acceptable to both parties..."); Memphis 52-20 ("no flexibility on part of IRS . . . rejection letter - then case closed"); South Atlantic 53-2 ("due to lack of response or inability to negotiate a positive outcome (for both IRS and the taxpayer), the IRS seems to be unable or unwilling to find an agreeable result and would instead prefer rejection or return of the offer . . ."); Gulf States 54-18 19 ("the process . . . is geared towards rejection of offers") (June 30, 2010).

27 The MITRE Corporation, *Offer in Compromise Study* 36, 43-45 (Jan. 20, 2010); IRM 5.13.4 (Aug. 28, 2009).

receive from the taxpayer's future income.[28] These procedures are in place for cases involving wage earners, unemployed individuals, and self-employed taxpayers who fit certain criteria.[29] SB/SE intends to evaluate the results of this new approach at the end of the calendar year.

While it may be too soon to draw firm conclusions, it appears that early results of the modified COIC procedures are very encouraging. IRS data reflect significant increases in the number of offers accepted by COIC (*e.g.*, during the fourth quarter of FY 2010, COIC accepted 87 percent more offers than in the same period of FY 2009, and the dollars accepted in these offers increased by 64 percent).[30] During the same period, program performance in the OIC Field operation did not reflect corresponding improvements, and dollars accepted in compromise by the OIC Field groups (excluding Appeals) decreased by 42 percent during FY 2010.[31] While the COIC improvements may not be entirely attributable to the new process, it certainly appears that this initiative has installed a new perspective in the manner in which OICs are being worked in these units. The National Taxpayer Advocate is encouraged by these indicators and looks forward to reviewing the ongoing results of the new "streamlined" processing and SB/SE's analysis of this effort, including plans to expand the application of these procedures to the general OIC program.

There is further evidence of potential improvements to the OIC program. In response to the National Taxpayer Advocate's concerns about IRS collection practices, the IRS Deputy Commissioner for Services and Enforcement chartered the Collection Process Study (CPS) to review collection practices, identify potential improvements, and recommend enhancements.[32] Concerning the offer program, the CPS recommends the IRS develop and implement more realistic expense standards, redefine RCP, and implement an OIC outreach campaign for low income taxpayers in CNC status.[33]

Specifically, the CPS proposes to make the ALE standards more flexible by allowing taxpayers' actual expenses less than 110 percent of the established national standards, developing separate expense standards for taxpayers who rent or own their homes, and permitting **minimum** payments on certain debts junior to the federal tax lien (*e.g.*, state tax debts, credit cards, and student loans).[34] Further, the CPS recommends that the IRS:

28 IRS, *COIC Streamline Processing Test Executive Briefing* 6 (May 27, 2010). The RCP typically includes the value of all of the taxpayer's assets plus future income (net of reasonable living expenses) for 48, 60, or the number of months remaining in the statutory period for collection depending on the payment terms of the offer. IRM 5.8.5.6(1) (Sept. 30, 2008).

29 IRS, *COIC Streamline Processing Test Executive Briefing* 5 (May 27, 2010).

30 IRS, Collection Activity Report NO-5000-108, *Monthly Report of Offer in Compromise Activity* (Oct. 4, 2010 and Oct. 6, 2009). These data reflect only COIC activity, and do not include offers accepted by Appeals.

31 *Id.*

32 IRS, *Collection Process Study, Final Report* 1 (Sept. 30, 2010).

33 *Id*. at 8-10.

34 *Id*. at 89.

- Revise Policy Statement 5-100 to state that the RCP should reflect the "amount of delinquent taxes that the IRS actually expects to collect from the taxpayer if the OIC is rejected;"
- Adopt procedures to eliminate the inclusion of dissipated assets, exclude up to $2,500 equity in vehicles, use forced sale value (75 percent of value) instead of quick sale value (80 percent) for personal residences, exclude up to $400 in retired debt attributed to a vehicle loan, waive or eliminate the 20 percent down payment requirement; and
- Define "protracted installment agreement" as an IA that lasts five years or the remaining statutory period for collection, whichever is shorter.[35]

The National Taxpayer Advocate applauds the CPS for recommending steps that support her proposals in current and past annual reports, and looks forward to seeing these recommendations implemented.[36]

CONCLUSION

The offer program provides an excellent opportunity to give taxpayers a fresh start while enhancing the government's goal of bringing taxpayers into compliance. The IRS's attempts to enhance this program will fall short unless it looks at taxpayers' complete financial situations, uses the appropriate measures, gathers comments from customers, and clearly communicates goals for OIC acceptance and future compliance to its employees.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS take the following specific actions to improve the OIC program:

1. Adopt the Collection Process Study recommendations concerning allowable living expenses, reasonable collection potential, and OIC outreach for low income taxpayers in currently not collectible status.
2. Expand the scope and incorporate the positive elements of the Centralized Offer in Compromise unit's new streamlined processing procedures into routine IRM direction covering all OICs, including those worked in the OIC Field operation.
3. Revamp OIC quality reviews to evaluate whether offer examiners consider special circumstances and educate taxpayers about the offer process.

35 IRS, *Collection Process Study, Final Report* 91-92 (Sept. 30, 2010).

36 *See* Most Serious Problem: *The IRS Does Not Know the Impact of Ignoring Non-IRS Debt When Analyzing a Taxpayer's Ability to Pay an IRS Debt, supra*; National Taxpayer Advocate 2009 Annual Report to Congress 216. The recommendations to the IRS included, among other things, reinstating its 1992 procedures to more closely follow Policy Statement 5-100, recommending OICs consistent with the collectibility curve to taxpayers whose tax liabilities have aged more than three years, requiring offer processors to build an offer file with information the IRS already has, and offer examiners or offer specialists exploring potential offers with taxpayers by telephone.

4. Conduct periodic studies to review taxpayer compliance one to ten years after offer acceptance and rejection (*i.e.*, did the IRS collect what was offered, did the taxpayer stay compliant, and for how long).

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

RESPONSIBLE OFFICIAL

Richard E. Byrd Jr., Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

Any individual who has a tax return filing obligation but is not eligible to obtain a Social Security number (SSN) must apply to the IRS for an Individual Taxpayer Identification Number (ITIN).[1] Yet the IRS processes most ITIN applications only when they are attached to paper returns, which creates a recurring bottleneck of ITIN applications and tax returns during peak tax season, totaling 1.6 million applications and more than 960,000 returns in 2010 alone.[2] This policy precludes first-time ITIN applicants from filing electronic returns, and causes backlogs of hundreds of thousands of unworked and suspended applications.[3] Taxpayers whose applications are suspended may also have their refunds delayed for as long as eight months.[4] Of the 117,000 suspended applications as of April 10, 2010, 115,000 (98 percent) had associated and still unprocessed paper tax returns.[5] A prior year analysis of ITIN returns showed that 83 percent of the taxpayers were due refunds totaling more than $500 million.[6]

For several years, the National Taxpayer Advocate has expressed serious concerns about IRS processing of ITIN applications and associated tax returns.[7] This status update on the ITIN program will discuss recent improvements to IRS processes and procedures and address the following concerns:

- Inefficient ITIN processing, resulting in recurring seasonal bottlenecks of ITIN applications; and
- Extended delays in processing hundreds of thousands of tax returns and refunds annually when the associated ITIN applications are suspended.

1 Internal Revenue Code (IRC) § 6109; Treas. Reg. § 301.6109-1(d)(3).

2 IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*.

3 On April 11, 2009, the ITIN Program Office had 360,000 unworked applications in inventory, of which 347,000 (97 percent) included unprocessed paper tax returns. On March 20, 2010, the IRS had another peak of unworked applications totaling 195,000, of which 192,000 (99 percent) had unprocessed paper returns. IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*. All percentages hereinafter are computed from the unrounded numbers.

4 Internal Revenue Manual (IRM) 3.21.263.7.3 (Jan. 1, 2010); IRM 21.4.1.3 (May 10, 2010). *See also* IRS, *ITIN Production Report, Yearly Comparative Data* (2008, 2009, and 2010).

5 IRS, *ITIN Production Report, Yearly Comparative Data* (Apr. 10, 2010).

6 IRS, *Individual Taxpayer Identification (ITIN) Usage Analysis for 2004 (Follow-on) Project # 4-06-25-2-051N* (March 2007).

7 *See* National Taxpayer Advocate 2009 Annual Report to Congress 520-522; National Taxpayer Advocate 2008 Annual Report to Congress 126-140; National Taxpayer Advocate 2004 Annual Report to Congress 143-162; National Taxpayer Advocate 2003 Annual Report to Congress 60-86. In 2003, 2004, and 2008, the National Taxpayer Advocate identified the IRS's failure to timely process ITIN applications as a Most Serious Problem.

ANALYSIS OF PROBLEM

Background

The National Taxpayer Advocate addressed problems with the processing of ITIN applications or associated tax returns in the 2003, 2004, 2008, and 2009 Annual Reports to Congress. In February 2009, the National Taxpayer Advocate issued a Taxpayer Advocate Directive[8] directing the IRS to develop a process that allows taxpayers to obtain ITINs during the year without an associated return, upon proof of employment and withholding (or self-employment).[9] The National Taxpayer Advocate has briefed the Commissioner regarding the changes to the ITIN process mandated in the directive, and continues to advocate on this matter at the highest levels of IRS leadership. However, the IRS has not adequately addressed these concerns or acted to acknowledge, and more importantly alleviate, the undue hardship placed on these taxpayers.

Recent Improvements to ITIN Processes and Procedures

The National Taxpayer Advocate applauds the IRS's recent steps to assist decedent and minor ITIN applicants, and commends the IRS for beginning to measure unworked ITIN inventory. Acting on the National Taxpayer Advocate's recommendations from the 2008 Annual Report to Congress and Taxpayer Advocate Directive 2009-1,[10] the IRS made significant progress in improving ITIN processes and procedures. This includes the following:

- The IRS began measuring the backlog of unworked ITIN inventory in 2008;[11]
- As the result of an agreement with TAS, effective April 1, 2009, the IRS reversed its prior policy and began routinely assigning ITINs to qualified decedents so long as a death certificate was submitted for the applicant.[12] The Wage and Investment (W&I) Division promptly issued guidance to IRS employees, changed the Internal Revenue Manual (IRM), and electronically notified all ITIN acceptance agents;[13]
- In 2010, the IRS revised instructions for Form W-7, *Application for Individual Taxpayer Identification Number (ITIN)*, and Publication 1915, *Understanding Your IRS Individual Taxpayer Identification Number*, regarding the issuance of ITINs to decedents;[14] and
- The IRS acted promptly on the National Taxpayer Advocate's concern about the then-new requirement for all minor applicants to submit birth certificates. The requirement

8 *See* Taxpayer Advocate Directive (TAD) 2009-1 (Processing of Forms W-7/Filing of ITIN Applications and Associated Tax Returns) (Feb. 25, 2009), *infra*.

9 *E.g.*, three consecutive pay stubs or other payment documentation, employment or independent contractor commitment letters or contracts, Forms 1099-MISC, *Miscellaneous Income, etc*.

10 *See* National Taxpayer Advocate 2008 Annual Report to Congress 140; TAD 2009-1 (Feb. 25, 2010).

11 *See* IRS, *ITIN Production Report, Yearly Comparative Data* (Sept. 27, 2008).

12 On May 5, 2009, the National Taxpayer Advocate signed a formal memorandum of understanding with the Director of W&I Submission Processing on ITIN application procedures for deceased applicants.

13 Servicewide Electronic Research Program (SERP) Alert 090413, *Change in ITIN Decedent Policy* (Apr. 10, 2010); IRM 3.21.263.6.1.36 (Apr. 10, 2009); IRM 3.21.263.7.8 (Apr. 10, 2009).

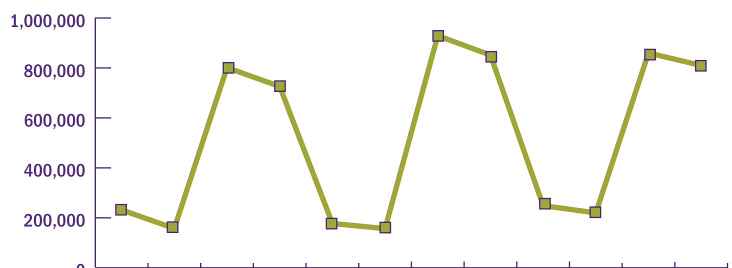
14 Instructions for Form W-7 (Jan. 2010); IRS Publication 1915, *Understanding Your IRS Individual Taxpayer Identification Number* (2010).

was not properly communicated and was burdensome and unnecessary for applicants who submitted passports.[15] The IRS updated the form instructions and agreed to process ITIN applications of dependents, including deceased minors, without birth certificates if a passport or at least two acceptable identification documents are enclosed.[16]

ITIN Processing Remains Inefficient and Causes Recurring Seasonal Bottlenecks of ITIN Applications During Peak Tax Season.

The IRS processes most ITIN applications only when they are associated with attached paper returns. As shown in Figure 1.24.1 below, this policy results in a recurring bottleneck of about 900,000 ITIN applications during peak tax return filing season.[17]

FIGURE 1.24.1, ITIN Receipts by Quarter, FY 2007 – FY 2010[18]



	FY 07	FY 2008				FY 2009				FY 2010		
	JUL-SEP	OCT-DEC	JAN-MAR	APR-JUN	JUL-SEP	OCT-DEC	JAN-MAR	APR-JUN	JUL-SEP	OCT-DEC	JAN-MAR	APR-JUN
Quarterly Receipts	231,662	157,544	801,344	726,035	177,347	156,900	929,290	851,682	248,805	219,826	860,095	809,708

15 Prior to January 2, 2009, the IRS accepted medical and school records or a national identity card for minors. IRM 3.21.263.4.7 (Oct. 14, 2008). For purposes of an ITIN application, a minor is anyone under 14 years of age (under 18 if a student). IRM 3.21.263.4.7 (Mar. 31, 2009).

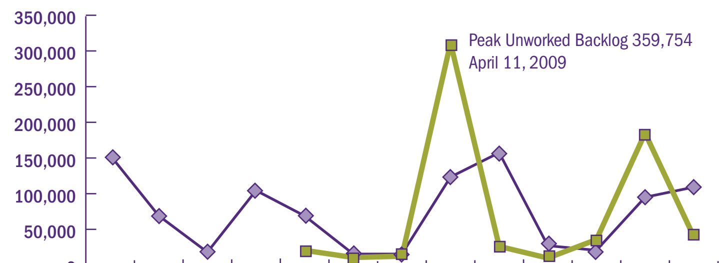
16 IRM 21.3.4.20.11 (July 24, 2009) and IRM 3.21.263.6.1.36 (Jan. 1, 2010). *See also* IRM 3.21.263.4.7 (Jan. 15, 2010). Systemic Advocacy Management System (SAMS) Project 15154 successfully negotiated the update to IRM 3.21.263.5.3.4 (July 24, 2009).

17 IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*.

18 IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*. In FY 2010, April-June figures are from the period ending June 12, 2010.

These seasonal bottlenecks strain IRS resources and create repeated backlogs of unworked and suspended ITIN applications, as illustrated by Figure 1.24.2 below.[19]

FIGURE 1.24.2, Unworked and Suspended ITIN Application Backlogs by Quarter, FY 2007 – FY 2010[20]



	FY 2007		FY 2008				FY 2009				FY 2010		
	APR-JUN	JUL-SEP	OCT-DEC	JAN-MAR	APR-JUN	JUL-SEP	OCT-DEC	JAN-MAR	APR-JUN	JUL-SEP	OCT-DEC	JAN-MAR	APR-JUN
Unworked					20,589	10,567	12,393	311,093	26,137	9,775	35,698	184,780	40,131
Suspended	153,890	69,025	18,054	104,470	68,877	15,419	15,449	123,390	157,454	27,122	20,650	95,032	109,171

On April 11, 2009, the ITIN Program Office had 360,000 *unworked* applications in inventory, of which 347,000 (97 percent) included unprocessed paper tax returns as shown on Figure 1.24.2.[21] On March 20, 2010, the IRS had another peak of unworked applications totaling 195,000, of which 192,000 (99 percent) had unprocessed paper returns.[22]

Although the peak unworked inventory declined significantly from FY 2009 to FY 2010, the year-end inventory for calendar year 2009 rose by about 29 percent from 27,000 on December 31, 2008, to 34,000 on December 31, 2009.[23] The ITIN Program Office explained the growth by citing a 27 percent increase in scheduled receipts and a planned management action to carry over sufficient inventory for training purposes.[24] The National Taxpayer Advocate is concerned that the IRS intentionally delayed the processing of ITIN

19 The IRS began measuring unworked inventory in June 2008 in response to a recommendation from the National Taxpayer Advocate's 2008 Annual Report to Congress. *See* IRS, *ITIN Production Reports, Yearly Comparative Data* (June 28, 2008), measure titled *Applications Awaiting Input. See also* National Taxpayer Advocate 2008 Annual Report to Congress 140.

20 IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*. Unless otherwise noted, all figures reflect inventory levels at the end of the quarter and do not necessarily show peak inventory. For example, the peak of 359,754 unworked ITIN applications for FY 2009 occurred in the week ending April 11, 2009 (the ending unworked ITIN inventory for the preceding quarter was 311,093 on March 28, 2009). In FY 2010, April-June figures are from the period ending June 12, 2010.

21 *Id*. All percentages hereinafter are computed from the unrounded numbers.

22 *Id. See particularly ITIN Production Report, Yearly Comparative Data* (Mar. 20, 2010).

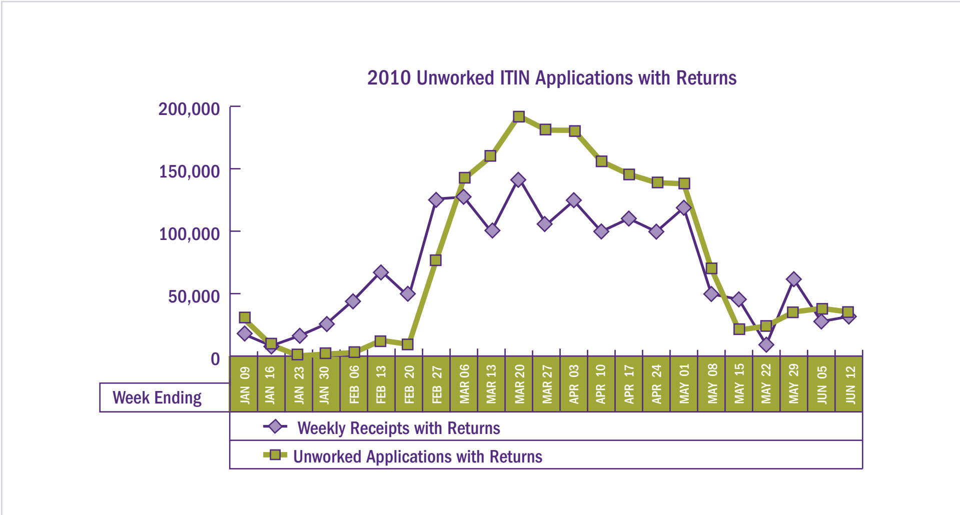
23 The IRS had 47,017 unworked ITIN applications on December 31, 2009, of which 12,700 were fraudulent cases placed in the system temporarily to allow the IRS to revoke the ITINs. E-mail from Program Manager, ITIN Policy Section (Feb. 2, 2010).

24 E-Mail from Program Manager, ITIN Policy Section (Feb. 2, 2010).

applications for training purposes. Such action unnecessarily harms affected taxpayers and is unacceptable from both tax administration and taxpayer service perspectives.

A similar comparison of unworked applications to weekly receipts from January to June 2010 (see Figure 1.24.3) shows the current policy creates a cycle in which, despite employees' best efforts, the IRS cannot keep up with ITIN applications and tax returns.

FIGURE 1.24.3, Unworked ITIN Applications with Returns, January to June 2010[25]



Current IRS Policy Delays the Processing of Hundreds of Thousands of Returns Annually When the Associated ITIN Applications are Suspended.

The seasonal strain on IRS resources also delays the processing of tax returns filed with suspended applications.[26] As Figure 1.24.2 shows, the IRS has high volumes of suspended applications during the second and third quarters of each fiscal year, corresponding to its peak return processing periods. By June 27, 2009, the IRS had 157,000 suspended applications in inventory compared to 69,000 on June 28, 2008, an increase of 129 percent.[27] Thus, a relatively small increase of roughly 128,000 applications (16 percent) in the first three months of the 2009 filing season over the previous year caused a substantial increase of about 89,000 (or 129 percent) in the suspense inventory.[28]

25 IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*. In FY 2010, April-June figures are from the period ending June 12, 2010.

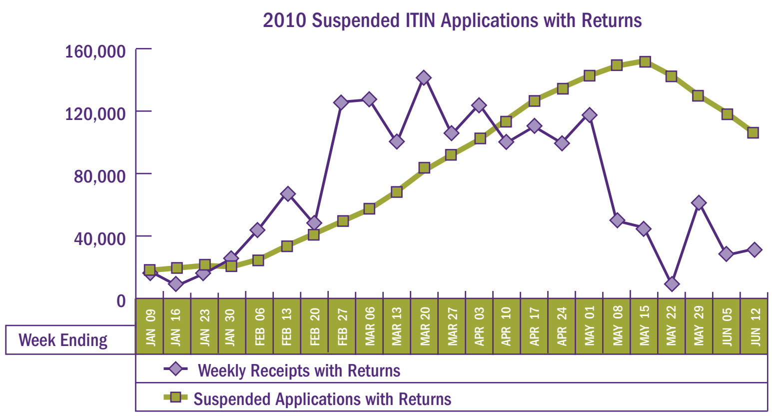
26 The IRS suspends an ITIN application if documentation necessary for its processing is missing. The associated tax return with a suspended application is also suspended and will not be processed until the suspense period has elapsed. *See* IRM 3.21.263.5.2.8(2) (Jan. 1, 2010); IRM 3.21.263.5.2.11(2) (Oct. 14, 2008).

27 IRS, *ITIN Production Report, Yearly Comparative Data* (June 28, 2008, and June 27, 2009).

28 IRS, *ITIN Production Report, Yearly Comparative Data* (Mar. 29, 2008, and Mar. 28, 2009). The IRS received 801,344 applications in 2008 compared to 929,290 in 2009.

The policy of requiring most ITIN applicants to file tax returns with their applications also requires the IRS to postpone processing those returns until it assigns or denies the ITIN. Taxpayers whose ITIN applications are suspended may experience a delay of as long as eight months in receiving refunds.[29] For example, of the 117,000 suspended applications as of April 10, 2010, 115,000 (98 percent) had associated and still unprocessed paper tax returns.[30] However, the IRS does not measure the total numbers of unworked and suspended applications and the average days for resolution on the ITIN Real Time System, its inventory management system.[31] Figure 1.24.4 below compares suspended ITIN applications filed with returns to weekly ITIN receipts, showing that the IRS's approach to ITIN processing consistently creates a large backlog of unprocessed returns. These delays impose a significant burden on taxpayers.[32]

FIGURE 1.24.4, Suspended ITIN Applications with Returns from January to June 2010[33]



29 IRM 3.21.263.7.3 (Jan. 1, 2010) and IRM 21.4.1.3 (May 10, 2010) provide standard timeframes for ITIN refund processing: a total of 16-18 weeks for issuing a refund if the ITIN application is filed during peak filing season (January 15 through April 30), and an additional 12-14 weeks from the time of mailing of any requested supporting documentation if an ITIN application was suspended.

30 IRS, *ITIN Production Report, Yearly Comparative Data* (Apr. 10, 2010).

31 IRM 3.21.263.5.11 (Oct. 14, 2008) lists the management reports currently available from the ITIN Real Time System, the database used for processing ITIN applications.

32 Foreign persons selling U.S. real property interests make up another class of taxpayers who are unduly burdened by the requirement to file a return before obtaining an ITIN. For example, escrow agents must often withhold taxes and file withholding tax returns, but without a pre-assigned TIN, problems occur when the taxpayer attempts to claim withholding on a tax return. For a description of the convoluted process of processing ITINs for Foreign Investment in Real Property Tax Act of 1980 withholding, see IRM 3.21.263.5.9.1(3) (Oct. 14, 2008). *See also* SAMS Project 16762.

33 IRS, *ITIN Production Reports, Yearly Comparative Data* (Jan. 9 through June 12, 2010).

CONCLUSION

Because most ITIN applications are attached to tax returns, the IRS must process a 12-month ITIN workload in the four-month filing season. Regular, non-seasonal processing of ITIN applications would be less burdensome to taxpayers and more efficient for the IRS. Thus, the National Taxpayer Advocate offers these preliminary recommendations:

1. Assign ITINs throughout the year upon proof of employment or self-employment; and
2. Measure the timeliness of ITIN processing on the Real Time System, including the total numbers of unworked and suspended applications and the average days for resolution.

IRS COMMENTS

ITIN Accomplishments

The IRS received over two million applications and issued over 1.8 million ITINs during 2009. Through mid-September 2010, the IRS received over 1.9 million applications and assigned over 1.6 million ITINs. These figures represent a significant increase from 1.5 million applications and less than one million ITINs assigned in 2004 and reflect the IRS's commitment to meeting the needs of non-resident and resident alien taxpayers in meeting their U.S. tax return filing and payment requirements.

We appreciate the National Taxpayer Advocate's acknowledgement of the improvements made in the ITIN program. The IRS continually strives to provide the best possible service without unduly burdening the taxpayer while preserving the integrity of the tax system. In addition to the improvements noted by the National Taxpayer Advocate, we are very pleased to report that there have been numerous additional enhancements.

The IRS implemented new mandatory training for all Acceptance Agents (AA). AAs are individuals or entities, such as colleges, financial institutions, accounting firms, etc., that have entered into formal agreements with the IRS that enable them to assist alien applicants in obtaining ITINs. Certifying Acceptance Agents (CAA) are AAs that are also authorized to verify an applicant's identity and foreign status on behalf of the IRS, thus further facilitating and streamlining the ITIN application process for these taxpayers. This training ensures all AAs and CAAs have the basic knowledge to assist resident and non-resident aliens in obtaining ITINs for federal tax administration purposes. During 2010, the IRS also implemented its first ITIN Filing Season Readiness Webinar specifically designed to provide the latest ITIN-related information and address questions or issues raised by AAs in anticipation of the coming filing season.

The IRS established quality standards and implemented a quality review program to measure the accuracy of AA submissions and delivered new reporting capabilities for use in monitoring AA activities. If an AA's quality is below established standards, the IRS now has a three-step monitoring program to improve quality that includes a warning, probation, and termination process. IRS also developed an ITIN AA Compliance Review Program that is conducted by IRS Revenue Agents on-site to evaluate the quality of AAs' adherence to program requirements. These reviews validate the accuracy of W-7 applications and ensure compliance with document retention standards and office security requirements as required in Revenue Procedure 2006-10. The thoroughness of these reviews is reflected in the fact that 237 such visits during 2010 resulted in issuance of 138 warning letters, 27 probation letters, and 50 recommendations for removal from the program.

The IRS established a standard open season from May through August for accepting AA applications. This ensures fair and equitable treatment of all applicants, gives practitioners sufficient time to apply without adversely impacting the filing season, establishes parity among practitioners, and improves the use of IRS resources. The IRS also implemented a 100 percent FBI background check for all AA applicants.

The IRS is improving the customer experience in applying for an ITIN by increasing the number of CAAs available at IRS-sponsored Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites. These sites provide free tax return preparation assistance and taxpayer education for low income and elderly taxpayers. IRS is also improving its guidance and procedures for assisting taxpayers requesting ITIN assistance at our nationwide Taxpayer Assistance Centers.

The IRS is improving its employees' experience by completely revising IRM 3.21.236 to update and clarify procedures related to the ITIN Real Time System (RTS) used by IRS employees to process ITIN applications. IRM 3.21.264 was also updated to include clear and effective procedures for accurately processing Form 13551, *Application to Participate in the ITIN Acceptance Agent Program.*

The IRS increased its efforts to reduce tax fraud by working closely with the IRS Criminal Investigation Division to identify schemes that rely on the use of ITINs to claim fraudulent refunds. Finally, the *ITIN Production Report* reflects that cycle times for W-7 applications significantly improved in 2010.

TABLE 1.24.5, Form W-7 Cycle Times

	April 11, 2009	April 10, 2010
With Return		
To Input	18 days	11 days
To Final Disposition	26 days	18 days
Without Return		
To Input	28 days	11 days
To Final Disposition	36 days	29 days

IRS Policy of Requiring ITIN Applications to Include Tax Returns

With respect to the issues raised in the report, the IRS disagrees with the report's definition and analysis of the problem, as well as the conclusions and preliminary recommendations. As noted below, we believe this analysis is flawed and that the conclusions are based on erroneous characterizations of IRS performance.

The National Taxpayer Advocate recommends the IRS allow taxpayers to obtain ITINs throughout the year without an associated return, upon proof of employment and withholding (or self-employment). The report contends the current requirement to attach a tax return to the Form W-7, *ITIN Application*, is the cause of recurring seasonal bottlenecks in processing ITIN applications. This recommendation ignores the valid tax administration purpose for the requirement to attach a return to Form W-7.

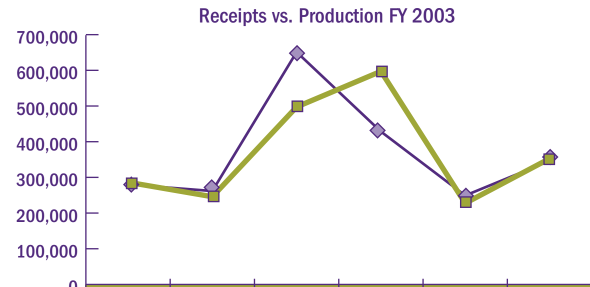
In 1996, the U.S. Department of the Treasury issued regulations that introduced the ITIN and required foreign persons to use an ITIN as their unique identification number on federal tax returns (see T.D. 8671, 1996-1 C.B. 314). These regulations were intended to address the concern by the IRS and Treasury Department that without a unique number, taxpayers could not effectively be identified and their tax returns could not be efficiently processed. As a result, ITINs are issued by the IRS to non-resident and resident alien individuals that do not have, and do not qualify for, a Social Security number (SSN). ITINs enable these individuals to comply with U.S. tax laws and provide the IRS a means to effectively process and account for their returns and payments. An ITIN does not authorize work in the U.S., establish immigration status, or provide a valid form of identification outside of the federal tax system. For this reason, the IRS does not apply the same strict standards as agencies that provide genuine identity certification, such as a requirement to apply in person or third-party verification of identity documentation.

Because most ITIN applications are received from resident aliens, in December 2003, the IRS adopted a requirement for most ITIN applicants to attach a valid tax return to their Form W-7 application. Resident aliens include non-citizens that do not have, and do not qualify to obtain, an SSN. As a result, the preponderance of ITIN applications from resident aliens employed in the U.S. represent applications from foreign nationals working in the U.S. illegally. This fact has been noted by the Government Accountability Office and the Treasury Inspector General for Tax Administration (see GAO-04-529T and TIGTA Audit # 200230050). As a result, this procedure was designed to ensure that the ITIN assigned to such alien individuals is used for its proper tax administration purpose. Associating the issuance of the ITIN with the filing of a tax return is the only reliable method for IRS to verify the number is being requested and used for tax administration purposes. As a result, ITINs are no longer issued solely based upon a statement that an applicant requires an ITIN in order to file a return without proof that the individual actually needs the number to do so.

The IRS had, and continues to have, significant and valid concerns that ITINs were being requested for non-tax purposes, such as for obtaining a driver's license. Because a growing number of states were beginning to accept ITINs for driver's license purposes, in August 2003, the IRS took the unprecedented step of sending letters to the department of motor vehicles in each state to alert them to the risks of accepting ITINs as a form of non-tax identification. In March 2004, this and related concerns about potential misuse of ITINs were also the subject of a joint hearing before the House Ways and Means Subcommittees on Oversight and Social Security. During this hearing, the General Accounting Office, now the Government Accountability Office, testified that it was able to obtain a bogus ITIN and use it for a variety of non-tax purposes that could allow someone to blend into society under a false identity. In light of these concerns, the IRS believes the requirement to attach a return to the Form W-7 ITIN application strikes a reasonable balance between the competing objectives of facilitating aliens' compliance with U.S. tax laws and ensuring, to the extent possible, that ITINs are not issued for purposes other than federal tax administration. The National Taxpayer Advocate's recommendation to assign ITINs upon proof of employment or self-employment in lieu of the requirement to file a tax return with the ITIN application will not achieve the same degree of assurance. Submission of a pay stub by a resident alien that may reflect use of a stolen or false SSN for employment (or similar claim of self-employment) does not establish or equate to the intent to file a U.S. tax return.

In support of the recommendation, the National Taxpayer Advocate maintains that the requirement to file a return with the ITIN application is inefficient and causes recurring seasonal bottlenecks of ITIN application during peak tax season. The receipt pattern shown in the report properly depicts the increase in applications immediately before and after the due date for individual tax returns. However, as reflected in the chart below, an analysis of ITIN applications received in 2003 (the year prior to the requirement to attach a tax return to the ITIN application) shows the very same increase in volume at the same time of year. As a result, the seasonal increase in applications identified by the National Taxpayer Advocate cannot be directly associated with the mandate requiring a tax return with an ITIN application. The 2003 ITIN application receipt pattern also parallels the receipt patterns for income tax returns. As a result, it is just as logical to surmise that the ITIN application receipt patterns the National Taxpayer Advocate is concerned about would continue even without the requirement to attach a return as resident-alien taxpayers focus on their return filing requirements during the filing season similar to U.S. citizens.

FIGURE 1.24.6, ITIN Applications and Production, FY 2003



	Jul-Sep 02	Oct-Dec 02	Jan-Mar 03	Apr-Jun 03	Jul-Sep 03	Oct-Dec 03
Productrion	286,412	245,809	497,399	597,235	227,469	352,519
Receipts	280,224	261,751	651,231	428,340	249,144	346,298

The report also raises concerns that the IRS intentionally delays the processing of ITIN applications for training purposes, thus further contributing to peak season inventories. The IRS does not routinely hold ITIN applications for training purposes. All classroom training utilizes manually prepared work examples (dummy applications). Once the classroom training is complete and employees report to their new jobs, generally in January/February, on-the-job (OJT) training continues as the employees work live cases. As the National Taxpayer Advocate's report reflects, there are recurring seasonal peaks of ITIN applications beginning in January at about the same time new employees are reporting to their jobs. Consequently, there is no need for the IRS to carry over live work for OJT purposes. This assertion by the National Taxpayer Advocate is based on an e-mail exchange that occurred unrelated to development of the National Taxpayer Advocate's 2010 Annual Report to Congress and that does not reflect the practice of the IRS. The IRS disagrees with the assertion in the report.

With regard to the National Taxpayer Advocate's additional concern that taxpayers who are filing an ITIN application with a tax form are not able to file electronically and may not receive their refunds as quickly as other taxpayers, it is important to note that a taxpayer must apply for and obtain an ITIN only with their initial tax return. This is necessary to ensure an ITIN is used for its intended purpose. As a result, the taxpayer is unable to file electronically for the first year only. Any subsequent years are not affected. We believe the requirement to attach a return to the ITIN application and the one-time need for an alien taxpayer to file a paper tax return is reasonable and prudent in light of the concerns outlined above.

Timeliness of ITIN Processing

The seasonal inventory figures cited in the report are largely irrelevant to the discussion of the issue. Multiple IRS programs have inventories that fluctuate. Seasonal inventories are successfully managed by the IRS's ability to plan for and work these inventories. In the ITIN program, our 2010 goal for input of applications submitted with tax returns is 11 business days, seven days less than 2009. Despite the inventories cited in the report, the *ITIN Production Report* reflects that ITIN applications with returns were input in 18 days as of mid-April 2009 and 11 days as of mid-April 2010.

The IRS also disagrees with the generalization that taxpayers whose applications are suspended may also have their refunds delayed for as long as eight months. While theoretically possible, this is not the norm and is based on the National Taxpayer Advocate's interpretation of cited IRM provisions that instruct IRS Accounts Management employees how to respond to refund inquiries. In fact, IRM 3.21.263.7.3, cited in the report, contains no tax return processing timeframes for ITIN returns at all; rather it cautions employees to refer to the guidelines for refund return processing timeframes that apply to all tax returns. IRM 21.4.1.3, also cited in the report as a basis for this statement, is the procedures used by Accounts Management employees in responding to any refund inquiries. It is important to understand that ITIN applications are only suspended because they are incomplete and IRS needs additional information from the applicants before it can properly process their applications. The maximum time allowed for any suspended application is 65 days (IRM 3.21.263.5.10.5.1), after which the IRS will reject the application and process the attached return without assigning an ITIN. However, the *ITIN Yearly Comparative Report* for the week ending April 10, 2010 (a peak period) reflects the average final disposition for ITIN applications with returns was 18 days, down from 26 days in the prior year. Final disposition is the time in days to process all ITIN applications that were complete, *and includes cases in suspense with return*. Once cases in suspense are perfected or the taxpayer fails to respond, the attached paper tax return is processed in the same manner – and with the same speed – as any other paper tax return.

Further, timeliness is measured for all categories in the ITIN program, including W-7 applications that are considered perfected, suspended, or rejected. The IRS measures cycle time from the date a W-7 application is received until its final disposition, which is the date the application is closed. The *ITIN Comparative Report* produced every week with data from the RTS system used to process ITIN applications includes the number of days for input and final disposition for every W-7 application. These measures are defined as:

- **Input:** the average number of days measured from the IRS received date to the date the application is entered on RTS.
- **Final Disposition:** the average number of days measured from the IRS received date to the date the application is either assigned an ITIN or rejected on the system. The "final disposition" includes all the time that any application is suspended prior to assignment or rejection.

RTS is a robust system. A key feature of RTS is the ability to systematically process W-7's in real-time. The system assigns the Document Locator Number (DLN) used to track all applications and either assigns a unique ITIN for the taxpayer or creates reject or suspense correspondence per automated business rules. For complete applications, RTS automatically issues an ITIN Assignment Notice by mail. The system also tracks all suspended applications and generates a rejection notice (final disposition) when the suspense period expires.

The IRS agrees that management information specific to suspended ITIN applications on RTS is limited. As the National Taxpayer Advocate is aware, the IRS has plans, contingent on funding availability, to expand and improve the management reports available through RTS to specifically monitor the status of suspended ITIN applications. Nevertheless, current timeliness measures ensure that applications submitted with tax returns are processed and refunds are issued timely.

For the reasons discussed above and as discussed in prior reports discussing this same recommendation, the IRS does not agree with the preliminary recommendations and does not plan to change its policy on this issue.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate commends the IRS for recent improvements to the ITIN Acceptance Agent Program. However, she is very disappointed with the IRS maintaining its policy of requiring ITIN applications to be filed only with paper tax returns.[34] This policy burdens applicants and artificially delays processing of over one million tax returns and associated refunds annually. The IRS maintains that receiving a return with the application is "the *only* reliable method for IRS to verify the number is being requested and used for tax administration purposes" (emphasis added). However, the IRS has offered no rationale for this statement. *Despite concerns about ITIN misuse, the IRS does not address how its refusal to issue an ITIN upon early proof of earned income may instead perpetuate the misuse or fabrication of SSNs or fake ITINs for employment purposes.*

The IRS permits an exception for ITIN assignment for a taxpayer who owns "an asset that generates income subject to IRS information reporting and/or tax withholding requirements."[35] *This inconsistent treatment of unearned and earned income for assigning ITINs essentially ignores the legal requirement to provide the taxpayer identification number regardless of the type of income at issue.*[36] Yet the IRS does not permit assignment of an ITIN based on a comparable showing of earned income from U.S. sources, such as pay stubs and affidavits, until the applicant actually files a tax return. In contrast, an employer can obtain a TIN by filing an online Employer Identification Number (EIN) application and have the EIN assigned instantly online without any proof of identity or any tax administration purpose.[37] The willingness of the IRS to issue ITINs for interest bearing accounts, and with no evidence of intent to file a tax return, deflates the IRS's argument for delaying the issuance of ITINs to applicants with earned income.

The applicable Treasury Regulation requires the individual to make an ITIN application "far enough in advance of the first required use of the IRS individual taxpayer identification number to permit issuance of the number in time for compliance with such requirement."[38] The National Taxpayer Advocate suggests that the taxpayer provides a strong evidence of the intent to file a tax return well in advance of the filing season by submitting multiple pay stubs, affidavits signed under penalty of perjury, independent contractor agreements and paychecks, etc.

The IRS also states the filing of applications under the pre-2004 regime parallels the current filing pattern, and suggests that the change in the policy advocated by the National

34 While the IRS denies electronic filing to one million ITIN returns annually, it touts that electronic filing is now preferred by 70 percent of individual filers. *See* IRS, *Nearly 70 Percent of Taxpayers Used IRS e-file in 2010*, IR-2010-112 (Nov. 10, 2010), *at* http://www.irs.gov/newsroom/article/0,,id=231381,00.html.

35 IRS Pub. 1915, *Understanding Your IRS Individual Taxpayer Identification Number* 12 (Apr. 2010).

36 IRC § 6109; Treas. Reg. § 301.6109-1(d)(3).

37 *See* EIN Online Application, *at* http://www.irs.gov/businesses/small/article/0,,id=102767,00.html (last visited Nov. 23, 2010).

38 Treas. Reg. § 301.6109-1(d)(3)(ii).

Taxpayer Advocate may not affect taxpayer filing behavior. The IRS's analysis does not consider that prior to 2004, applicants might have anticipated the need for the ITIN and requested the number at the beginning of the year when the income was earned, *e.g.*, up to one year before the tax return would become due. The post-2003 policy change resulted in a dramatic increase in both percentage and number of ITIN applications in the first two quarters of the year. While IRS receipts for June through December totaled 35.5 percent of all calendar year 2003 receipts, the receipts for the same period of CY 2009 totaled only 20.8 percent.[39] The policy change caused a statistically significant change in taxpayer behavior, leaving hundreds of thousands of taxpayers to wait until peak filing season to request an ITIN.[40]

Despite the IRS's contentions about protecting national security and deterring fraud, the IRS does not have a process for or a method of revoking dormant ITINs. The fact that the IRS does not revoke dormant ITINs undermines the IRS's claim that it cannot issue ITINs during the year due to national security concerns, despite the proof of tax-generating activity. Instead of arbitrarily and unreasonably refusing to consider the well-balanced approach to ITIN assignment proposed by the National Taxpayer Advocate,[41] the IRS should find a way to verify that previously issued ITINs have been used for tax administration purposes and systematically revoke dormant numbers after notifying the ITIN holders. This approach would help the IRS ensure that the ITINs are used for tax administration purposes, without imposing significant and unnecessary burden on this taxpayer population.

Finally, the IRS's comments do not address the National Taxpayer Advocate's concern that the IRS does not properly measure the overall ITIN process, from the receipt of an application to the acceptance of the return and release of the refund. The IRS tracks a mere average timeframe for processing all applications. It does not separately measure its two distinct work processes: one for applications that are complete and ready, and another for those that are incomplete, require follow-up contact with taxpayers, and are suspended for weeks or months. In addition, the IRS's measures of both of these processing streams do not include the ultimate processing of the suspended paper returns and associated refunds. In other words, the IRS does not measure this process from the perspective of the taxpayer's experience, which would create a sense of urgency. The IRS should measure the overall ITIN process from the time it receives the application to the time it accepts the tax return and issues the refund.

39 *See* chart *Receipts vs. Production FY 2003, supra*; IRS, *ITIN Production Reports* (Mar. 28, June 27, Sept. 26, and Dec. 31, 2009).

40 IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*.

41 The National Taxpayer Advocate recommends assignment of ITINs during the year, prior to filing season, upon proof of employment and withholding (or self-employment), *e.g.*, three consecutive pay stubs or other payment documentation, employment or independent contractor commitment letters or contracts, Forms 1099-MISC, *Miscellaneous Income, etc*.

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Assign ITINs throughout the year upon proof of employment or self-employment;
2. Develop a process to verify that previously issued ITINs have been used for tax administration purposes and revoke unused ITINs on a regular basis after notifying ITIN holders; and
3. Measure the overall ITIN process on the Real Time System, from the receipt of an ITIN application to the acceptance of the tax return, including the total numbers of unworked and suspended applications and the average days for resolution.

February 25, 2009

MEMORANDUM FOR RICHARD E. BYRD, JR.
COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Nina E. Olson
National Taxpayer Advocate

SUBJECT: Taxpayer Advocate Directive 2009-1 (Processing of Forms *W-7/Filing of ITIN Applications and Associated Tax Returns*)

TAXPAYER ADVOCATE DIRECTIVE

I am issuing this Taxpayer Advocate Directive (TAD) to direct the Commissioner, Wage and Investment Division:

1) to develop a process that allows individual taxpayers to obtain Individual Taxpayer Identification Numbers (ITINs) without an associated tax return upon proof of employment and withholding (or self-employment);[1] and

2) to develop a process for routine assignment of ITINs to deceased applicants who are otherwise entitled to a taxpayer identification number and upon proof of a legitimate tax need.

I direct that such processes be developed by and implemented prior to the 2010 filing season.

I. Authority

This TAD is being issued pursuant to Delegation Order No. 13-3, which grants the National Taxpayer Advocate the authority to issue a TAD to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers.[2] I have raised concerns, in writing (via three Annual Reports to Congress[3]), regarding the IRS policy of allowing taxpayers to submit ITIN applications only when associated with a tax return. In addition, I have raised concerns, in writing (via the 2008 Annual Report to Congress), regarding the IRS's refusal to issue ITINs for deceased individuals. Attached is

1 To address the IRS's concern that persons may seek an ITIN for a non-tax purpose, the IRS should require documentation of employment and withholding (or self-employment), *e.g.*, pay stubs, Forms 1099-MISC, *Miscellaneous Income, etc*. as proof that they will need to file a form with the IRS that requires a TIN.

2 Internal Revenue Manual (IRM) 1.2.50, *Delegation of Authorities for Taxpayer Advocate Service Activities* (Aug. 1, 2008); Delegation Order 13-3 (formerly DO-250, Rev. 1) (Jan. 17, 2001). *See also* IRM 13.2.1.5, *Taxpayer Advocate Directives* (Aug. 21, 2000).

3 National Taxpayer Advocate 2003 Annual Report to Congress 60-86; National Taxpayer Advocate 2004 Annual Report to Congress 143-62; National Taxpayer Advocate 2008 Annual Report to Congress 126-40.

the Most Serious Problem, *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*, from the National Taxpayer Advocate's 2008 Annual Report to Congress, which serves as a formal memorandum issued to the responsible operating area within the meaning of IRM 13.2.1.5.1.3 (Oct. 1, 2001), and which includes the IRS formal written response, declining to make those changes. In addition, since 2002, TAS has raised these concerns in IRS-TAS taskforces and working groups. Therefore, all procedural requirements for issuing this TAD have been satisfied.[4]

II. Background

Federal law requires individuals with U.S. income, regardless of immigration status, to pay U.S. taxes. Section 6109 of the Internal Revenue Code provides that if a person is required to file a return, statement, or other document with the IRS, the person must include an identifying number. In general, an individual required to furnish a taxpayer identifying number must use a social security number.[5] Taxpayers who are not eligible for a Social Security number must obtain an ITIN before they can file a U.S. tax return.[6] The requirement to provide a taxpayer identifying number does not end upon death; deceased individuals are also required by law to furnish a taxpayer identification number when filing returns or other documents with the IRS.

Because of concerns about the use of ITINs for nontax purposes, the IRS requires taxpayers to document their identity and tax administration need for the number before it will issue an ITIN.[7] With limited exceptions, the IRS also requires all ITIN applicants to demonstrate the need for a number by submitting the application along with a tax return filed on paper (*i.e.*, the return cannot be submitted electronically).[8] In addition, the IRS generally refuses to issue ITINs for deceased individuals as a matter of policy.

III. Reasons for Issuing This TAD

Because a taxpayer generally cannot obtain an ITIN before filing a return, the IRS receives most ITIN applications during the tax return filing season. Thus, the IRS's restriction creates a bottleneck of ITIN applications at that time.[9] This bottleneck also delays tax return

4 In advance of issuing a TAD, the National Taxpayer Advocate is required to work with and communicate with the owners of the process in order to correct the problem. IRM 13.2.1.5.1 (Aug. 21, 2000). The requirement to issue a proposed TAD was satisfied when the Most Serious Problem was submitted to the IRS for comment. Thus, the procedural requirements set forth in IRM 13.2.1.5.1.4 have been satisfied.

5 Treas. Reg. § 301.6109-1(a)(1)(ii)(A).

6 Treas. Reg. § 301.6109-1(a)(1)(ii)(B).

7 In contrast, it is much easier for an employer to obtain a TIN by filing an online Employer Identification Number (EIN) application, with the EIN assigned instantly online without any proof of identity or tax administration purpose. *See* EIN Online Application, *at* http://www.irs.gov/businesses/small/article/0,,id=102767,00.html (last visited Jan. 5, 2009).

8 For example, applicants who have income from property or an income-generating asset (*e.g.*, a savings account) may still apply for an ITIN at any time throughout the tax year, substantiating their need for an ITIN by simply attaching a letter from a third party, such as a bank or financial institution. IRS Pub. 1915, *Understanding Your IRS Individual Taxpayer Identification Number* 11 (Jan. 2009).

9 Of the 1,409,903 ITIN applications with tax returns received by September 30, 2008, at the AUSPC, 1,201,109 (or 85 percent) had been received by May 19, 2008. IRS, *ITIN SP001 Reports* (May 19, and Sept. 30, 2008).

processing and associated refunds, causing significant taxpayer burden.[10] For example, in 2005 alone, the inability to receive an ITIN before preparing and filing a paper tax return caused processing delays that affected 280,000 refunds totaling over $500 million.[11]

Due to the taxpayer burden created by these delays, in my 2003, 2004, and 2008 Annual Reports to Congress, I identified the IRS's failure to timely process ITIN applications as a Most Serious Problem.[12] In the IRS's formal response to the 2008 Most Serious Problem, *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*, it stated:

> [T]he IRS had, and continues to have, significant and valid concerns that ITINs were being requested for non-tax purposes, such as for obtaining a driver's license.... In light of these concerns, the IRS believes the requirement to attach a return to the Form W-7 ITIN application strikes a reasonable balance between the competing objectives of facilitating compliance with U.S. tax laws and ensuring, to the extent possible, that ITINs are not issued for purposes other than federal tax administration. The National Taxpayer Advocate's suggested acceptance of a pay stub in lieu of the requirement to file a tax return with the ITIN application will not achieve the same degree of assurance.[13]

I believe that a taxpayer can document the need for an ITIN without providing a return. Indeed, the IRS will issue an ITIN before receiving a return if the taxpayer owns "an asset that generates income subject to IRS information reporting and/or tax withholding requirements."[14] This inconsistent treatment of unearned and earned income for assigning ITINs ignores the legal requirement for the taxpayer to furnish a taxpayer identification number when filing returns or other documents with the IRS, regardless of the type of income at issue.[15] I have proposed a well-balanced approach to developing a process for taxpayers to obtain ITINs at any time during the year, rather than just during filing season, upon proof of employment and withholding (or self-employment), *e.g.*, pay stubs, Forms 1099-MISC, *Miscellaneous Income*, etc. Such an approach would help the IRS smooth out its workload during the year especially the logjam created when ITIN applications are received during the filing season, while allowing the taxpayers to e-file and receive their refunds expeditiously.

In my 2008 Annual Report to Congress, I expressed a concern about the IRS's policy to deny ITIN applications to deceased individuals, which causes unwarranted negative tax

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10 In addition, the IRS requirement for ITIN applicants to file paper returns is inconsistent with the congressional mandate for the IRS to achieve an 80 percent e-file rate. *See* Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 2001(a)(2), 112 Stat. 685, 723 (1998).

11 ITIN processing delays also result in other burdens as described in my 2008 Annual Report to Congress (Most Serious Problem, *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*), which is attached.

12 National Taxpayer Advocate 2003 Annual Report to Congress 60-86; National Taxpayer Advocate 2004 Annual Report to Congress 143-62; National Taxpayer Advocate 2008 Annual Report to Congress 126-40.

13 National Taxpayer Advocate 2008 Annual Report to Congress 137.

14 IRS Pub. 1915, *Understanding Your IRS Individual Taxpayer Identification Number* 11 (Jan 2009).

15 IRC § 6109; Treas. Reg. § 301.6109-1(d)(3).

consequences to their estates or, in the case of a deceased dependent, to the primary taxpayer.[16] In the IRS's formal response to the 2008 Most Serious Problem, *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*, the IRS concluded:

> [I]t was not prudent to allow ITINs for decedent applicants due to increased vulnerability of fraud, the limited tax purpose (one time use), and the IRS's limited ability to monitor and subsequently revoke the number to eliminate future use.... As a result, effective for the 2009 filing season we will make every effort to accommodate decedent ITIN applications on a case-by-case basis after a review of the particular circumstances involved in each such application.[17]

The IRS does not explain how an ITIN assigned to a decedent is any more susceptible to fraud or misuse than one assigned to a yet living applicant. As a result of the business decision to consider ITIN applications for deceased individuals only on a case-by-case basis, such deceased individuals, their estates, spouses, or dependents may be unable to secure a taxpayer identifying number and claim certain tax benefits such as personal exemption, dependency exemption, child tax credit, or a particular filing status.

I believe the IRS ITIN Policy should uniformly apply to all ITIN applicants living or deceased, upon satisfaction of documentary evidence requirements and proof of a legitimate tax need.

If you have any questions, please contact Rosty Shiller on my staff at (202) 622-4248.

Attachment (3)

cc: Linda Stiff, Deputy Commissioner, Services and Enforcement

16 National Taxpayer Advocate 2008 Annual Report to Congress 126-40.

17 National Taxpayer Advocate 2008 Annual Report to Congress 137.

Status Update: The IRS's Handling of Collection Statute Expiration Dates Continues to Adversely Affect Taxpayers

RESPONSIBLE OFFICIALS

Chris Wagner, Commissioner, Small Business/Self-Employed Division
Richard E. Byrd Jr., Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

By statute, the IRS generally has ten years from the assessment of a tax to collect the amount due.[1] The collection statute expiration date (CSED) is sometimes difficult to track because the collection period may be extended by taxpayer agreement or suspended by certain provisions of the tax code.[2] The IRS continues to miscalculate CSEDs in some instances, subjecting taxpayers to unlawful collection. According to a TAS analysis of IRS data, over 4,600 taxpayers have accounts with CSED extensions or waivers that would violate IRS policy if entered into today.[3]

ANALYSIS OF PROBLEM

IRS Responds to Excessive CSED Waiver Extensions

On January 20, 2010, the National Taxpayer Advocate issued a Taxpayer Advocate Directive (TAD) to the Commissioner of the IRS Small Business/Self-Employed Division (SB/SE) directing resolution, adjustment, or correction of all accounts with CSEDs extended beyond 15 years after assessment (plus any statutory suspensions).[4] In connection with this directive, SB/SE requested an opinion from the IRS Office of Chief Counsel on whether the IRS could terminate or modify CSED waivers on accounts exceeding current policy limits, and whether the IRS could write off or abate taxes on these accounts as "excessive in amount" under IRC § 6404(a)(1).[5]

The Office of Chief Counsel opined that the IRS cannot modify or rescind waivers extending the collection statute, eliminating an opportunity for the IRS to cancel and thereby

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1 Internal Revenue Code (IRC) § 6502(a)(1).

2 The IRS and the taxpayer may extend the statutory period for collection by agreement in connection with an installment agreement or before releasing a levy after the ten-year period. IRC § 6502(a)(2). A number of IRC sections provide the period may also be suspended by operation of law. *See, e.g.*, IRC § 6015(e)(2); IRC § 6330(e); IRC § 6331(i) & (k); IRC § 6503.

3 TAS Research data from IRS Compliance Data Warehouse (CDW) extract (Sept. 24, 2009).

4 National Taxpayer Advocate, TAD 2010-3 (Jan. 20, 2010). National Taxpayer Advocate Report to Congress FY 2011 Objectives App. VIII, 14-20 (June 30, 2010).

5 The IRS Office of Chief Counsel is legal counsel to the IRS. IRC § 7803(b)(2).

resolve waivers that violate current policy.[6] Further, Counsel concluded the IRS can only abate assessments "excessive in amount" under IRC § 6404(a)(1) if the assessments are incorrect, thereby limiting IRS authority to write off accounts with CSED extensions that violate current IRS policy to cases where administration and collection costs would not warrant collection under IRC § 6404(c).[7]

On June 10, 2010, the IRS Deputy Commissioner for Services and Enforcement responded to the TAD by agreeing that the IRS would participate in a TAS-SB/SE workgroup to review, correct, and resolve accounts with excessively long CSED extensions. The IRS stated that it will follow Counsel's guidance and abate taxes subject to these lengthy extensions only when the collection and administration costs associated with a particular account would not warrant collection.[8] Further, the IRS may employ administrative remedies, such as permanently suspending collection (including offsets) or accepting offers in compromise (OICs), to resolve these accounts.[9] In December 2010, SB/SE notified TAS that it had validated and accepted the list prepared by TAS in 2009 of over 4,600 taxpayer accounts with excessively long CSED extensions. SB/SE and TAS will now develop a data collection instrument and review the particular circumstances of the accounts. The National Taxpayer Advocate commends the IRS for being responsive to her concerns and urges the IRS to apply all due haste in resolving this problem.

The IRS Uses a Makeshift Process to Resolve CSED Errors.

Notwithstanding the progress made on excessive CSED extensions, the IRS has not attempted to centralize the operations that correct taxpayers' miscalculated CSEDs. In response to the concerns described in the National Taxpayer Advocate's 2009 Annual Report to Congress, the IRS agreed to review its training program on CSEDs to address any gaps, to monitor the accuracy of CSED computations, and change its programs as needed.[10] The National Taxpayer Advocate recognizes the IRS computes many CSEDs accurately.

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6 National Office Program Manager Technical Advice, PMTA-2010-10 (Feb. 12, 2010). Counsel relied on *Simmons v. Westover*, 76 F. Supp. 442, 450-452 (S.D. Cal. 1948), as support for the proposition that unilateral waivers of the collection statute may not be modified or rescinded. In *Simmons*, the court explained the IRS may have accepted a limited waiver with a fixed expiration to prevent the taxpayer from giving notice to unilaterally revoke an unlimited waiver, but concluded that the subsequent limited waiver was insufficient. The court suggests a taxpayer could unilaterally revoke an unlimited waiver if it lasted for an unreasonable period and was "clearly inoperative." The court also concluded it did not need to decide if unlimited waivers automatically expire because the 12-year period (including seven years of inactivity by the IRS) in *Simmons* was not an unreasonable time because the taxpayer had received the benefit he had sought – avoiding enforced collection during the period. As a result, the court's analysis might be read to suggest that under certain circumstances (not present in *Simmons*) unlimited or lengthy waivers may expire when unreasonable. Because there is no clear precedent and the statutory scheme has changed since *Simmons* was decided, the National Taxpayer Advocate will request that Counsel revisit the issue of whether a CSED waiver can be modified or rescinded.

7 *Burns v. United States*, 974 F.2d 1064 (9th Cir. 1992) (interpreting "excessive in amount" under IRC § 6404(a)(1)). *But see H & H Trim & Upholstery Co. v. Commissioner*, T.C. Memo. 2003-9 (interpreting "excessive in amount" under IRC § 6404(a)(1) as applying to abatements where it would be unfair or unjust to enforce the tax assessment).

8 IRS, Memorandum from Deputy Commissioner for Services and Enforcement re: Taxpayer Advocate Directives 2010-1, 2010-2 and 2010-3 (June 10, 2010).

9 For example, the IRS has proposed to add a new Internal Revenue Manual (IRM) provision, which would limit the number of years of future income, in calculating offers in compromise (OICs) for a taxpayer with a lengthy CSED extension, to a maximum of the original CSED or five years. *See* IRM 5.8.5.25, *Deferred Payment Offer in Compromise Received After Collection Statute Expiration Date Extension* (Oct. 22, 2010).

10 National Taxpayer Advocate 2009 Annual Report to Congress 224-225.

However, until the IRS develops a centralized unit to identify and correct CSED errors, the process creates an unacceptably high risk of harm to taxpayers.

The IRS has considerable trouble correctly computing CSEDs on accounts with multiple events such as bankruptcies, divorces, and OICs. For example, as part of the National Taxpayer Advocate's 2009 Annual Report to Congress, TAS analyzed 3,105 tax modules where the accounting procedures to separate joint accounts were done incorrectly and created erroneous CSEDs.[11] As a result, the IRS reviewed these modules but only where they had a balance due or the module was fully paid and the statutory period for refund was open.[12] The IRS determined 1,033 of the 3,105 modules, representing 681 taxpayers, had incorrect CSEDs, resulting in refunds or credits for 44 taxpayers averaging approximately $2,200 per taxpayer. The National Taxpayer Advocate is particularly troubled with this discovery in light of the stringent statutory time limitations placed on taxpayers to claim a refund. In many cases, the statute prohibits a taxpayer who does not claim a refund within two years of payment from receiving a refund.[13]

Current procedures permit IRS employees to reverse the CSED expiration code to apply subsequent payments on a balance due tax year module, even though the taxpayer is under no legal obligation to make payments on a CSED-expired account.[14] The procedures call for the IRS to send a letter to the taxpayer explaining the IRS has received a payment for a CSED-expired tax period and that the taxpayer may receive a refund, but if he or she does not respond, the IRS will apply the payments to the expired account rather than refund them.[15] The taxpayers in at least three TAS cases had payments applied to accounts with expired CSEDs.[16] In these instances, IRS employees may have mistakenly disregarded systemic CSED calculations or the taxpayers may not have received the letters, further highlighting the need for improvement in CSED handling.[17]

In the 2009 Annual Report, the National Taxpayer Advocate recommended the IRS develop a CSED calculator for employees to improve the accuracy of CSED calculations.[18] The National Taxpayer Advocate is pleased that the IRS has recently established a cross-functional team, including TAS, to address this issue. The CSED Calculator Project had its

11 *Id.* at 275-276.

12 IRC § 6511 provides that claim for credit or refund must be made no later than three years after a return is required or two years from payment, whichever is later. IRC § 6402 limits the time that a credit may be made to the applicable limitations period under IRC § 6511. The IRS did not review about 900 of the modules where the balance was full paid or had a credit balance and the period for credit or refund expired.

13 *See* IRC §§ 6402 & 6511.

14 IRM 3.17.220.2.13.1 (Jan. 1, 2010).

15 The IRS maintains the credits on expired accounts in its excess collections file until the account is closed or seven years have passed. Credits removed from excess collections will usually have exceeded the statute of limitations for refund. IRM 3.17.220.2(9) (Jan. 1, 2010). The IRS will not apply the credit to another tax year unless requested by the taxpayer. IRM 3.17.220.2.13.1(5) (Jan. 1, 2010). *See* National Taxpayer Advocate 2006 Annual Report to Congress 157-171 (Most Serious Problem: *Excess Collections*).

16 TAS, Taxpayer Advocate Management Information System CF 4305244, 4255452, and 4495313.

17 See Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers, supra*, for a discussion of problems with the IRS's handling of undelivered mail.

18 National Taxpayer Advocate 2009 Annual Report to Congress 226.

initial meeting in late August 2010 to develop a spreadsheet-based calculator to assist employees in determining the correct CSEDs on accounts.[19] The National Taxpayer Advocate is pleased with this development and looks forward to seeing an improved CSED tool for all IRS employees.

CONCLUSION

The IRS has joined TAS in establishing at least two teams focusing on CSEDs and is slowly moving forward to correct CSED problems. However, the National Taxpayer Advocate is concerned that the IRS's piecemeal approach to CSED problems will not fully resolve them. The National Taxpayer Advocate continues to urge the IRS to identify one function to take full responsibility for the accounting and management of CSED issues.

RECOMMENDATION

The National Taxpayer Advocate renews her recommendation from the 2009 Annual Report to Congress that the IRS designate a centralized CSED function whose mission is to identify and resolve CSED problems.

19 SB/SE, CSED Calculator (CCalc) – MS Excel Based Project Definition Form (approved Aug. 20, 2010).

Introduction: Legislative Recommendations

Section 7803(c)(2)(B)(ii)(VIII) of the Internal Revenue Code 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 legislative recommendations the National Taxpayer Advocate proposed in her 2001 through 2009 Annual Reports to Congress.[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 considers a taxpayer perspective. The following discussion details recent legislative activity incorporating proposals made by the National Taxpayer Advocate. The discussion is broken into two categories: Legislation Promoting Taxpayers' Rights and Legislation to Reduce the Tax Gap.

Legislation Promoting Taxpayers' Rights

- **Amend IRC § 6707A Penalty for Listed Transactions.** In 2008, the National Taxpayer Advocate raised concerns regarding the impact of IRC § 6707A.[2] At that time, section 6707A imposed 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." The penalty applies even if the taxpayer had no knowledge that the transaction was listed or questionable, even if the taxpayer derived no tax savings from the transaction, and even if the transaction is not "listed" until years after the taxpayer entered into, and filed a return reflecting, the transaction. The National Taxpayer Advocate recommended that Congress amend IRC § 6707A so that the amount of the penalty bears a proportional relationship to the amount of any tax savings realized. This year, Congress provided relief along the lines we proposed. The Small Business Jobs Act of 2010, which was signed into law, generally sets the penalty amount as a percentage of the tax savings resulting from the transaction.[3]
- **Improve Offer in Compromise Program Accessibility.** In 2006, the National Taxpayer Advocate recommended that Congress modify IRC § 7122(c) so that taxpayers are not required to include a partial payment with certain applications to the offer in compromise (OIC) program.[4] On April 14, 2010, the House passed the Taxpayer Assistance Act of 2010, which would repeal the 20 percent down payment requirement for submissions of offers in compromise.[5]

1 An electronic version of the chart is available on the TAS website at http://www.irs.gov/advocate.

2 National Taxpayer Advocate 2008 Annual Report to Congress 414-422.

3 Pub. L. No. 111-240, § 2041 (2010).

4 National Taxpayer Advocate 2006 Annual Report to Congress 507-519.

5 H.R. 4994, 111th Cong. (2010).

- **Allow Self-Employed Taxpayers to Deduct Health Insurance Premiums.** In 2004, the National Taxpayer Advocate recommended a suite of proposals to alleviate some of the significant burdens the tax code imposes on small businesses, including a recommendation allowing self-employed taxpayers to deduct the costs of health insurance premiums for purposes of self-employment taxes.[6] The Small Business Jobs Act of 2010, which was signed into law in 2010, allows self-employed taxpayers to deduct the costs of health insurance premiums for purposes of self-employment taxes.[7]
- **Repeal or Index the Alternative Minimum Tax.** In 2003, the National Taxpayer Advocate designated the alternative minimum tax (AMT) as the most serious problem faced by taxpayers.[8] The AMT, originally designed to prevent wealthy taxpayers from escaping taxation through the use of tax-avoidance transactions, has morphed into a second layer of taxation that increasingly affects middle-income taxpayers. In 2008, the National Taxpayer Advocate reiterated her recommendations that Congress repeal the AMT or revamp it substantially to achieve its original objective.[9] In 2010, legislation was introduced calling either for outright repeal of the AMT[10] or for the tax to be indexed for inflation.[11] In December, Congress passed legislation that included an additional two-year "patch" consisting of higher exemption amounts.[12]
- **Promote Awareness of and Access to Low Income Taxpayer Clinics (LITCs).** The National Taxpayer Advocate has repeatedly stressed the importance of LITCs and has asked the IRS to promote the services of LITCs and educate taxpayers about their existence.[13] The Taxpayer Assistance Act of 2010, passed by the House, authorizes the IRS to refer taxpayers to specific LITCs and increases the authorization for LITCs.[14] In addition, the Taxpayer Bill of Rights Act of 2010 (TBOR 2010) contains numerous LITC provisions, including increasing funding for LITCs, authorizing the promotion of LITCs, authorizing IRS employees to refer taxpayers to specific clinics, and including information about LITCs in notices of deficiency and collection due process notices.[15]
- **Provide greater protections for taxpayers using return preparers.** In 2002, the National Taxpayer Advocate recommended that Congress enact a registration, examination, certification, and enforcement program for federal tax return preparers.[16] The National Taxpayer Advocate reiterated these concerns in 2003.[17] In 2007, the National

6 *See* National Taxpayer Advocate 2004 Annual Report to Congress 386-402; National Taxpayer Advocate 2001 Annual Report to Congress 223.

7 Pub. L. No. 111-240 (2010).

8 National Taxpayer Advocate 2004 Annual Report to Congress 5-19.

9 National Taxpayer Advocate 2008 Annual Report to Congress 356-362 (and prior reports cited therein).

10 S. 3018, 111th Cong. (2010).

11 *See* S. 3223, 111th Cong. (2010); H.R. 5077, 111th Cong. (2010).

12 The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act, Pub. L. No. 111-312, § 202 (2010).

13 *See, e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 231-241.

14 H.R. 4994, 111th Cong. (2010).

15 S. 3215 111th Cong. (2010); H.R. 5047 111th Cong. (2010).

16 *See* National Taxpayer Advocate 2002 Annual Report to Congress 216-230.

17 *See* National Taxpayer Advocate 2003 Annual Report to Congress 270-301.

Taxpayer Advocate expressed her concern over the exploitation of taxpayers by preparers selling refund anticipation products[18] and urged the IRS to increase its enforcement of penalties on return preparers.[19] The National Taxpayer Advocate criticized the IRS for its lack of a servicewide return preparer strategy in her 2009 Annual Report to Congress.[20] TBOR 2010, introduced in the House and Senate, would address these concerns by explicitly authorizing the IRS to regulate federal income tax preparers, increasing preparer penalties, extending preparer penalties to preparation of OICs and financial statements, and regulating refund delivery products such as refund anticipation loans.[21] TBOR 2010 also would improve refund service for taxpayers by reducing refund delivery times and delivering tax refunds on debit cards,[22] which may lessen the incentive for taxpayers to purchase refund delivery products.

- **Strengthen taxpayer protections for the filing of federal tax liens.** In her 2009 Annual Report to Congress, the National Taxpayer Advocate recommended requiring the IRS to take certain steps prior to filing a lien.[23] Specifically, the IRS should have to review a taxpayer's information, weighing all the facts and circumstances, and make a determination that the lien will attach to property and that the benefit to the government outweighs the possible harm to the taxpayer and does not jeopardize the taxpayer's future ability to comply.[24] The Targeted Tax Lien Act of 2010 would require the IRS to take the steps we have recommended.[25] In addition, TBOR 2010 would require individualized lien determinations and supervisory review before the IRS can file a notice of federal tax lien.[26]
- **Codify a Taxpayer Bill of Rights.** The United States tax system is based on a tacit understanding between the government and its taxpayers that taxpayer protections encourage taxpayers to voluntarily comply with their tax obligations and protect them when they err. In her 2007 Annual Report to Congress, the National Taxpayer Advocate asked Congress to codify a taxpayer statement of rights in order to make explicit taxpayers' rights and responsibilities.[27] TBOR 2010, introduced in both the House and Senate, codifies a taxpayer statement of rights.[28]
- **Authorize the IRS to make *de minimis* apology payments to taxpayers.** In 2007, the National Taxpayer Advocate recommended that Congress give the IRS authority to make *de minimis* apology payments to taxpayers who had been seriously mistreated

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18 *See* National Taxpayer Advocate 2007 Annual Report to Congress 83-95.

19 *See id.* at 140-155.

20 *See* National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*).

21 S. 3215 111th Cong. (2010); H.R. 5047 111th Cong. (2010); *see also* H.R. 4994, 111th Cong. (2010) (allowing delivery of tax refunds on credit cards).

22 *Id.*

23 *See* National Taxpayer Advocate 2009 Annual Report to Congress 358.

24 *See Id.*

25 H.R. 6439, 111th Cong. (2010).

26 S. 3215, 111th Cong. (2010); H.R. 5047 111th Cong. (2010).

27 *See* National Taxpayer Advocate 2007 Annual Report to Congress 478-489.

28 S. 3215 111th Cong. (2010); H.R. 5047 111th Cong. (2010).

by the IRS. The authority would be vested solely in the National Taxpayer Advocate and would be nondelegable. To qualify for an apology payment, a taxpayer would have to meet established criteria and each case would have to meet the definition of significant hardship contained in IRC § 7811. The Taxpayer Advocacy and Government Accountability Promotion (TAX GAP) Act of 2010, introduced in the Senate, would create a pilot program that would allow the IRS to issue an apology payment in any case where the National Taxpayer Advocate determines that the IRS has caused an excessive or undue burden on the taxpayer.[29]

Legislation to Reduce the Tax Gap

- **Require Form 1099 Reporting for Incorporated Service Providers.** As part of a 2008 legislative recommendation on worker classification, the National Taxpayer Advocate recommended that Congress 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. The Patient Protection and Affordable Care Act, signed into law on March 23, 2010, reflected this recommendation, eliminating a reporting exemption for payments to corporate providers of property and services.[30]
- **Eliminate the $10 minimum on interest reporting for financial institutions.** In her 2007 Annual Report to Congress, the National Taxpayer Advocate addressed the problem of the cash economy and proposed both administrative and legislative recommendations to reduce the tax gap. One recommendation was to eliminate the $10 interest threshold beneath which financial institutions are not required to file Form 1099-INT reports with the IRS.[31] The TAX GAP Act of 2010 would enact this recommendation by repealing the $10 threshold and requiring the reporting of non-interest bearing financial accounts.[32]
- **Revise Form 1040, Schedule C to break out gross receipts reported on payee statements such as Form 1099.** In the 2007 Annual Report, the National Taxpayer Advocate recommended that the IRS add a line to Schedule C so that taxpayers would separately report the amount of income reported on Forms 1099 and other income not reported on Forms 1099.[33] This change to Schedule C could improve both voluntary compliance and audit selection and efficiency. The TAX GAP Act of 2010 would require the IRS to implement this recommendation.[34]
- **Include a checkbox on business returns requiring taxpayers to verify that they filed all required Forms 1099.** In 2007, the National Taxpayer Advocate recommended that

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29 S. 3795, 111th Cong. (2010).

30 Pub. L. No. 111-148 § 9006 (2010). However, this Act also contained 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, infra*.

31 *See* National Taxpayer Advocate 2007 Annual Report to Congress 501-502.

32 S. 3795, 111th Cong. (2010).

33 *See* National Taxpayer Advocate 2007 Annual Report to Congress 40.

34 S. 3795, 111th Cong. (2010).

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? If yes, did you file all required Forms 1099?"[35] The TAX GAP Act of 2010 would require the IRS to study whether placing a checkbox on business tax returns, or a similar indicator as discussed above, would affect voluntary compliance.[36]

- **Require voluntary withholding and backup withholding on certain payments upon request.** Previously, the National Taxpayer Advocate recommended that the IRS pursue authority for voluntary withholding agreements between independent contractors and service recipients as a mechanism to reduce the number of nonfilers, and that payors be required to commence backup withholding if they do not receive verification of a payee's TIN.[37] The TAX GAP Act of 2010 would require voluntary withholding on certain payments upon request of the payee and would require a payor to begin backup withholding if the IRS has not verified that the TIN furnished was correct.[38]

SUMMARY OF 2010 LEGISLATIVE RECOMMENDATIONS

We continue to advocate for the proposals we have made previously. In this report, we present eleven additional legislative recommendations, which are summarized below.

1. **Enact Tax Reform Now.** In the first section of this report, the National Taxpayer Advocate identified the complexity of the Internal Revenue Code as the most serious problem facing taxpayers and described the sources and impact of tax law complexity. In this section of the report, the National Taxpayer Advocate recommends that Congress make fundamental tax reform a high priority and approach reform in a manner similar to zero-based budgeting. To start out, the assumption should be that all tax expenditures would be eliminated unless a compelling business case can be made that the benefits of providing a tax incentive through the code outweigh the tax-complexity challenges that special rules create. Factors to consider in making this assessment include whether the government continues to place a priority on encouraging the activity for which the tax incentive is provided, whether the incentive is accomplishing its intended purpose, and whether a tax expenditure is more effective than a direct expenditure.

   The National Taxpayer Advocate further recommends that Congress place special emphasis on the protection of taxpayer rights and the minimization of burden. She suggests six core principles that should guide tax reform:

   1. The tax system should not "entrap" taxpayers.

35 National Taxpayer Advocate 2007 Report to Congress 40.

36 S. 3795, 111th Cong. (2010).

37 *See* National Taxpayer Advocate 2007 Annual Report to Congress 493-494; National Taxpayer Advocate 2005 Annual Report to Congress 238-248.

38 S. 3795, 111th Cong. (2010).

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 assistors 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.

2. **Repeal the information reporting requirement for purchases of goods over $600, but require reporting on corporate and certain other payments.** Under a provision of the health care bill enacted into law in 2010, any business that purchases $600 or more of goods from a single vendor during the course of a calendar year will have to file an information report with the IRS. Generally, third-party information reporting to the IRS significantly increases compliance by the taxpayer who receives the reported amount, thus helping to reduce the tax gap. In this case, however, the National Taxpayer Advocate is concerned that the new requirement for information reporting on goods will create a widespread administrative burden that is disproportionate to the value of the information for the IRS. We therefore recommend that Congress amend IRC § 6041 to repeal the requirement for information reports with respect to purchases of goods (as well as property of any sort). However, we also recommend that Congress retain the new requirement for information reports with respect to payments to corporations for services, determinable gains, or other income.[39] In the context of reassessing this reporting provision, we further recommend that Congress consider expanding third-party information elsewhere by eliminating the $10 threshold for certain bank information reports and by pursuing certain state data.
3. **Allow taxpayers to request equitable relief under IRC §§ 6015(f) or 66(c) at any time before the period of limitations on collection expires, and allow taxpayers to raise innocent spouse relief as a defense in collection actions.** Married taxpayers who file joint returns are jointly and severally liable for any deficiency or tax due. Spouses who live in community property states and file separate returns are generally required to report half of the community income on their separate returns. IRC §§ 6015 and 66, sometimes referred to as the "innocent spouse" rules, provide relief, including "traditional," "allocated," and "equitable" relief, from joint and several liability and from the operation of community property rules. Under IRC § 6015, both traditional and

39 The National Taxpayer Advocate has long supported information reporting as a means to increase compliance. *See* National Taxpayer Advocate 2004 Annual Report to Congress 483; National Taxpayer Advocate 2005 Annual Report to Congress 394-396; National Taxpayer Advocate 2007 Annual Report to Congress 494-496; National Taxpayer Advocate 2008 Annual Report to Congress 388.

allocated relief claims must be made within two years after the IRS initiates collection activity with respect to the taxpayer. However, neither IRC § 6015 nor IRC § 66 requires taxpayers to request equitable relief within a specified time. Nevertheless, a Treasury regulation imposes the two-year deadline for traditional and allocated relief on taxpayers claiming IRC §6015(f) equitable relief. Additional IRS guidance imposes the same deadline for claims for equitable relief from the operation of community property rules under IRC § 66. Taxpayers who seek equitable relief after the two-year period and otherwise qualify for such relief (including those who meet the requirements of traditional or allocated relief but for missing the statutory two–year deadline specifically stated in those provisions) are harmed because relief is foreclosed in situations for which IRC § 6015(f) was intended to provide a "safety valve," *e.g.*, where the delay was due to deceit or intimidation by a joint filer. The National Taxpayer Advocate recommends that Congress amend the Code to specify that taxpayers may request equitable relief under IRC §§ 6015(f) and 66(c) at any time before the expiration of the period of limitations on collection and that taxpayers may request innocent spouse relief as a defense in collection actions.

4. **Amend IRC § 6050P to remove the 36-month nonpayment period from a list of triggering events requiring a creditor to issue a Form 1099-C.** A creditor that cancels a debt is generally required to report that amount to the IRS on Form 1099-C, *Cancellation of Debt*, and a taxpayer whose debt is canceled must generally include the amount canceled in his or her income when filing a tax return. However, current Treasury regulations create a presumption that a 36-month period in which the debtor does not make a payment is a "triggering event" that requires the creditor to issue a Form 1099-C, even where the creditor is not actually discharging the debt. Thus, the creditor may be collecting the debt even as the IRS asserts the taxpayer owes additional tax based on the reported cancellation. The National Taxpayer Advocate recommends that Congress amend IRC § 6050P to remove the 36-month regulatory "testing period" as a basis on which to issue a Form 1099-C.

5. **Amend IRC § 3402(p) to require withholding on payments made for lost earnings or profits from disasters.** In significant disasters, affected taxpayers make hundreds of thousands of claims against responsible parties under federal and state laws and receive billions of dollars in payments. A vast majority of these claim payments are compensation for lost earnings or profits resulting from the disaster. Damages for non-natural disasters are generally includible in the recipient's gross income. However, unlike the wages they replace, the payments are not subject to federal income tax withholding, nor does current law allow voluntary withholding on these payments. As a result, many disaster victims with little or no experience making quarterly estimated tax payments will face a surprise year-end tax liability that they could have avoided through withholding. This situation causes hardship to taxpayers, not only because of the taxes owed, but because of the additional penalties, interest, and IRS collection actions. The National Taxpayer Advocate recommends amending IRC § 3402(p) to make withholding mandatory for payments made for lost earnings or profits from disasters.

6. **Enact a statute of limitations to limit the retroactive effect of revocation of an organization's exempt status.** Generally, charities enjoy tax-exempt status with accompanying benefits. A charity that fails to function as described in IRC § 501(c)(3), however, may lose exempt status through an IRS process known as revocation. When this occurs, the IRS typically audits a charity to determine how it operates, then revokes its exempt status and assesses tax as of the date the requirements for exemption are not satisfied. A revocation affects exempt status, but is not an assessment of tax subject to a statute of limitation, which generally limits assessment to three years after filing of the tax return. This creates a procedural loophole through which the IRS may revoke an organization's exempt status for time-barred years (*i.e.*, those for which it cannot collect additional tax). Even if a revoked organization complies with IRS requirements and then re-applies for exempt status, certain funding sources or program qualifications may have lapsed upon revocation, impeding future operation as a charity. The National Taxpayer Advocate recommends that Congress enact a statute of limitation for revocation of exempt status, generally three years, which would run from the filing of the return for the year in question. In case of substantial omission of items from the return, the statute would run for six years, and 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 as a reason for revocation.
7. **Protect Taxpayer Privacy in Whistleblower Cases.** Generally, tax return information is confidential, even if the IRS finds a deficiency, unless judicial proceedings ensue. However, whistleblower claims create a loophole by allowing public disclosure of this information without the taxpayer's knowledge or consent in proceedings to which the whistleblower – but not the taxpayer – is a party. The National Taxpayer Advocate recommends that Congress amend IRC § 7623 and other applicable provisions to require redaction of third-party return information in administrative and judicial proceedings on 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.
8. **Revise the willfulness component of the trust fund recovery penalty.** Employers are generally required to withhold employment taxes and certain types of excise taxes, often called "trust fund" taxes, from payments to employees. IRC § 6672 provides for the assessment of a Trust Fund Recovery Penalty (TFRP) against defined "responsible persons" when these monies are not paid as required. To establish liability for this penalty, the IRS must conclude that the failure to pay the trust fund taxes was willful. Willfulness is established if the person had knowledge of the employer's obligation to pay the taxes and knew the funds were being used for other purposes. The statute does not contain a "reasonable cause" exception, nor does it treat the delinquency differently if it was caused by a third party bad act such as mismanagement or embezzlement by an employee or third-party payor. The National Taxpayer Advocate recommends that Congress 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.

9. **Amend IRC § 7430 to clarify that attorney fee awards may not be retained by the government to satisfy a litigant's preexisting government debts.** IRC § 7430 provides that courts may award attorneys' fees to taxpayers who prevail against the United States in connection with the determination, collection, or refund of any tax if certain procedural requirements are met. Fee-shifting provisions like § 7430 are intended to decrease apprehension among those who feel they have been victims of unreasonable government action but who might be reluctant to challenge those actions because of the expense involved in securing representation. However, a recent Supreme Court ruling found that the attorneys' fees awarded under the Equal Access to Justice Act were payable to the litigant and thus subject to offset by the government to satisfy a litigant's preexisting but unrelated government debt. Subjecting attorney fee awards to offset for unrelated government debts of the litigant undercuts the purpose of fee-shifting statutes and creates a chilling effect on reduced fee and *pro bono* assistance. The National Taxpayer Advocate recommends that Congress amend IRC § 7430 to clarify that attorneys' fees may not be used to satisfy a litigant's preexisting government debt.

10. **Allow small business corporations to elect to be treated as S corporations by checking a box on a timely filed return.** Small business corporations may elect to be treated as flow-through entities by submitting Form 2553, *Election by a Small Business Corporation*, on or before the 15th day of the third month of its first taxable year. However, the due date for an S corporation to file Form 1120S, *U.S. Income Tax Return for an S Corporation*, is the 15th day of the third month after the end of its taxable year. Consequently, many taxpayers overlook the requirement to submit Form 2553, subjecting themselves to serious tax consequences that include taxation at the corporate level and rendering shareholders unable to deduct operating losses on their individual tax returns. The National Taxpayer Advocate recommends 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 first timely filed (including extensions) Form 1120S.

11. **Enact a Federal Agency External Ombudsman Act to protect future federal ombudsmen.** The external ombudsman function in the federal government expands yearly through both legislation and individual agency initiatives. However, these new offices often lack the basic structure and protections necessary to succeed in their varying ombuds roles. A Federal Agency External Ombudsmen Act would provide, at minimum, a basic structure and set of protections to each new ombudsman. The National Taxpayer Advocate recommends that Congress enact a Federal Agency External Ombudsmen Act to ensure protections to and create uniformity among all future federal external ombudsmen.

National Taxpayer Advocate Legislative Recommendations with Congressional Action

Alternative Minimum Tax (AMT)				
Repeal the Individual AMT 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.	Repeal the AMT outright.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	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
	S 932	Shelby	4/30/2009	Referred to the Finance Committee
Legislative Activity 110th Congress	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 1365	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
	S 2293	Lott	11/1/2007	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 464
Legislative Activity 109th Congress	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 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
	S 1967	Clinton	8/2/2007	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 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	Referred to the Finance Committee
	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 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.	Create an effective oversight and penalty regime for return preparers by taking the following steps: ◆ 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 check-box on all returns in which preparers would enter their category of return preparer (*i.e.*, 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 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
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 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
	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 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.			
	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 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 4318	Crowley/ Ramstad	12/6/2007	Referred to the Ways & Means Committee
	S 2851	Bunning	4/14/2008	Referred to the Finance 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

Refund Delivery Options National Taxpayer Advocates 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.			
	Bill Number	**Sponsor**	**Date**	**Status**
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 Senate Finance Committee
	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
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. 111-124, § 2041 STAT 2560 (2010).**			
	Bill Number	**Sponsor**	**Date**	**Status**
	S725	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 sub-chapter 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**
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
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, *U.S. Income Tax Return for an S Corporation*.			

	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
Regulation of Payroll Tax Deposits Agents National Taxpayer Advocate 2004 Annual Report to Congress 394-399.	Require payroll services to meet certain qualifications to protect businesses that use payroll service providers from tax deposit fund misappropriation or fraud.			
	Bill Number	**Sponsor**	**Date**	**Status**
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
Tax Gap Provisions				
Corporate Information Reporting National Taxpayer Advocate 2008 Annual Report to Congress 388.	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.			
	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
Reporting on Customer's Basis in Security Transaction National Taxpayer Advocate 2005 Annual Report to Congress 433-441.	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.			
Legislative Activity 110th Congress	**Pub. L. No. 110-343, § 403, 121 Stat. 3854, 3855 (2008).**			
	Bill Number	**Sponsor**	**Date**	**Status**
	HR 878	Emanuel	2/7/2007	Referred to the Ways & Means Committee
	S 601	Bayh	2/14/2007	Referred to the Finance Committee
	S 1111	Wyden	4/16/2007	Referred to the Finance Committee
	HR 2147	Emanuel	5/3/2007	Referred to the Ways & Means Committee
	HR 3996 PCS	Rangel	10/30/2007	11/14/2007–Placed on the Senate Calendar; became Pub. L. No. 110-166 (2007) without this provision
Legislative Activity 109th Congress	S 2414	Bayh	3/14/2006	Referred to the Finance Committee
	HR 5176	Emanual	4/25/2006	Referred to the Ways & Means Committee
	HR 5367	Emanual	5/11/2006	Referred to the Ways & Means Committee
IRS Promote Estimated Tax Payments Through the Electronic Federal Tax Payment System (EFTPS) National Taxpayer Advocate 2005 Annual Report to Congress 381-396.	Amend IRC § 6302(h) to require the IRS to promote estimated tax payments through EFTPS and establish a goal of collecting at least 75 percent of all estimated tax payment dollars through EFTPS by fiscal year 2012.			

	Bill Number	Sponsor	Date	Status
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
Study of Use of Voluntary Withholding Agreements National Taxpayer Advocate 2004 Annual Report to Congress 478-489; National Taxpayer Advocate 2005 Annual Report to Congress 381-396.	Amend IRC § 3402(p)(3) to specifically authorize voluntary withholdings agreements between independent contractors and service-recipients as defined in IRC § 6041A(a)(1).			
	Bill Number	**Sponsor**	**Date**	**Status**
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
Require Form 1099 Reporting for Incorporated Service Providers National Taxpayer Advocate 2007 Report to Congress 494-496.	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.			
Legislative Activity 111th Congress	**Pub. L No. 111-148 § 9006 (2010).** 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, infra.			
Require Financial Institutions to Report All Accounts to the IRS by Eliminating the $10 Threshold on Interest Reporting National Taxpayer Advocate 2007 Report to Congress 501–502.	Eliminate the $10 interest threshold beneath which financial institutions are not required to file Form 1099-INT reports with the IRS.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Senate Finance Committee
Revise Form 1040, Schedule C to break out gross receipts reported on payee statements such as Form 1099 National Taxpayer Advocate 2007 Report to Congress 40.	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.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Include a Checkbox on Business Returns Requiring Taxpayers to Verify that they Filed all Required Forms 1099 National Taxpayer Advocate 2007 Report to Congress 40.	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.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Authorize Voluntary Withholding Upon Request National Taxpayer Advocate 2007 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 When TINs Cannot Be Validated National Taxpayer Advocate 2005 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
Taxpayer Bill of Rights and *De Minimis* "Apology" Payments				
Taxpayer Bill of Rights National Taxpayer Advocate 2007 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 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Ways & Means Committee
	HR 5047	Becerra	4/15/2010	Referred to the Senate Finance Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
***De Minimis* "Apology" Payments** National Taxpayer Advocates 2007 Report to Congress 490.	Grant the National Taxpayer Advocate the discretionary, nondelegable authority to provide *de minimis* 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 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 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).**			
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 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 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
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 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: ◆ § 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 2004 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).**			
Partial Payment Installment Agreements				
National Taxpayer Advocate 2001 Annual Report to Congress 210-214.	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.			
Legislative Activity 108th Congress	**Pub. L. No. 108-357, § 833, 118 Stat. 1589-1592 (2004).**			
Penalties and Interest				
Interest Rate and Failure to Pay Penalty				
National Taxpayer Advocate 2001 Annual Report to Congress 179-182.	Repeal the failure to pay penalty provisions of IRC § 6651 while revising IRC § 6621 to allow for a higher underpayment interest rate.			
	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
Interest Abatement on Erroneous Refunds				
National Taxpayer Advocate 2001 Annual Report to Congress 183-187.	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.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 109th Congress	HR 726	Sanchez	2/9/2005	Referred to the Ways & Means Committee
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
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
	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 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
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				
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 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 2004 Annual Report to Congress 471-477.	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 2861	Schumer	4/15/2008	Referred to the Finance Committee
Office of the National 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 2002 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 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Senate 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
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 108th 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
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. 1546-1548 (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

LR #1

Enact Tax Reform Now

PROBLEM

In the first section of this report, the National Taxpayer Advocate identified the complexity of the Internal Revenue Code as the most serious problem facing taxpayers. We described the sources and impact of complexity as well as some of the key obstacles to achieving fundamental reform.[1] In this section, we offer some principles and proposals to streamline the tax code.

RECOMMENDATIONS

As a threshold matter, we note that the terms "tax reform" and "tax simplification" are not necessarily synonymous. The term "reform" suggests a more fundamental revision of the tax code, and in theory, the code could be "reformed" in a way that adds complexity. By contrast, the term "simplification" suggests reducing complexity but does not necessarily imply a comprehensive revision. Simplifying discrete provisions that are particularly confusing for large numbers of taxpayers would fit within this definition.

In the first section of this report, we described the magnitude of the burden the existing tax code imposes. Overall compliance consumes an estimated 6.1 billion hours a year – the equivalent of more than three million full-time workers. The monetary compliance burden for the median taxpayer (as measured by income) comes to more than $250 a year. The tax code has grown so long that no one can even determine how long it is, with one measurement suggesting it has reached 3.8 million words.

We further discuss the breadth of "tax expenditures," a term that generally encompasses any reduction in revenue attributable to an exclusion, exemption, or deduction from gross income or a credit, preferential tax rate, or deferral of tax.[2] Tax expenditures now total about $1.1 trillion a year. As compared with about 138 million individual tax returns filed in 2010,[3] that translates to an average reduction in tax per return of about $8,000.[4] Moreover, tax is computed as a percentage of income. Therefore, for example, a taxpayer who pays a 25 percent tax rate may be benefiting from deductions or exclusions from income worth $32,000 (*i.e.*, a reduction in taxable income of $32,000 produces a reduction

1 *See* Most Serious Problem, *The Time for Tax Reform Is Now*, *supra*.

2 Congressional Budget and Impoundment Control Act, Pub. L. No. 93-344, § 3(3) (1974).

3 *See* IRS 2010 Filing Season Statistics *at* http://www.irs.gov/newsroom/article/0,,id=220953,00.html (last visited Dec. 27, 2010).

4 Tax expenditures have interactive effects, so if all tax expenditures were simultaneously eliminated, the change in revenue would likely be somewhat less than $1.1 trillion. Accordingly, the average tax reduction per taxpayer could be somewhat less than $8,000. Nevertheless, this total represents a reasonable approximation and is used for illustrative purposes in this report. *See* Leonard Burman, Eric Toder & Christopher Geissler, *How Big Are Total Individual Income Tax Expenditures, and Who Benefits from Them?* Discussion Paper 31, Amer. Soc. Sci. Assoc'n (New Orleans, La., Jan. 5, 2008) 3, shorter version published in 98 *Amer. Econ. Rev*. 79 (2008) (stating that despite interaction effects, "commentators have added up tax expenditures to make general statements about their magnitude").

in tax of $8,000 when the tax rate is 25 percent).[5] Few taxpayers recognize the extent of tax expenditures, but because the system is so complex, many suspect that well-advised taxpayers are taking advantage of loopholes while they themselves are paying full freight. Some likely feel justified in "fudging" on their taxes to right the perceived unfairness. This suspicion and cynicism are not good for the tax system, nor for tax compliance. Indeed, among taxpayers who have a choice about reporting their income, compliance rates are well under 50 percent.[6]

For these reasons, the National Taxpayer Advocate has become convinced that fundamental tax reform – not merely *ad hoc* simplification – is required. However, the National Taxpayer Advocate has previously offered numerous simplification proposals that still have merit and should be considered as part of an overall tax reform effort. Below we suggest several fundamental principles that should help guide tax reform and then summarize notable simplification recommendations from past reports.

General Principles

In attempting to reform the tax code, a threshold challenge that the new Congress will face is balancing tax administration considerations with other policy objectives. From a tax administration perspective, tax expenditures are to be avoided. The rationale is simple: Every exclusion, deduction, credit, or other deviation from the general concept of taxing total income at a specified rate of tax introduces complexity into the tax code.

At the same time, we recognize that competing policy objectives exist. For example, the mortgage interest deduction arose from the desire to encourage home ownership; the exclusions for retirement plan contributions and employer contributions for health insurance are designed to increase retirement savings rates and health insurance coverage, respectively; the deduction for charitable contributions aims to encourage taxpayers to support organizations that seek to advance the common good; the earned income tax credit (EITC) seeks to promote work and raise low income families out of poverty. The evidence is mixed concerning the extent to which these tax incentives encourage more of the behavior they seek to induce,[7] and some of these objectives may be better accomplished through direct expenditures rather than through tax expenditures. Still, tax expenditures are generally motivated by legitimate policy objectives, so Congress must carefully balance the tax administration interests of simplification against other policy priorities.

5 Tax expenditures are discussed in more detail elsewhere in this report. *See* Most Serious Problem: *The Time for Tax Reform Is Now, supra, and Evaluate the Administration of Tax Expenditures*, vol. 2, *infra*). These sections note that the largest tax expenditures include the exclusion for employer-provided health care, the exclusion for retirement plan contributions and earnings, and the mortgage interest deduction for owner-occupied housing.

6 IRS studies show that non-farm sole proprietors report only 43 percent of their business income and unincorporated farming businesses report only 28 percent. *See* IRS News Release, *IRS Updates Tax Gap Estimates*, IR-2006-28 (Feb. 14, 2006) (accompanying charts at http://www.irs.gov/newsroom/article/0,,id=154496,00.html). As low as these rates are, they would be even lower if not for the fact that some of this income is reported to the IRS by third parties.

7 For a more complete discussion, see *Evaluate the Administration of Tax Expenditures*, vol. 2, *infra*.

Our suggestion is to approach tax reform in a manner similar to zero-based budgeting. To start the discussion, the assumption should be that all tax expenditures would be eliminated. Then a tax benefit would be added back only if a compelling business case can be made that the benefits of providing the benefit through the tax code outweigh the tax-complexity challenges it creates. Factors to consider in making this assessment include whether the government continues to place a priority on encouraging the activity for which the tax incentive is provided, whether the incentive is accomplishing its intended purpose, and whether a tax expenditure is more effective than a direct expenditure for achieving that purpose.[8]

The immediate elimination of certain tax benefits could cause hardships for individuals or businesses where established pricing or conduct is based on those provisions. For example, homeowners paid a purchase price that took into account the federal subsidy provided through the mortgage interest deduction. Sudden elimination of that deduction would cause the value of existing homes to drop substantially. If Congress decides to eliminate tax incentives in situations like this, transitional relief should be provided.

This approach, at a conceptual level, is similar to two other proposals presented during the past year. In December 2010, the National Commission on Fiscal Responsibility and Reform issued a report that, among other things, also recommended a zero-based budgeting approach to tax reform.[9] In February 2010, Senators Wyden and Gregg introduced legislation that would substantially revamp the tax code.[10] While we do not endorse specific proposals, we think both are thoughtful and worthy starting points.

In addition to suggesting a zero-based budgeting approach to tax reform, we believe the protection of taxpayer rights and minimization of taxpayer burden should be emphasized along with the IRS's ability to administer the law. Toward those ends, we suggest six core principles that should help guide the development of tax reform legislation:

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 assistors can fully and accurately answer taxpayers' questions.

8 The National Taxpayer Advocate has previously discussed design elements that should be considered when running social benefit programs through the tax code. *See* National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, *Running Social Programs through the Tax System*.

9 *See* National Commission on Fiscal Responsibility and Reform, *A Moment of Truth*, at 28-34 (Dec. 2010) *at* http://www.fiscalcommission.gov/news/moment-truth-report-national-commission-fiscal-responsibility-and-reform. The mandate of the commission was to address the nation's long-term fiscal challenges, and as a result, its tax reform recommendations are partly designed to increase revenue. It is beyond the mission of the National Taxpayer Advocate to take a position on these broader fiscal issues. However, we note that the question of whether and to what extent to raise revenue is extremely contentious, and we are concerned that the debate over revenue levels could overshadow and derail meaningful tax reform. Therefore, we suggest it may be more productive for Congress to consider these issues in two steps. First, Congress could enact systemic reforms to the tax code on a revenue-neutral basis. Second, Congress could decide on appropriate revenue levels and adjust the tax rates accordingly.

10 Bipartisan Tax Fairness and Simplification Act, S. 3018, 111 Cong. (2010).

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.
6. The tax system should incorporate a periodic review of the tax code – in short, a sanity check.[11]

Finally, we offer one recommendation that, while not a general principle, would help make taxpayers more aware of the connection between the taxes they pay and the benefits they receive. We recommend that Congress direct the IRS to provide each taxpayer with a "taxpayer receipt" presenting a general breakdown of how federal dollars are spent.

One commentator has noted:

> Sending taxpayers a one-page summary of Federal spending is a big step toward a more rational discussion of debt and deficits. Polls show Americans think over 50 percent of the Federal budget is wasted; liberals think it all goes to wars, conservatives think it all goes to welfare and foreign aid. If people knew that half the budget goes to Social Security, Medicare, Medicaid and interest on the debt, everyone would recognize the need for tough choices on taxes and spending.[12]

From a tax administration standpoint, we believe better awareness of how our tax dollars are spent would increase the sense that "we're all in this together" and potentially improve attitudes toward tax compliance.[13]

Simplification Proposals

Over the past decade, this office has made numerous proposals to simplify various sections or areas of the tax code. While these proposals were not written with the goal of structural tax reform in mind, they should be considered as part of an overall tax reform process.

Repeal the Alternative Minimum Tax (AMT) for Individuals. Few people think of having children or living in a high-tax state as a tax-avoidance maneuver, but under the unique logic of the AMT, that is essentially how those actions are treated. The AMT effectively

11 The National Taxpayer Advocate previously articulated these principles in a presentation to the President's Advisory Panel on Federal Tax Reform. *See* Public Meeting of the President's Advisory Panel on Federal Tax Reform (Mar. 3, 2005) (statement of Nina E. Olson, National Taxpayer Advocate), *at* http://www.taxreformpanel.gov/meetings/meeting-03032005.shtml. For more detail, see National Taxpayer Advocate 2005 Annual Report to Congress 375-380 (Key Legislative Recommendation: *A Taxpayer-Centric Approach to Tax Reform*).

12 Comment of Steve Novick, posted on website of Senator Ron Wyden *at* http://wyden.senate.gov/imo/media/doc/statements.pdf.

13 A "taxpayer receipt" would be relatively easy to generate. The IRS already provides a high-level breakdown of federal spending in the Form 1040 instructions booklet. *See* Form 1040 Instructions (2009), at 100. This information could be provided in somewhat more detail and mailed or provided electronically to each taxpayer. Third Way, a liberal advocacy group, has promoted the idea, and the Tax Foundation, a conservative group, has supported it. *See* Laura Saunders, *Tracking Your Federal Tax Dollars*, Wall Street Journal, Nov. 6, 2010, *at* http://online.wsj.com/article/SB100014240527487045064045755929004545472226.html?KEYWORDS=%22taxpayer+receipt%22.

requires taxpayers to compute their taxes twice – once under the regular tax rules and again under the AMT rules – and then to pay the higher of the two amounts. The regular rules allow taxpayers to claim tax deductions for each dependent (recognizing the costs of maintaining a household and raising a family) and for taxes paid to state and local governments (reducing "double taxation" at the federal and state levels), but the AMT rules disallow those deductions. An estimated 77 percent of all additional income subject to tax under the AMT is attributable to the disallowance of deductions for dependents and state and local tax payments. The AMT computations are also extremely burdensome. The National Taxpayer Advocate has recommended that the AMT be repealed. Moreover, we note that if tax expenditures are substantially reduced, the AMT would be rendered largely irrelevant.[14]

Consolidate the Family Status Provisions. Notwithstanding the improvements brought about by enactment of a Uniform Definition of a Child in 2004, the tax code's family status provisions continue to ensnare taxpayers and make tax administration difficult simply because of the number of such provisions and their structural interaction. These provisions include filing status, personal and dependency exemptions, the child tax credit, the EITC, the child and dependent care credit, and the separated spouse rule under IRC § 7703(b). Many of the eligibility requirements – such as support or maintenance costs of the home – are difficult for the IRS to verify without conducting audits into taxpayers' personal and private lives. The National Taxpayer Advocate has recommended that, as part of a comprehensive reform of the tax code's tax treatment of families, Congress consolidate the numerous existing family status-related provisions into two categories: (1) a Family Credit and (2) a Worker Credit. The refundable Family Credit would reflect the costs of maintaining a household and raising a family, while the refundable Worker Credit would provide an incentive and subsidy for low income individuals to work.[15]

Improve Other Provisions Relating to Taxation of the Family Unit. The tax code currently imposes "joint and several liability" on married persons who file a joint federal income tax return. This concept dates back to the early years of the income tax when a husband was typically the sole wage earner for the family unit. Today, husbands and wives often have separate assets and incomes that they do not equally control. Recognizing that it is inequitable to hold one spouse liable for tax on the other spouse's income, at least in cases where he or she does not know about the income of the other spouse and does not

14 The National Taxpayer Advocate has repeatedly identified the AMT as a serious problem for taxpayers and has recommended its repeal in prior reports and congressional testimony since 2001. *See* National Taxpayer Advocate 2008 Annual Report to Congress 356-362 (Legislative Recommendation: *Repeal the Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2006 Annual Report to Congress 3-5 (Most Serious Problem: *Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2004 Annual Report to Congress 383-385 (Legislative Recommendation: *Alternative Minimum Tax*); National Taxpayer Advocate 2003 Annual Report to Congress 5-19 (Most Serious Problem: *Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2001 Annual Report to Congress 166-177 (Legislative Recommendation: *Alternative Minimum Tax for Individuals*); *see also Alternative Minimum Tax: Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways & Means* (March 7, 2007) (statement of Nina E. Olson, National Taxpayer Advocate); *Blowing the Cover on the Stealth Tax: Exposing the Individual AMT: Hearing Before the Subcomm. on Taxation and IRS Oversight of the Senate Comm. on Finance* (May 23, 2005) (statement of Nina E. Olson, National Taxpayer Advocate).

15 *See* National Taxpayer Advocate 2008 Annual Report to Congress 363-369 (Legislative Recommendation: *Simplify the Family Status Provisions*); National Taxpayer Advocate 2005 Annual Report to Congress 397-406 (Legislative Recommendation: *Tax Reform for Families: A Common Sense Approach*).

significantly benefit from it, Congress has enacted relief rules. However, these relief rules are complex, do not always produce the right result, and impose a large burden on the "innocent spouse" to prove his or her case. The National Taxpayer Advocate has recommended several steps to improve equity and simplify the rules, including eliminating joint and several liability for joint filers.[16]

The "kiddie tax" rules are another family-related area of taxation that create significant burden for some taxpayers. The tax code currently taxes a minor child's unearned income above a certain threshold at the parent's tax rate. The parent must decide whether to file a separate return for the child or include the child's income on the parent's own return. The calculations required to determine which option is preferable in a particular case are complex. Moreover, if the child's parents are separated, additional complications arise. If a custodial parent has been designated, the child's income must be included on that parent's return. If no custodial parent has been designated, the law requires the tax to be computed by reference to the return of the parent with the greater taxable income. During a divorce proceeding, however, spouses sometimes conceal their assets or income from the other spouse, making compliance with these rules impractical. The National Taxpayer Advocate has recommended that the unearned income of minor children above a specified threshold be taxed at a higher rate and that the link between the computation of the child's tax liability and the parent's tax return be severed.[17]

Consolidate Education Savings Tax Incentives. The tax code contains at least 11 separate incentives to encourage taxpayers to save for and spend on education. The eligibility requirements, definitions of common terms, income-level thresholds, phase-out ranges, and inflation adjustments vary from provision to provision. The point of a tax incentive, almost by definition, is to encourage certain types of economic behavior. However, taxpayers will only respond to incentives if they know they exist and understand them. Few, if any, taxpayers are aware of each of the education tax incentives and familiar enough with the particulars to make wise choices. The National Taxpayer Advocate has recommended that Congress consolidate incentives and harmonize definitions and other terms to the extent possible.[18]

Consolidate Retirement Savings Tax Incentives. The tax code contains at least 16 separate incentives to encourage taxpayers to save for retirement. These incentives are subject to different sets of rules governing eligibility, contribution limits, taxation of contributions and distributions, withdrawals, availability of loans, and portability. Similar to education incentives, the large number of options and lack of common definitions and terms can

16 *See* National Taxpayer Advocate 2005 Annual Report to Congress 407-432 (Legislative Recommendation: *Another Marriage Penalty: Taxing the Wrong Spouse*); *see also* National Taxpayer Advocate 2001 Annual Report to Congress 128-165 (Legislative Recommendation: *Joint and Several Liability*).

17 *See* National Taxpayer Advocate 2002 Annual Report to Congress 231-242 (Legislative Recommendation: *Children's Income*).

18 *See* National Taxpayer Advocate 2008 Annual Report to Congress 370-372 (Legislative Recommendation: *Simplify and Streamline Education Tax Incentives*); National Taxpayer Advocate 2004 Annual Report to Congress 403-422 (Legislative Recommendation: *Simplification of Provisions to Encourage Education*).

preclude taxpayers from making wise choices or understanding how each incentive works. The National Taxpayer Advocate has recommended that Congress 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.[19]

Simplify Worker Classification Determinations to Minimize Employee-versus-Independent Contractor Disputes. The complexity of, and ambiguities in, the existing worker classification rules create uncertainty and lead to noncompliance. In general, businesses are only required to pay and withhold employment tax, withhold income tax, and provide benefits with respect to employees. Consequently, businesses often classify workers as independent contractors to reduce their costs. Some employees seeking to avoid their tax obligations may also prefer to be classified as contractors if the employer does withhold taxes or report the payments for employees to the IRS. Depending on the terms of the relationship between a business and a worker, however, many workers should be classified as independent contractors. The National Taxpayer Advocate has recommended that Congress (1) replace § 530 of the Revenue Act of 1978 with a provision applicable to both employment and income taxes and require the Secretary to issue associated guidance, including guidance with specific industry focus; (2) direct the IRS to develop an electronic tool to determine worker classifications that employers would be entitled to use and rely upon, absent misrepresentation; (3) allow both employers and employees to request classification determinations and seek recourse in the United States Tax Court; and (4) direct the IRS to conduct outreach and education campaigns to increase awareness of the rules as well as the consequences associated with worker classification.[20]

Eliminate (or Reduce) Procedural Incentives for Lawmakers to Enact Tax Sunsets. The tax code contains more than 100 provisions that are temporary and set to expire soon, up from about 21 in 1992. Tax benefits have increasingly been enacted for a limited number of years in order to reduce their cost for budget-scoring purposes. Tax sunsets make it difficult for both the government and taxpayers to plan ahead, especially when it is uncertain whether Congress will extend a provision that is set to expire. The complexity and uncertainty caused by sunsets make it more difficult for taxpayers to estimate liabilities and pay the correct amount of estimated taxes, complicate tax administration for the IRS, reduce the effectiveness of tax incentives, and may even reduce tax compliance. The National

19 *See* National Taxpayer Advocate 2008 Annual Report to Congress 373-374 (Legislative Recommendation: *Simplify and Streamline Retirement Savings Tax Incentives*); National Taxpayer Advocate 2004 Annual Report to Congress 423-432 (Legislative Recommendation: *Simplification of Provisions to Encourage Retirement Savings*).

20 *See id.* at 375-390 (Legislative Recommendation: *Worker Classification*).

Taxpayer Advocate has suggested several ways for Congress to reduce or eliminate the procedural incentives to enact temporary tax provisions.[21]

Eliminate (or Simplify) Phase-Outs. More than half of all individual income tax returns filed each year are affected by the phase-out of certain tax benefits as a taxpayer's income increases. There are, in fact, legitimate policy reasons for using phase-outs in certain circumstances. Like tax sunsets, however, phase-outs are largely used to reduce the cost of tax provisions for budget-scoring purposes. Moreover, phase-outs are burdensome for taxpayers, reduce the effectiveness of tax incentives, and make it more difficult for taxpayers to estimate their tax liabilities and pay the correct amount of withholding or estimated taxes, possibly reducing tax compliance. Phase-outs also create marginal "rate bubbles" – income ranges within which an additional dollar of income earned by a relatively low income taxpayer is taxed at a higher rate than an additional dollar of income earned by a relatively high income taxpayer. Because Congress could achieve a similar distribution of the tax burden based on income level by adjusting marginal rates, phase-outs introduce unnecessary complexity to the Code. The National Taxpayer Advocate has recommended that Congress repeal phase-outs or at least reassess them individually to ensure that they are necessary to accomplish their intended objective.[22]

Streamline the Penalty Regime. The number of civil tax penalties has increased from about 14 in 1954 to more than 130 today. The last comprehensive reform of the tax code's penalty provisions was enacted in 1989, after careful study by Congress, the IRS, and others. Since then, legislative and administrative changes to the penalty regime have proceeded piecemeal, but without the kind of careful analysis conducted in 1989. The National Taxpayer Advocate has recommended that Congress direct the IRS to (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. Congress should appropriate additional funds for this research, as necessary. In the meantime, based on penalty reform principles identified in 1989, the National Taxpayer Advocate recommended 11 steps that could be taken immediately.[23]

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21 *See* National Taxpayer Advocate 2008 Annual Report to Congress at 397-409 (Legislative Recommendation: *Eliminate (or Reduce) Procedural Incentives for Lawmakers to Enact Tax Sunsets*).

22 *See id*. at 410-413 (Legislative Recommendation: *Eliminate (or Simplify) Phase-outs*).

23 *See* National Taxpayer Advocate 2008 Annual Report to Congress 414-418 (Legislative Recommendation: *Reforming the Penalty Regime*, and vol. 2 (Research Study: *A Framework for Reforming the Penalty Regime*).

LR #2

Repeal Information Reporting on Purchases of Goods but Require Reporting on Corporate and Certain Other Payments

PROBLEM

In 2012, a business that purchases $600 or more worth of goods from a single vendor will have to start collecting data for an information report reflecting the aggregate purchase price associated with the vendor's Taxpayer Identification Number (TIN) for filing with the IRS, with a copy to the vendor.[1] The intent of this provision may have been to capture income unreported by vendors or to verify deductions claimed by purchasers. However, if it was the former, the resulting burden appears excessive with respect to the affected portion of the tax gap, and if it was the latter, the legislated mechanism unnecessarily involves a third party. In any case, more efficient means of obtaining data are available.

EXAMPLE

ABC Associates, a non-profit service organization, purchases paper, pens, toner cartridges, and other office supplies from the local XYZ Office Supply, Inc., a big box retailer, aggregating to $700 for 2012. ABC, which had to track all of its purchases by vendor to identify those receiving at least $600, must solicit XYZ's TIN to prepare Form 1099-MISC, *Miscellaneous Income*, reporting the gross purchase amount to the IRS by February 28, 2013. ABC must also provide a copy of the Form 1099-MISC to XYZ by January 31, 2013, when all other similarly situated business customers must also report to XYZ.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 6041 to repeal the requirement for information reports on purchases of goods (as well as property of any sort). Retain the new requirement for information reports on payments to corporations for services, determinable gains, or other income. Expand third-party data by eliminating the $10 threshold for certain bank information reports and by pursuing certain state data.

PRESENT LAW

Generally, aggregate annual payments of $600 or more to a payee for services, determinable gains, or other income, made in the course of a trade or business, are subject to information reporting.[2] Under a longstanding regulatory exception that was repealed by a provision in the Patient Protection and Affordable Care Act of 2010, payments to a corporation before

Legislative Recommendations

1 *See* Internal Revenue Code (IRC) § 6041 as amended by the Patient Protection and Affordable Care Act of 2010 (PPACA), Pub. L. No. 111-148, Title IX, Subtitle A, § 9006 (2010).

2 In addition to compensation for services, the information report requirement covers interest, "rents, royalties, annuities, pensions, and other gains, profits, and income." Treas. Reg. § 1.6041-1(a)(1)(i)(B); *see also* IRC § 6041A.

2012 generally were exempt from information reporting.[3] Further, PPACA made gross purchase amounts for goods (as well as property of any sort) reportable after 2011.[4]

Information reports are also required for annual payments of interest aggregating to $10 or more to a payee, generally on Form 1099-INT, *Interest Income*.[5] As a matter of data-sharing, the taxpayer privacy law permits the IRS to disclose return information to state tax agencies subject to safeguards.[6] Federal tax law generally does not govern state tax agencies' data or IRS use of those data.

REASONS FOR CHANGE

Generally, third-party information reporting to the IRS significantly increases compliance by the taxpayer who receives the reported amount, thus helping to reduce the tax gap. However, the new requirement for information reporting on goods will create a widespread administrative burden that is disproportionate to the value of the information for the IRS. The National Taxpayer Advocate's Fiscal Year 2011 Objectives Report to Congress discusses the burdens, starting with TIN collection and recordkeeping, followed by paper or electronic filing, and culminating in matching or mismatching, with potential penalties, at the IRS. Additionally, this PPACA requirement could have distortionary economic effects to the extent that purchasers may favor large vendors with recordkeeping capacity.[7]

Because purchases of goods are so common, small businesses and even non-profit organizations (totaling over 38 million with other affected entities)[8] will not escape the burden of filing paper information reports if they are not required to file electronically.[9] Nor would raising the threshold amount alleviate the burden because tabulation of all purchases by vendor TIN would still be necessary to determine if the threshold is reached. Exemption of a defined class of small businesses could relieve that burden but would introduce a tax-based distortion into decisions on business size. Ultimately, exemptions from information reporting limit the accuracy of data for IRS research purposes.

Meanwhile, the utility to tax administration of gross purchase amounts is unclear. Even if these amounts are reported, they represent only a first step in determining vendor income which, for instance, may be reduced by the cost of goods sold. On the other hand, if a provision is necessary to verify deductions by a purchaser, a requirement of a particular form

3 *See* Treas. Reg. § 1.6041-3(p)(1).

4 Treas. Reg. § 1.6041-3(c) excepts payments for merchandise. Rev. Rul. 81-232, 1981-2 C.B. 231, indicates that a payment for merchandise incidental to a service is included in the reportable amount. *But see* Rev. Proc. 2004-43, 2004-2 C.B. 124 (allowing certain payers to rely on merchant category codes to determine reportability).

5 *See* IRC § 6049.

6 *See* IRC § 6103(d)(1), (p)(8).

7 *See* National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress 9-13.

8 *See Id*. at 10.

9 *See* IRC § 6011(e)(2)(A); Treas. Reg. § 301.6011-2 (applying e-filing to 250 or more returns).

of receipt could accomplish this goal without impinging on the vendor.[10] Finally, third-party data can be enhanced by other recommendations, such as those on bank account reporting and state data matching, that do not impose significant administrative burdens on business taxpayers and use data the IRS has already collected.

EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate has long supported information reporting as a means to increase compliance.[11] In particular, the corporate exception is outmoded now that a significant number of businesses, including small businesses, are incorporated.[12] At the same time, repeal of the corporate exception relieves payers of the burden of investigating whether a merchant is incorporated or takes another organizational form. Even if a corporation's fiscal year results in a mismatch with calendar year information reporting, itemization of monthly amounts can achieve reconciliation.[13] Consequently, the National Taxpayer Advocate recommends retention of the PPACA provision that repealed the regulatory exception to information reporting on payments to corporations.

At the same time, the information reporting law and regulations distinguish in various places between determinable gains that represent income and other amounts that may be misleading.[14] Given the limited utility of gross purchase amounts for tax administration coupled with the mass burden required to collect the information, the National Taxpayer Advocate recommends repeal of the recently enacted requirement.

To enhance information reporting, the National Taxpayer Advocate has recommended elimination of the $10 threshold for interest reporting by modifying the requirement to encompass deposits.[15] Not only would this step reduce sorting burden for payers, but it effectively would apprise the IRS of the existence of all accounts, even those that do not bear interest, potentially deterring taxpayers from underreporting amounts deposited, and leading to greater accuracy by the IRS in selecting returns for audit.[16]

If further relevant programs are to be considered, the National Taxpayer Advocate has recommended that the IRS expand matching of reported gross receipts with state sales tax

10 *See* IRC § 170(f)(8), (f)(17) (requiring a particular form of receipt – even for cash transactions in any amount – for charitable deductions).

11 *See* National Taxpayer Advocate 2004 Annual Report to Congress 483; National Taxpayer Advocate 2005 Annual Report to Congress 394-396; National Taxpayer Advocate 2007 Annual Report to Congress 494-496; National Taxpayer Advocate 2008 Annual Report to Congress 388.

12 In fact, the majority of corporate taxpayers are S corporations. In 2009, S corporations filed 4.5 million returns, compared with 2.5 million returns filed by other corporations. *See* IRS *Data Book* (2009) Table 2 at 4.

13 *See* Treas. Reg. § 1.6050W-1(h)(2)(ii)(B), 75 Fed. Reg. 49,833 (Aug. 16, 2010) (requiring monthly amounts on information reports of gross purchases by credit and debit card).

14 *See* IRC § 6041(a); Treas. Reg. § 1.6041-3 (excepting from information reports payment for merchandise, excludable payments for services abroad, deductible employee expense reimbursements, certain excludable interest, payments to certain tax-exempt entities, etc.).

15 *See* National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, § 1, 16.

16 *See* Taxpayer Advocacy and Government Accountability Promotion Bill, S. 3795, 111th Cong., 2nd Sess. § 106 (2010) (containing provisions that would repeal the $10 threshold while requiring information reports on non-interest bearing deposits, which potentially could be reported in a similar form with $0 interest).

and other data to identify unreported income.[17] The success of these efforts so far may indicate that it is time to formalize these programs.[18]

17 *See* National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, § 1, 17-18.

18 *See* National Taxpayer Advocate 2009 Annual Report to Congress 174.

LR #3

Allow Taxpayers to Request Equitable Relief Under Internal Revenue Code Section 6015(f) or 66(c) at Any Time Before Expiration of the Period of Limitations on Collection and to Raise Innocent Spouse Relief as a Defense in Collection Actions

PROBLEMS

Married taxpayers who file joint returns are jointly and severally liable for any deficiency or tax due.[1] Spouses who live in community property states and file separate returns are generally required to report half of the community income on their separate returns.[2] Internal Revenue Code (IRC) §§ 6015 and 66, sometimes referred to as the "innocent spouse" rules, provide relief from joint and several liability and from the operation of community property rules. In addition to providing for relief in specific circumstances as described in subsections 6015(b), 6015(c), and 66(c), each statute grants the IRS the authority to establish procedures for relieving a spouse of liability when, in consideration of all the facts and circumstances, it would be inequitable to hold the spouse liable. These latter provisions are known as "equitable relief." Neither IRC § 6015 nor IRC § 66 requires taxpayers to request equitable relief within a specified time. However, a Treasury regulation provides that a taxpayer must request equitable relief from liability arising from a joint return under IRC § 6015(f) within two years after the IRS initiates collection activity with respect to the taxpayer.[3] Additional IRS guidance imposes the same deadline for claims for equitable relief from the operation of community property rules under IRC § 66.[4] Taxpayers who seek relief after the two-year period are harmed because relief is foreclosed in situations for which IRC § 6015(f) was intended to provide a "safety valve," *e.g.*, where the delay was due to deceit or intimidation by a joint filer.[5] The U.S. Tax Court recently held the regulation invalid, and although the decision was reversed by the U.S. Court of Appeals for the Seventh Circuit,[6] the Tax Court adheres to its position in cases appealable to other Courts of Appeals.[7] The IRS maintains that the regulation is a valid interpretation of IRC § 6015(f) and has appealed the issue to other Courts of Appeal.[8] As discussed in detail in Volume

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1 Internal Revenue Code (IRC) § 6013(d)(3); Rev. Proc. 2003-61, 2003-2 C.B. 296.

2 *Poe v. Seaborn*, 282 U.S. 101 (1930).

3 Treas. Reg. § 1.6015-5(b)(1) .

4 Rev. Proc. 2000-15, §§ 4.01(3) and 5, 2000-1 C.B. at 448, 449, *superseded by* Rev. Proc. 2003-61, §§ 4.01(3) and 5, 2003-2 C.B. at 297, 299.

5 As the Tax Court noted in *Hall v. Comm'r*, 135 T.C. No. 19, slip op. at 12 (Sept. 22, 2010), "application of the 2-year limits in subsections (b) and (c) makes subsection (f) ineffective in situations where an innocent spouse is unaware of the need to or unable to contact the IRS for some of the very reasons that Congress considered in enacting section 6015. For example, a spouse is sometimes subject to abuse by a partner. The abuse can take many forms. Where a spouse is prevented from acting by fear, intimidation, or fraud, an administrative procedural hurdle would eliminate consideration of relief by the IRS. The Secretary did not allow any exception even for extreme cases, but rather adopted a strict time bar that requires the IRS to deny relief without any consideration of the facts and circumstances."

6 *Lantz v. Comm'r*, 132 T.C. 131 (2009), *reversed and remanded by* 607 F.3d 479 (7th Cir. 2010).

7 *See Hall v. Comm'r*, 135 T.C. No. 19 (Sept. 22, 2010).

8 *E.g., Mannella v. Comm'r*, 132 T.C. 196 (2009), *appeal docketed*, No. 07-175310 (3rd Cir. Jan. 25, 2010); *Coulter v. Comm'r*, Tax Court Docket No. 1003-09, *appeal docketed*, No. 10-680 (2d Cir. Feb. 24, 2010); *Buckner v. Comm'r*, Tax Court Docket No. 12153-09, *appeal docketed*, No.10-2056 (6th Cir. Aug. 18, 2010); *Jones v. Comm'r*, Tax Court Docket No. 17359-08, *appeal docketed*, No. 10-1985 (4th Cir. Aug. 30, 2010).

2 of this report, the National Taxpayer Advocate believes that the language and legislative and administrative history of IRC § 6015 and its predecessor IRC § 6013(e) make clear that Congress did not intend to limit claims for equitable relief to a two-year window.[9] While the courts will ultimately settle this question, in the meantime, taxpayers are harmed by both the IRS's continued enforcement of the two-year rule and the uncertainty in the law. Therefore, the National Taxpayer Advocate recommends that Congress explicitly state that a taxpayer may raise a claim for relief under IRC § 6015(f) and § 66(c) at any time before the statutory period for collecting the tax expires.

EXAMPLE 1

In *Lantz v. Commissioner*,[10] Mrs. Lantz's spouse, Dr. Chentnik, had income from Medicare fraud that he did not report when he prepared the couple's 1999 joint return. Mrs. Lantz was unaware of the fraud and relied on her husband to resolve the tax issue that arose when it was discovered. In his correspondence with the IRS, Dr. Chentnik, who was incarcerated at the time, characterized Mrs. Lantz as an innocent spouse and asked that the IRS send him the appropriate forms so he could claim innocent spouse relief on behalf of Mrs. Lantz. Dr. Chentnik died in a halfway house without requesting relief on Mrs. Lantz's behalf or informing her that he had not requested innocent spouse relief. When Mrs. Lantz requested equitable relief under IRC § 6015(f), the IRS denied her claim because she had not requested relief within two years of the first collection activity. The IRS concedes that Mrs. Lantz would be entitled to relief under IRC § 6015(f) if her claim had been timely filed.

In addition to the problem of the two-year rule, the National Taxpayer Advocate has identified a disturbing trend of restricting a taxpayer's ability to raise IRC § 6015 as a defense in collection suits in district court.[11] This development continues to harm taxpayers.[12]

EXAMPLE 2

A taxpayer ("W"), whose English proficiency was extremely limited, filed jointly with her husband ("H") in 1985 and 1986.[13] Unbeknownst to W, H had income from his sole proprietorship, which he used to support his mistress. The IRS discovered the income and assessed a total of $35,000 in taxes and penalties for the two years. H hid from W all notices pertaining to the tax assessment and collection efforts. Years later, after H abandoned his wife and family and fled the country, the United States reduced the liens to judgment.

9 For a more detailed discussion of this topic and recommendation, see *Unlimit Innocent Spouse Equitable Relief*, vol. 2, *infra*.

10 132 T.C. 131 (2009), *reversed and remanded by* 607 F.3d 479 (7th Cir. 2010).

11 *See* National Taxpayer Advocate 2007 Annual Report to Congress 631; National Taxpayer Advocate 2008 Annual Report to Congress 524; National Taxpayer Advocate 2009 Annual Report to Congress 487.

12 *See* Most Litigated Issue, *Relief from Joint and Several Liability Under Internal Revenue Code Section 6015, infra.*

13 This example is generally based on a case in which the National Taxpayer Advocate, when she was Executive Director of the Community Tax Law Project in Richmond, Virginia, served as the taxpayer's representative.

W learned about the tax liability when the IRS offset her Earned Income Tax Credit refund and about the judgment when she attempted to refinance her home. When W sought innocent spouse relief, more than two years had elapsed since the IRS's first collection activity. In 1997, almost ten years after the IRS assessed the tax and initiated collection activity, the IRS abated the tax against W and refunded all amounts collected from her as permitted under IRC § 6511(b)(2)(B).[14] Under these facts today, W would be ineligible for innocent spouse relief under IRC § 6015(b) or (c) because she did not submit her claim within the *statutory* two-year period, and would be barred from IRC § 6015(f) relief by the *regulation's* two-year limit.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that Congress amend IRC §§ 6015 and 66 to specify that:

1. Effective with respect to any liability for tax arising after the date of enactment and any liability for tax arising on or before such date but remaining unpaid as of such date, taxpayers may request equitable relief at any time before expiration of the period of limitations on collection,[15] regardless of whether the taxpayer previously received a final administrative determination denying as untimely a request for equitable relief for the same tax year or meaningfully participated in a prior proceeding in which equitable relief for the same tax year was denied as untimely; and
2. 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.

CURRENT LAW

IRC § 6015(f) and the flush language of IRC § 66(c), in identical terms, provide for equitable relief where "taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or any deficiency (or any portion of either)." IRC § 6015 (e)(1)(A) provides that an individual who seeks relief from joint liability may, "in addition to any other remedy provided by law" petition the Tax Court to determine the

14 If a claim for credit or refund is filed within two years of a payment on the underlying tax liability (but not within three years of a return filing), IRC § 6511(b)(2)(B) limits the credit or refund to amounts paid during the two years immediately preceding the claim.

15 *See* IRC § 6502.

appropriate relief available. Other statutory provisions and judicial precedent make clear that taxpayers may raise IRC § 6015 relief in a variety of contexts.[16]

REASONS FOR CHANGE

As discussed in greater detail in Volume 2 of this report, innocent spouse relief was first enacted in 1971 and was revised in 1984, but prior to 1998 the innocent spouse provisions did not contain a statute of limitations.[17] From 1971 until 1998, nothing impeded the IRS from considering claims for relief under IRC § 6013(e) at any time before expiration of the statutory period of limitations on collection, generally ten years after the date the tax is assessed.[18] The innocent spouse provisions were revised as part of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98)[19] because, according to the Senate Committee on Finance, "the innocent spouse provisions of present law are inadequate."[20] While statutory limitation periods were explicitly stated for relief under IRC § 6015 (b) and (c), RRA 98 was silent as to the time limit within which taxpayers must request equitable relief, thereby implicitly retaining for IRC § 6015(f) relief the general statute of limitation period for collection actions.[21]

Equitable relief under IRC §6015(f) is "a safety-valve provision for innocent spouses who fall through cracks in (b) or (c)."[22] In hearings that preceded enactment of RRA 98, witnesses who were ineligible for relief under IRC § 6013(e) described to the Senate Committee on Finance how (1) they had not learned of the underlying assessment because their spouses hid IRS notices or (2) they were unaware that the tax had not been paid because their

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16 *See* IRC §§ 6320(c) and 6330(c)(2)(A)(i) (pertaining to collection due process proceedings); IRC § 6213 and *Corson v. Comm'r*, 114 T.C. 354, 363 (2000) (pertaining to deficiency proceedings); 11 U.S.C.§ 505(a) (pertaining to bankruptcy proceedings); and IRC § 7422 (pertaining to refund suits). *See also Pollock v. Comm'r*, 132 T.C. 21 (2009). In *Pollock*, the United States filed a collection suit seeking to foreclose its lien on the residence of the putative innocent spouse. The district court stayed the proceedings to permit the taxpayer to file a petition for relief in the Tax Court. In holding that the doctrine of equitable tolling did not apply to the 90-day period for filing a Tax Court petition, the court noted that "Perhaps not all hope is lost – the Commissioner conceded at oral argument that if [the taxpayer] filed a refund action in District Court after her home was seized and sold, [the taxpayer] could try to make her case that she is an innocent spouse." 132 T.C. at 37 n. 21. The Tax Court had earlier held in *Thurner v. Comm'r* that *res judicata* barred the taxpayer from raising IRC § 6015 as a defense in the Tax Court proceeding because the taxpayer could have raised IRC § 6015 as a defense in a prior collection suit. 121 T.C. 43 (2003).

17 *See* Pub. L. No. 91-679 (adding IRC § 6013(e)); Pub. L. No. 98-369, sec. § 424, 98 Stat. 801 (1984) (expanding the class of understatements for which innocent spouse relief was available).

18 IRC § 6502(a). However, if a court proceeding to collect the tax is brought, such as a suit to reduce a tax liability to judgment, the period of limitations on collection is extended. Therefore, the period of limitations on collection could exceed ten years and a claim for innocent spouse relief would be valid at any point during that time.

19 Pub. L. No.105-206, sec. 3201(a), (b), 112 Stat. 685 at 734, 739.

20 S. Rep. 105-174, accompanying H.R. 2676 (enacted as RRA 98), 105th Cong., 2nd Sess. (1998) at 55.

21 *See General Motors Corp. v. U.S.*, 496 U.S. 530, 538 (1990); *Russello v. U.S.*, 464 U.S. 16, 23 (1983) (stating "where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion").

22 *Lantz v. Comm'r*, 607 F.3d 479 at 484 (7th Cir.2010). As the conference report accompanying H.R. 2676 (enacted as RRA 98) stated, "The conferees do not intend to limit the use of the Secretary's authority to provide equitable relief to situations where tax is shown on a return but not paid. The conferees intend that such authority be used where, taking into account all the facts and circumstances, it is inequitable to hold an individual liable for all or part of any unpaid tax or deficiency arising from a joint return. The conferees intend that relief be available where there is both an understatement and an underpayment of tax." H.R. Conf. Rep. No. 105-599, 105th Cong., 2nd Sess. 254-255 (1998).

spouses had assured them it had been taken care of. Several of the witnesses learned about the tax debt many years after assessment and the initiation of collection activity.[23]

The IRS, by subjecting § 6015(f) claims to the same new limitations period as claims under (b) and (c), tightens the safety valve Congress provided. Moreover, the equitable relief provisions were part of a statutory scheme intended to address the perceived inadequacy of prior law; delay in claiming equitable relief may arise because of the very circumstances for which Congress intended to provide relief.[24] If not for the IRS's interpretation of the time limits for claiming equitable relief, which the Tax Court held was invalid, changes to the statutes would be unnecessary. However, because taxpayers are being harmed while this issue is litigated in the courts, the National Taxpayer Advocate recommends that Congress act to reaffirm the availability of the safety valve without the time limit imposed by the regulation.[25]

Although statutory provisions and judicial precedent make clear that taxpayers may raise IRC § 6015 in a variety of contexts,[26] taxpayers are harmed when district courts refuse to consider their innocent spouse claims as a defense in collection suits.[27] The National Taxpayer Advocate first identified this disturbing trend in 2007, and the Taxpayer Advocate Service continues to see this issue from time to time.[28] Therefore, Congress should clarify that the defense can be raised in all proceedings brought under any provisions of title 26 of the United States Code, including an action under IRC § 7402 to reduce federal tax assessments to judgment and a suit under IRC § 7403 to foreclose a tax lien on real property, or any case under title 11.

EXPLANATION OF RECOMMENDATION

The first recommendation would specify that taxpayers may request equitable relief without regard to the time that elapses between the commencement of collection activity and the request for relief. As long as the period of limitations for collection of the liability remains open, taxpayers may request innocent spouse relief with respect to deficiencies

23 Sen. Comm. on Finance, *IRS Restructuring Hearings*, 105th Cong., 2nd Sess. (Jan. 28-29; Feb. 5, 11 & 25, 1998).

24 *See Unlimit Innocent Spouse Equitable Relief*, vol. 2, *infra*, for a discussion of the similarity between innocent spouse cases described in 1998 congressional testimony and recent cases in which relief was denied because the claim was untimely.

25 The National Taxpayer Advocate previously recommended making it explicit that a taxpayer may request equitable relief from liabilities under IRC § 6015(f) or IRC § 66(c) at any time the IRS could collect such liabilities (*i.e.*, any time before expiration of the statute of limitations on collection). National Taxpayer Advocate 2006 Annual Report to Congress 540 (Legislative Recommendation: *Eliminate the Two-Year Limitation Period for Taxpayers Seeking Equitable Relief Under IRC § 6015 or § 66*).

26 See note 16, *supra*.

27 *See, e.g., U.S. v. Wallace*, 105 A.F.T.R.2d 2827 (S.D. Ohio Apr. 28, 2010), *adopted by* 105 A.F.T.R.2d (RIA) 2831 (S.D. Ohio June 8, 2010); *U.S. v. Pollock*, No. 06-80903 (S.D. Fla. filed Sept. 27, 2006); *U.S. v. Boynton*, 99 A.F.T.R.2d (RIA) 920 (S.D. Cal. 2007); *U.S. v. Bucy*, 100 A.F.T.R.2d (RIA) 6666 (S.D. W. Va. 2007); *U.S. v. Cawog*, 97 A.F.T.R.2d (RIA) 3069 (W.D. Pa. 2006), *appeal dismissed* (3d Cir. 2007); *U.S. v. Feda*, 97 A.F.T.R.2d (RIA) 1985 (N.D. Ill. 2006).

28 The National Taxpayer Advocate twice recommended that legislation clarify that taxpayers may raise relief under IRC §§ 6015 and 66 as a defense in collection actions. National Taxpayer Advocate 2007 Annual Report to Congress 549; National Taxpayer Advocate 2009 Annual Report to Congress 378. For a discussion of *U.S. v. Wallace*, a case in which the issue arose this year, see Most Litigated Issue: *Relief from Joint and Several Liability Under Internal Revenue Code Section 6015, supra*.

and underpayments. The provision should be effective with respect to any liability for tax arising after the date of enactment and any liability for tax arising on or before such date but remaining unpaid as of such date.[29] Additionally, allowing taxpayers whose requests for equitable relief were previously denied as untimely to obtain relief, in light of removal of the two-year period, would require careful drafting of the effective date in order to extend relief to taxpayers who were previously denied equitable relief solely because the claim was made more than two years after collection activity commenced, as long as the period of limitations on collection has not expired. In the case of credits or refunds, taxpayers would still be subject to the general requirements and time limitations found in IRC § 6511. This recommendation would be consistent with Congress' intent in enacting the innocent spouse rules, would correct the IRS's misinterpretation of the statutes, and would avert a potential conflict among the Courts of Appeals. The second recommendation would clarify that, consistent with the statutory language of IRC § 6015 and other statutory and judicial provisions, taxpayers may raise IRC § 6015 as a defense in district court collection suits. This recommendation would avert further confusion as to whether the defense is allowed in district court collection suits, and would provide uniformity among district courts.

29 The effective date of IRC § 6015 as originally enacted was identical, applying to "any liability for tax arising after the date of the enactment of this Act and any liability for tax arising on or before such date but remaining unpaid as of such date." Pub. L. No. 105-206, sec. 3201(g)(1), 112 Stat. 685 at 740. Moreover, when IRC § 6015 was amended in 2006 to clarify that the Tax Court has jurisdiction to review "stand alone" cases under IRC § 6015(f) (*i.e.*, petitions filed in response to a notice of determination, or after the claim has been pending for more than six months, where no deficiency has been asserted), the effective date of the amendment was similar, applying "with respect to liability for taxes arising or remaining unpaid on or after the date of the enactment of this Act." Pub. L. No. 109-432, sec. 408(c), 120 Stat. 2922, 3062.

LR #4

Remove the 36-Month "Testing Period" that May Trigger Cancellation of Debt Reporting[1]

PROBLEM

A creditor that cancels a debt is generally required to report that amount to the IRS on Form 1099-C, *Cancellation of Debt*, and a taxpayer whose debt is canceled must generally include the amount canceled in his or her income when filing a tax return.[2] An exception to this general rule applies if the taxpayer was insolvent when the debt was canceled. As discussed in greater detail elsewhere in this report,[3] creditors issued Forms 1099-C to record numbers of taxpayers in recent years.[4] However, under Treasury regulations, a creditor may legitimately issue a Form 1099-C even though it is not actually discharging a debt.[5] Thus, a creditor can collect the debt even as the IRS proposes additional tax due to the reported cancellation of the same debt.

EXAMPLE

D incurred a debt in December 2006, but because she was unemployed did not make any payments for 36 months. In January 2010, D's creditor issued a Form 1099-C, as permitted by the applicable Treasury regulations, which do not prohibit a creditor from continuing to collect the debt even after issuing the form. The creditor continued to collect the debt. D did not report the "canceled" debt on her 2009 tax return. The IRS's automated document matching system identified a discrepancy between the amount D's creditor reported on Form 1099-C and the amount of canceled debt D reported on her return, and issued a Notice CP 2000, in which it proposed to increase D's tax liability based on the discrepancy.[6]

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 6050P to repeal the 36-month regulatory "testing period" as a basis on which to issue a Form 1099-C.

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1 For a more detailed discussion of this topic and recommendation, see Most Serious Problem: *Third-Party Reporting of Cancellation-of-Debt Events is Not Always Accurate, and the IRS's Reliance on Such Reporting May Burden Taxpayers, supra.*

2 Internal Revenue Code (IRC) §§ 61(a)(12), 6050P(a). Treas. Reg. §1.6050P-1(a) requires creditors that discharge an indebtedness of at least $600 during any calendar year to file a Form 1099-C information return with the IRS.

3 Most Serious Problem: *Third-Party Reporting of Cancellation-of-Debt Events is Not Always Accurate, and the IRS's Reliance on Such Reporting May Burden Taxpayers, supra.*

4 Almost half the taxpayers who were issued a Form 1099-C in 2008 were low income, and in addition to facing additional tax on "canceled" debt, they faced losing earned income tax credits (EITC). *See* Most Serious Problem: *Third-Party Reporting of Cancellation-of-Debt Events is Not Always Accurate, and the IRS's Reliance on Such Reporting May Burden Taxpayers, supra.*

5 Treas. Reg. § 1.6050P-1(a)(1). Moreover, a creditor may threaten to issue a Form 1099-C as a means of pressuring a debtor to pay. *See* Jacob Barron, *Leveraging Uncle Sam, Getting the Threat of the IRS Behind Your Collection Effort*, National Association of Credit Management, *Business Credit*, June 2008.

6 The Notice CP 2000 is the first step toward assessment of the tax and in this sense is an enforcement measure. The IRS issued 214,858 Notices CP 2000 in 2007 and TAS analyzed a random sample of 316 taxpayers to whom they were issued (TAS Notice CP 2000 sample). The Notice CP 2000 was issued *solely* on the basis of a Form 1099-C to 71 taxpayers in the Notice CP 2000 sample. *See* Most Serious Problem: *Third-Party Reporting of Cancellation-of-Debt Events is Not Always Accurate, and the IRS's Reliance on Such Reporting May Burden Taxpayers, supra.*

CURRENT LAW

IRC § 61(a)(12) provides that a taxpayer's gross income includes income from the discharge of indebtedness. Whether a creditor has forgiven a debt is a question of fact.[7] Prior to 1993, the Code did not require lenders to file information returns with respect to discharged debts.[8] IRC § 6050P was enacted in 1993 in part "to encourage taxpayer compliance with respect to discharged indebtedness" and "to enhance the ability of the IRS to enforce the discharge of indebtedness rules."[9] Section 6050P requires certain financial entities to report to the IRS discharges of indebtedness of $600 or more during any calendar year, and to provide a copy of the report to the person whose debt was discharged.[10] Congress did "not intend that this provision alter the present law determination of when a discharge of indebtedness occurs under section 61(a)(12)."[11] While a creditor's failure to report canceled debt was made subject to a penalty,[12] there is no penalty for issuing a Form 1099-C when a debt was not actually canceled.

Temporary regulations under IRC § 6050P issued in 1993 provided, in relevant part, "For purposes of this section, indebtedness will be considered discharged upon the occurrence of an identifiable event indicating that the indebtedness will never have to be paid by the debtor, *taking into account all the facts and circumstances*"[13] (emphasis added). A creditor's collection efforts were one of the facts and circumstances to be taken into account in determining whether a discharge occurred.[14] Commentators objected to the facts and circumstances test of the proposed regulation because "creditors do not have the resources to weigh all the facts and circumstances in order to determine whether a debt will never have to be repaid by the debtor."[15]

In response to comments and testimony, the final regulations provide that indebtedness is considered discharged, and reporting is required, *only* upon the occurrence of specified identifiable events. The facts and circumstances test, which tied the actual discharge of debt with the creditor's reporting obligation, was discarded. A discharge of indebtedness is now "deemed" to have occurred if (and only if) an identifiable event has occurred, "whether or not an actual discharge of indebtedness has occurred."[16] As explained below, a creditor's

7 *Carl T. Miller Trust v. Comm'r*, 76 T.C. 191, 195 (1981); *Cozzi v. Comm'r*, 88 T.C. 435, 445 (1987).

8 IRC § 6050J, however, required lenders to report foreclosures or other acquisitions of property in satisfaction of a debt secured by the property, and such events may effect a discharge of indebtedness.

9 H.R. Rep. No. 103-111, at 758 (1993) *reprinted in* 1993 U.S.C.C.A.N. 378, 989.

10 IRC § 6050P(a), (b), (d). Treas. Reg. §1.6050P-1(a) designates Form 1099-C as the appropriate information return.

11 H.R. Rep. No. 103-213, at 672 (1993)(Conf. Rep.) *reprinted in* 1993 U.S.C.C.A.N. 1088, 1361.

12 *See* IRC §§ 6721-6723, 6724(d)(1)(B)(ix), (d)(2)(Q).

13 Treas. Reg. § 1.6050P-1T(b)(1), 58 Fed. Reg. 68301-01, 1994-1 C.B. 286. The temporary regulations included a nonexclusive list of three identifiable events: discharge of the debt in bankruptcy; an agreement between the creditor and debtor to discharge the indebtedness; and cancellation by operation of law such as the expiration of the statute of limitations for collection of the debt.

14 Treas. Reg. § 1.6050P-1T(b)(2)(C), 58 Fed. Reg. 68301-01, 1994-1 C.B. 286.

15 *See* Information Reporting for Discharges of Indebtedness, Explanation of Revisions and Summary of Comments, 61 Fed. Reg. 262, 1996-1 C.B. 298.

16 Treas. Reg. § 1.6050P-1(a). The only exception is that a creditor may, at its discretion, report an actual discharge of indebtedness that occurs before an identifiable event occurs. Treas. Reg. § 1.6050P-1(b)(3).

continued collection activity is relevant only where *the creditor* wishes to rebut a presumption that a debt has been canceled.

The IRC § 6050P regulations now specify eight identifiable events that trigger the creditor's obligation to report canceled debt. Seven identifiable events describe circumstances in which the creditor cannot, or clearly intends not to, collect the debt.[17] However, the mere passage of time (generally 36 months, referred to as a "testing period") with no payment from the debtor creates a presumption that an identifiable event triggering the creditor's reporting obligation has occurred.[18] Thus, a creditor, by issuing a Form 1099-C after 36 months of nonpayment, avoids any penalty for failing to comply with its reporting obligations, and is still free to collect the debt.[19] If, on the other hand, the creditor *fails* to issue a Form 1099-C after 36 months of nonpayment, to avoid liability for a penalty it must overcome a presumption that an identifiable event occurred.[20] Regardless of the identifiable event that triggered issuance of the Form 1099-C, if the taxpayer does not report the amount shown on a Form 1099-C on a return, he or she may receive a Notice CP 2000, *Notice Proposing Adjustments to Income, Payments, or Credits*, which is the IRS's first step toward assessing the tax.[21]

REASONS FOR CHANGE

The regulations under IRC § 6050P, by divorcing the creditor's reporting obligation from the question of whether a debt has been discharged and providing for a 36-month nonpayment period as an identifiable event, create an incentive for creditors to issue Forms 1099-C when they are *not* cancelling debts. This may activate IRS compliance resources even

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17 These seven identifiable events are: (1) a discharge in bankruptcy; (2) cancellation in the context of asset transfers in corporate reorganizations pursuant to bankruptcy; (3) expiration of the statute of limitations if the debtor's affirmative statute of limitations defense is upheld in a final judgment or decision of a judicial proceeding, and the period for appealing the judgment or decision has expired; (4) cancellation pursuant to an election of foreclosure remedies that statutorily extinguishes or bars the creditor's right to pursue collection of the indebtedness; (5) cancellation that renders a debt unenforceable pursuant to a probate or similar proceeding; (6) discharge pursuant to an agreement between the creditor and the debtor; or (7) discharge pursuant to a decision by the creditor, or the application of a defined policy of the creditor, to discontinue collection activity and discharge the debt. Treas. Reg. § 1.6050P-1(b)(2)(i)(A)-(G).

18 Treas. Reg. § 1.6050P-1(b)(2)(i)(H). Treas. Reg. § 1.6050P-1(b)(2)(iv) defines a "testing period," generally 36 months, and provides that if the testing period expires without payment by the debtor, a presumption arises that an identifiable event has occurred. This provision does not apply to all creditors, but rather to "applicable financial entities" as described in IRC § 6050P(c)(2)(A) through (C). Such entities generally include banks, credit unions, their regulated subsidiaries, and Federal executive agencies such as the Federal Deposit Insurance Corporation and the National Credit Union Administration.

19 Because Form 1099-C does not require an issuer to indicate the basis on which it is issuing the form, the number of forms that are triggered by the 36-month testing period is unknown. However, as one representative of the American Bankers Association noted at the hearing on the final IRC § 6050P regulations, "banks and other institutions almost never entirely give up on an uncollected debt." BNA Banking Daily, *Discharge Rules: Witnesses Call for Narrower View of Indebted; Say IRS Proposal Burdensome*, Mar. 31, 1994. Therefore, we would expect that the 36-month testing period accounts for a substantial number of Forms 1099-C. The National Taxpayer Advocate recommends that the Form 1099-C be revised to capture this information. *See* Most Serious Problem: *Third-Party Reporting of Cancellation-of-Debt Events is Not Always Accurate, and the IRS's Reliance on Such Reporting May Burden Taxpayers, supra.*

20 The regulatory framework gives creditors an incentive to issue a Form 1099-C even though they are *not* canceling a debt, yet a state court, in a subsequent collection action, may view the Form 1099-C as *prima facie* evidence that the debt *was* actually canceled. See, *e.g.*, *CoBiz Financial v. CF Homes*, No. 09-0711, slip op. at 6 (Ariz. Ct. App. Nov. 23, 2010) *available at* http://www.cofad1.state.az.us/memod/CV/CV090711.pdf, in which the Arizona Court of Appeals held that a Form 1099-C was *prima facie* evidence that the issuer had discharged the debt.

21 See National Taxpayer Advocate 2008 Annual Report to Congress 47 for a description of the IRS's Automated Underreporter program, which matches a Form 1099-C against the taxpayer's return. *See also* Internal Revenue Manual (IRM) 4.19.3.7.19.1 (Oct. 15, 2008).

though there has been no taxable event, and may place taxpayers in the position of facing collection activity by the creditor to collect the debt and simultaneous enforcement action by the IRS with respect to tax it believes is owed due to cancellation of the same debt.

EXPLANATION OF RECOMMENDATION

The rules pertaining to cancellation of debt are complex and counterintuitive to most taxpayers. As discussed in greater detail earlier in this report, according to a Taxpayer Advocate Service (TAS) sample of taxpayers who were issued a Notice CP 2000, many may have been eligible to exclude canceled debt from income because they were insolvent. However, many taxpayers simply agreed with the adjustment proposed in the CP 2000 or notice of deficiency, or did not respond at all, which indicates that they were not aware of the insolvency exception.[22] Because taxpayers are even less likely to appreciate that expiration of the 36-month testing period may have triggered issuance of the Form 1099-C (rather than a creditor cancelling their debt) they may inappropriately pay additional tax and lose the EITC.

Third-party reporting by means of Form 1099-C could usefully direct taxpayers' attention to the general rule that canceled debt is includible in income. But where the reporting rules burden taxpayers without reliably signaling a taxable event, they become counterproductive. Removing the 36-month testing period as an identifiable event would benefit taxpayers and conserve IRS resources.

22 Most Serious Problem: *Third-Party Reporting of Cancellation-of-Debt Events is not Always Accurate, and the IRS's Reliance on Such Reporting May Burden Taxpayers, supra.*

LR #5

Amend Internal Revenue Code Section 3402(p) to Allow Voluntary Withholding on Payments Made for Lost Earnings or Profits from Disasters

PROBLEM

In significant disasters, affected taxpayers make hundreds of thousands of claims against the responsible parties under federal and state laws and receive billions of dollars in payments.[1] A vast majority of these claim payments are for lost earnings or profits resulting from the disaster.[2] Taxpayers rely on these payments to make up for their lost income. Some rely on them just to survive.

Damages for non-natural disasters are generally includible in the recipient's gross income.[3] Unlike the wages they may replace, the claim payments are not subject to federal income tax withholding; nor does current law provide for voluntary withholding on these payments.[4] Thus, the only way for payment recipients to satisfy their quarterly tax obligations is through the estimated tax payment process. However, many disaster victims with little or no experience making quarterly estimated tax payments will not make the required deposits and will face a surprise year-end tax liability that could have been avoided through withholding. This situation causes hardship to taxpayers, not only because of the taxes owed, but also because of the penalties, interest, and potential IRS collection efforts. Without a withholding mechanism, taxpayers may face an "IRS disaster" that could rival the personal economic damage caused by the disaster they just survived.

EXAMPLE

On April 20, 2010, BP Plc's Deepwater Horizon drilling rig exploded in the Gulf of Mexico, exposing a tapped well that began leaking up to 60,000 barrels of crude oil per day. This quickly became the worst oil spill in U.S. history.[5] The President did not pronounce the spill a federally-declared disaster pursuant to the Stafford Act.[6]

1 *E.g.*, as of November 20, 2010, BP Plc (BP) and the Gulf Coast Claims Facility (GCCF) received claims from 565,483 claimants for damages from the 2010 Deepwater Horizon incident and paid $2,351,075,419 in claims. *See* BP Plc, *Summary of BP Claims Statistics* (Aug. 23, 2010); Gulf Coast Claims Facility, *GCCF Program Statistics – Overall Summary* 1 (Nov. 20, 2010). BP and GCCF data are combined since GCCF took over claims administration from BP on August 23, 2010. BP continues to be responsible for all damages.

2 Of all claims made due to the Gulf oil spill since August 23, 2010, 89.63 percent were for lost earnings or profits. Of all claims paid, 99.96 percent were for lost earnings or profits. Data are for individuals and businesses combined. Gulf Coast Claims Facility, *GCCF Program Statistics – Overall Summary* 4 (Nov. 20, 2010).

3 *See* Internal Revenue Code (IRC) § 61(a); *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955). IRC § 139 exempts payments from gross income if an incident is a federally-declared disaster under the Stafford Act. Most non-natural disasters are not federally-declared disasters.

4 *See* IRC § 3402(p) *et seq.*

5 ADM Robert J. Papp, USCG, *Shipmates 5 - Honor Our Profession*, ALCOAST 308/10 (June 12, 2010) ("What started out on April 20, 2010, as a search and rescue operation … has evolved into the largest offshore oil spill in U.S. history.").

6 See the Robert T. Stafford Disaster Relief and Emergency Assistance Act, P.L. No. 93-288, as amended, 42 U.S.C. §§ 5121-5206 (Stafford Act), and implementing regulations in 44 C.F.R. §§ 206.31-206.48. To trigger provisions of the Stafford Act, the governor of an affected state must request that the President declare a major disaster. 42 U.S.C. § 5170. To date, no governor has made such a request for the Gulf oil spill.

Almost immediately, taxpayers whose livelihoods were damaged by the oil spill began making claims against BP. As of November 20, 2010, BP paid $2.4 billion on approximately 565,000 claims.[7] About 48 percent of payments went to individuals for lost earnings or profits.[8] In other words, almost one-half of all claimants will have to include the payments in their individual gross incomes for tax year 2010, and none of these payments are subject to income tax withholding.[9]

The average initial payment per individual claimant for lost earnings or profits was $9,269.[10] Given a 15 percent marginal tax rate, the average individual taxpayer might have a $1,390 "tax surprise" for 2010.[11] Had the disaster not occurred, the taxpayer's employer would have withheld income tax from the taxpayer's wages. However, current law does not require the payor of these types of payments to withhold income taxes. Instead, disaster victims must utilize the process of estimating and paying taxes in advance. This can be overly burdensome to a taxpayer whose focus is on daily survival.

Based on this data, about a quarter of a million individual taxpayers may have a "tax surprise" for 2010.[12] If taxpayers cannot afford to pay the tax, current law will require the IRS to assess penalties and interest that can quickly double the amount due.[13] Many taxpayers may also be subject to IRS collection efforts.

RECOMMENDATION

The National Taxpayer Advocate recommends Congress amend IRC § 3402(p) to require withholding of income taxes from payments made pursuant to claims for lost earnings or profits that result from an event designated by the Secretary of Treasury to be a disaster, regardless of whether that event is declared a disaster by the President pursuant to the Stafford Act, unless the recipient expressly opts out of such withholding at the time of payment.

7 BP Plc, *Summary of BP Claims Statistics* (Aug. 23, 2010); *GCCF Program Statistics – Overall Summary* 1 (Nov. 20, 2010).

8 Of the $2.4 billion paid to date, $1.1 billion was paid to individuals for lost earnings or profits. *Summary of BP Claims Statistics* (Aug. 23, 2010); *GCCF Program Statistics – Overall Summary* 1 (Nov. 20, 2010).

9 Business claimants must also include payments for lost earnings or profits in their gross incomes, although some will have expenses and losses to offset some of the tax liability.

10 Total amount paid to individuals divided by the number of claims by individuals. *GCCF Program Statistics – Overall Summary* 2 (Nov. 20, 2010).

11 This is a conservative estimate since claims paid in 2010 represent initial Emergency Assistance Claims only. BP/GCCF expects to make final payments in 2011 and 2012 for all legal claims an individual may have against BP for the oil spill. As a result, the final payments should be significantly more than amounts paid in 2010. In other words, we can expect larger surprise tax liabilities in the future without a statutory withholding mechanism. Some self-employed taxpayers may owe an additional tax.

12 Total claims paid as of November 20, 2010 (565,483) times 48 percent equals 271,432.

13 *See, e.g.*, IRC §§ 6651(a) (delinquency penalties), 6601(a) (interest on underpaid tax).

PRESENT LAW

Payments for lost earnings or profits are generally includible in the recipient's income (*i.e.*, subject to income tax).[14] If a disaster becomes a federally-declared disaster under the Stafford Act, these payments are excluded from the recipient's income.[15] However, if a payment is not excluded from income by reason of being related to a federally-declared disaster, and thus, is includible in income, the law does not require the payor to withhold federal income taxes.

Under IRC § 3402(p)(3)(B), the Secretary is authorized to provide regulations for income tax withholding from any payment with respect to which the Secretary finds that withholding would be appropriate, if the person making such payment and the person receiving such payment agree to such withholding. In other words, the Secretary can determine that voluntary withholding is *permitted*, but only pursuant to an enacting regulation, which currently does not exist for IRC § 3402(p)(3)(B). Further, IRC § 3402(p)(3)(B) permits voluntary withholding only if *both* the payee and the payor agree to it. This means that even if an enacting regulation were in place for IRC § 3402(p)(3)(B), a payor could still legally refuse to withhold any income tax even if the taxpayer elected withholding.

REASONS FOR CHANGE

One purpose of tax withholding is to assist the government in securing needed revenue without having to inefficiently resort to levies after assessments.[16] This recommendation will improve taxpayer compliance and the timing of receipts to the federal government. Withholding can also assist taxpayers in ameliorating their annual lump-sum tax payments. Taxpayers who find it burdensome to make quarterly estimated tax payments may find it more convenient to have federal income taxes withheld at the time the payment is made.

Although IRC § 3402(p)(3)(B) currently authorizes the Secretary to permit voluntary withholding by regulation if both parties agree, the payor could legally refuse to enter into a voluntary withholding arrangement even if the IRS publishes a regulation. To get around this regulatory void, the IRS in past disasters encouraged payors to establish estimated tax payment mechanisms in which taxpayers authorize payors to "withhold" a certain amount and pay it to the IRS to be applied toward any tax due.[17] Taxpayer participation in this

Legislative Recommendations

[14] *See* IRC § 61(a); *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955); *see also* Internal Revenue Service, Press Release (June 25, 2010), *available at* http://www.irs.gov/newsroom/article/0,,id=224886,00.html.

[15] IRC § 139.

[16] *See United States v. American Friends Service Committee,* 419 U.S. 7, 10 n.6 (1974), *citing* H. R. Rep. No. 268, 78th Cong., 1st Sess., 1-2 (1943); S. Rep. No. 221, 78th Cong., 1st Sess., 1 (1943).

[17] *See, e.g.*, IRS Letter 4429 (Nov. 2008) (advising taxpayers who received punitive damages from the *Exxon Valdez* oil spill to make estimated tax payments on their own or request a voluntary withholding agreement with the Exxon Qualified Settlement Fund).

workaround was low and some payors refused to create the mechanism.[18] This resulted in a number of "tax surprises" for taxpayers.[19]

Congress should amend IRC § 3402(p) to require ten percent withholding on payments of lost earnings or profits due to a disaster, unless taxpayers expressly elect to opt out at the time of payment. The provision would be for disasters declared by the Secretary specifically for income tax withholding purposes.[20] This will decrease the time necessary to authorize withholding since the Secretary can trigger the provision by declaration.

The Deepwater Horizon oil spill shows just how many taxpayers might find a "tax surprise" waiting for them on April 15 without an opt out withholding provision. These unexpected tax liabilities, and the ensuing penalties, interest, and potential IRS collection efforts, are easily avoidable if the payor is required to withhold income tax when making the payment. Even if a ten percent withholding is less than the total tax due, the withholding will reduce the outstanding tax liability at the end of the year. An opt-out provision will also increase taxpayer participation in withholding. Although some taxpayers will opt out of withholding, many will choose the path of least resistance and be subject to withholding.

The Gulf oil spill is not the first non-natural disaster to affect U.S. taxpayers,[21] and it will certainly not be the last.[22] By modifying the tax code now to require withholding, Congress could protect taxpayers from an "IRS disaster" before the next actual disaster strikes.

EXPLANATION OF RECOMMENDATION

This recommendation will authorize the Secretary of Treasury to declare a disaster for income tax withholding purposes, even if the incident is not a federally-declared disaster under the Stafford Act. The recommendation requires the payor of lost earnings or profits resulting from the disaster to withhold federal income tax from payments at a ten percent rate unless the recipient opts out of withholding at the time of payment. Treasury regulations may also specify additional withholding rates.

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18 Only seven percent of taxpayers who received damages from the *Exxon Valdez* settlement opted to participate in the estimated tax payment mechanism. E-mail from the Exxon Qualified Settlement Fund administrator dated June 6, 2008 (on file with TAS).

19 Out of the 25,000 claimants in the *Exxon Valdez* settlement, only 1,800 participated in the estimated tax election. This means over 23,000 may have owed additional tax without the benefit of withholding or estimated payments. E-mail from IRS Office of Chief Counsel dated June 6, 2008 (on file with TAS).

20 *Cf.* 13 CFR § 123.3, authorized under the Small Business Act, 15 U.S.C. § 636(b), (c), and (f). This allows the Small Business Administration (SBA) to declare a disaster for purposes of granting SBA disaster loans notwithstanding the Stafford Act.

21 *E.g.*, the *Exxon Valdez* oil spill of 1989.

22 The gas pipe explosion in San Bruno, California, is an example of a non-natural disaster that may not be as far-reaching as the Gulf oil spill, but could create just as much economic harm to individual taxpayers if there is no withholding on damage payments. As of September 16, 2010, California Governor Arnold Schwarzenegger asked the responsible party, Pacific Gas and Electric, to create a $100 million fund for victims, including the 271 people displaced by the explosion. *See Answers Promised: Schwarzenegger Tours San Bruno Disaster Site*, The Daily Journal (Sep. 16, 2010), *available at* http://www.smdailyjournal.com/article_preview.php?id=141268.

LR #6 Enact a Statute of Limitations to Limit the Retroactive Effect of Revocation of an Organization's Exempt Status

PROBLEM

Generally, charities enjoy tax-exempt status with accompanying benefits.[1] A charity that fails to function as described in Internal Revenue Code (IRC) § 501(c)(3) may lose exempt status through an IRS process known as revocation. Typically, the IRS audits a charity to determine compliance, and then revokes exempt status and assesses tax as of the date the requirements for exemption are not satisfied.[2] Although assessment is subject to the general three-year statute of limitation,[3] no statute of limitation governs revocation.[4] This creates a procedural asymmetry through which the IRS may revoke an organization's exempt status even for time-barred years, *i.e.*, those for which it cannot collect additional tax.[5] Even if a revoked organization complies with IRS instructions to change its organization or operations and then re-applies for exempt status, certain funding sources or program qualifications may have lapsed upon revocation, impeding future operation as a charity.

EXAMPLE

In Year 1, charitable organization O applies for exempt status, which the IRS recognizes. O functions through a state program that requires maintenance of IRC § 501(c)(3) status. In Year 10, the IRS opens an audit of Years 6, 7 and 8, pending which O agrees to extend the statutory period of limitation on assessment of tax. Meanwhile, O acts on advice from the state program to remedy certain conduct that caused concern in prior years. In Year 11, the IRS discovers a pattern of questionable conduct dating back to Years 4 and 5 and proposes to revoke O's exempt status, but O appeals and extends the period of limitation until Year 12. In Year 12, the IRS issues a final notice of revocation. Already, assessment on Years 4 and 5 is time-barred, yet the IRS assesses a deficiency in tax for Years 6 through 11. O protests to no avail that its activities in Year 9 and later are not accurately characterized

1 IRC § 501(c)(3) exempt organizations are referred to as 'charities' . . . even though it is only one of several adjectives used in § 501(c)(3), partly because 'charitable' is the residual category used to classify these groups when they do not fit under any of the other adjectives, and partly because the Supreme Court has held that all § 501(c)(3) groups must conform to certain fundamental common-law charitable criteria." John Simon, Harvey Dale, and Laura Chisholm, *The Federal Tax Treatment of Charitable Organizations*, in The Nonprofit Sector: A Research Handbook 2nd ed. (New Haven, Conn.: Yale Univ. Press, 2006) 267, 268; *see Bob Jones Univ. v. U.S.*, 461 U.S. 574 (1983).

2 When there has been a material change inconsistent with exemption in the character, purpose, or operation of a charity, revocation ordinarily will take effect as of the date of such material change. Rev. Proc. 2010-9, § 12.01(1), 2010-1 C.B. 258, 268. In 2009, the IRS examined almost 4,000 exempt organization returns and revoked the exempt status of 44 charities. *See* IRS Pub. 55, *Data Book* (2009), Table 13; Ann. 2009-90, 2009-2 C.B. 1010 (revoking the exempt status of one charity); Ann. 2009-86, 2009-2 C.B. 759 (revoking two charities); Ann. 2009-80, 2009-2 C.B. 646 (two); Ann. 2009-78, 2009-2 C.B. 594 (one); Ann. 2009-72, 2009-2 C.B. 500 (one); Ann. 2009-66, 2009-2 C.B. 364 (two); Ann. 2009-64, 2009-2 C.B. 319 (four); Ann. 2009-61, 2009-2 C.B. 246 (twenty-eight); Ann. 2009-60, 2009-2 C.B. 166 (three).

3 *See* IRC § 6501.

4 *Cf.* Internal Revenue Manual (IRM) 4.75.13.5.3.1(4) (stating in "most instances the examiner will not expand the examination to a prior year if the statute of limitations for the assessment of tax has expired").

5 *See, e.g., John Marshall Law School v. U.S.*, 48 A.F.T.R.2d 81-5340 (Ct. Cl. Trial Div. 1981), *aff'd per curiam* 228 Ct. Cl. 902 (1981) (revoking closed years without contest); *Anclote Psychiatric Center v. Comm'r*, T.C. Memo. 1998-273, *aff'd without written opinion* 190 F.3d 541 (11th Cir. 1999) (revoking closed year without contest).

by an audit of Years 4 through 8. Even if O applies for relief from retroactive effect,[6] upon revocation O can no longer conduct certain activities that would allow it to survive as a charity.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress 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.[7] 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.

PRESENT LAW

Generally, the IRS may determine whether an organization is exempt from taxation of its income as described in IRC § 401(a), or 501(c) or (d).[8] In particular, IRC § 501(c)(3) organizations apply to the IRS on Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code.*[9] Thereafter, charities (along with other exempt organizations) annually file Form 990, *Return of Organization Exempt from Income Tax.*[10]

A revocation affects exempt status, but is not an assessment of tax subject to a statute of limitation, which generally forecloses assessment three years after filing of the tax return.[11] The period extends to six years in cases of substantial omission from a return exceeding 25 percent of gross income or of tax in case of certain charity excises.[12] No period of limitation would apply in the case of a false or fraudulent return, willful attempt to evade tax, or

6 *See* IRC § 7805(b)(8); Rev. Proc. 2010-4 § 13.09, 2010-01 I.R.B. 122, 152.

7 *Cf.* IRC § 6501(c), (e).

8 *See* IRC § 501(a). In 2009, there were almost a million employee plans as described in IRC § 401(a) and approximately 1.8 million organizations as described in IRC § 501(c) and (d), 1.2 million of which fell under IRC § 501(c)(3). *See* IRS Pub. 55, Data Book (2009), Tables 13 & 25.

9 *See* IRC § 508; Treas. Reg. § 1.508-1(a)(1), (a)(2). Generally, the IRS recognizes exemption as of the date a charity was organized as long as it filed Form 1023 within 27 months. *See* Treas. Reg. § 301.9100-2(a)(2)(iv).

10 *See* IRC § 6033; Treas. Reg. § 1.6033-2. For 2010, exempt organizations with gross receipts normally less than $200,000 or total assets less than $500,000 may file Form 990-EZ. Pursuant to the charity reform subtitle of the Pension Protection Act of 2006, very small charities have to file a Form 990-N, *Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or 990-EZ*, to apprise the IRS of their ongoing existence. *See* Pub. L. No. 109-280, § 1223, 120 Stat. 780, 1090 (adding IRC § 6033(i) & (j)). However, submission of this e-Postcard is not considered the filing of a complete return that would start the period of limitations. *See* Treas. Reg. § 1.6033-6(c)(4). Failure to file a required Form 990-N for three consecutive years automatically results in revocation of exempt status. *See* IRC § 6033(j).

11 *See* IRC § 6501(g)(2) (indicating for limitation purposes that Form 990 is the return of a charity that determined in good faith that it is an exempt organization).

12 *See* IRC § 6501(e).

non-filing of a return.[13] If the IRS determines a charity is not "described in" IRC § 501(c)(3), an unwitting donor who claims a charitable deduction would be held harmless until announcement of revocation.[14]

The requirements to apply for exempt status and file annual returns do not apply to churches or certain related religious organizations.[15] If it plans to audit a church, the IRS must provide notice of a so-called church tax examination, which initially is limited to "tax status or liability" for the three most recent years before the examination notice date. If the IRS determines the church was not exempt for this period and did not file a return, the examination may extend back to six years before the notice date. These three- and six-year periods in the regulations correspond to periods of limitation on assessment prescribed by the church tax examination statute.[16]

An organization whose tax-exempt status is revoked may come into compliance with IRS requirements and then re-apply for exemption. Nevertheless, certain funding sources or program qualifications may have lapsed upon revocation, which would impede future operation as a charity.

REASONS FOR CHANGE

Exempt status generates numerous benefits, such as qualification for certain bond financing or participation in certain programs, which potentially could affect third parties such as bondholders or beneficiaries.[17] Additional benefits of § 501(c)(3) exempt status may include deductibility of charitable contributions for federal income, estate, and gift tax purposes,[18] effectively favorable status as a grantee of a private foundation,[19] and numerous non-tax benefits such as preferred postal rates.[20] Given the far-reaching impact of these benefits on both charities and third parties such as beneficiaries or donors, equally far-reaching consequences follow revocation, to which procedural safeguards should apply. Current law, however, lacks a fundamental safeguard in the form of a statute of limitation on revocation.[21]

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13 *See* IRC § 6501(c).

14 *See* Rev. Proc. 82-39, 1982-2 C.B. 759. Further, IRC § 170 contribution deductions would continue to be allowed if a charity pursues judicial relief. *See* IRC § 7428(c).

15 *See* IRC §§ 508(c)(1)(A), 6033(c)(3)(A)(i).

16 *See* IRC § 7611; Treas. Reg. § 301.7611-1, A-15.

17 *See* Elizabeth Mills, *IRS Takes Hard Line on Section 501(c)(3) Bonds and Exempt Status*, Journal of Taxation of Exempt Organizations (July-Aug. 2001).

18 *See* IRC §§ 170(c), 2055(a), 2522(a).

19 *See* IRC § 4945(d)(4).

20 *See* 39 CFR § 111.1; Domestic Mail Man. 703 (1.0).

21 The Supreme Court long has observed that statutes of limitation are vital to the welfare of society, stimulating activity, punishing negligence, and protecting parties from the prosecution of stale claims, when, by loss of evidence from death of some witnesses, and the imperfect recollection of others, or the destruction of documents, it might be impossible to establish the truth. *See United States v. Oregon Lumber Co.*, 260 U.S. 290, 299-300 (1922).

In tax administration, a statute of limitation on revocation would maximize audit efficiency while minimizing taxpayer burden. Generally, the IRS receives notice of a charity's claim to exempt status upon organization and annually thereafter, so it would not be the case that the IRS lacks timely notice of the charity's claim.[22] The law precludes assessment of tax for closed years, for which donor deductions would be allowed, so it is unclear whose interests could be protected by an indefinite period for revocation.[23] Even if a charity acted improperly, revocation for time-barred years would yield no return on investment in terms of tax administration. Yet revocation for closed years (*i.e.*, those for which the period of limitation on assessment has expired) creates substantial uncertainty, and could impair a charity's ability to function and ultimately reform, which would serve the interest of tax administration.

While tax exemption should lapse whenever a charitable organization ceases to operate exclusively for a public rather than a private interest or otherwise fails to fulfill the requirements,[24] an organization that has transgressed may reform. Unless egregious operation warrants expeditious revocation, the IRS, pending reform, can obtain an agreement to extend the applicable limitation period. If a closing agreement ensues, public disclosure of reform actions can even be a condition of the agreement. Thus, charitable reform can proceed in harmony with the public interest in exempt operation. Otherwise, a revoked yet reformed charity would have to re-apply for exempt status, creating a tax administration burden that hinders future exempt operation. By limiting this scenario to open years, the recommendation would help make tax administration more efficient.

EXPLANATION OF RECOMMENDATION

Under the recommendation, a limitation period on revocations of charitable exemption generally would run concurrently with the existing period of limitation on assessment. Thus, revocation potentially may occur for up to three, or in case of substantial omission, six years following the filing of a return.[25] As under current law, no period of limitation on revocation would apply in cases of fraud, tax evasion, or non-filing.

This recommendation would apply in addition to the statute of limitation on assessment. Thus, assessment for a revoked period four, five, or six years ago would be time-barred except in case of substantial omission, fraud, or tax evasion.

22 As noted above, the IRS uses Forms 1023 and 990 to collect information about a charity's initial and ongoing organization and operation.

23 *See* Rev. Proc. 82-39, § 3.01 (stating "contributions made to the organization by persons unaware of the change in the status of the organization generally will be considered allowable if made on or before the date of an appropriate public announcement").

24 *See* Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii); *Bob Jones Univ.*, 461 U.S. at 591 (stating "[c]haritable exemptions are justified on the basis that the exempt entity confers a public benefit – a benefit which the society or the community may not itself choose or be able to provide, or which supplements and advances the work of public institutions already supported by tax revenues").

25 In this case, substantial omission may be interpreted to encompass unreported material change in organization or operation. In the case of a very small charity electronically filing a Form 990-N or *e-Postcard* rather than a return as such, the period would run from the electronic submission. Currently, the statute of limitation would not run when a return was not filed even if not required. *See* Rev. Rul. 71-55, 1971-1 C.B. 403.

Moreover, revocation could not proceed from failure to satisfy an exemption requirement in a year closed under the recommendation. Finally, the recommendation would not supersede the more specific church tax examination statute of limitation.

Theoretically, periods of limitation could be imposed by regulation, but the one that applies limitations in the case of church tax examinations closely parallels the statutory terms. Accordingly, the National Taxpayer Advocate recommends enactment of a statute of limitation on exempt charity revocations.

LR #7

Protect Taxpayer Privacy in Whistleblower Cases

PROBLEM

Generally, tax return information is confidential, even if the IRS finds a deficiency, unless judicial proceedings ensue or other exceptions apply. However, a significant gap in the case of a whistleblower claim, of which there are a significant number,[1] allows public disclosure of this return information without the taxpayer's knowledge or consent in proceedings to which the taxpayer is not a party.

EXAMPLE

An individual, W, believed that an acquaintance, T, was committing federal tax fraud. W filed a whistleblower claim reporting this belief to the Whistleblower Office (WO) within the IRS. After reviewing the claim, the WO sent a letter to W stating that his information did not lead to a federal tax issue upon which the IRS will take action. W disagreed with the IRS's finding through an administrative proceeding, filing a petition for review by the U.S. Tax Court. These administrative and judicial proceedings included a discussion of facts relevant to W's claim, including T's name, gross income, and other return information. Even though T was not a party to W's case, the Tax Court published an opinion discussing T's return information.[2]

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress 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.

PRESENT LAW

Generally, tax returns and return information are confidential,[3] with sanctions stating that it "shall be unlawful" for IRS employees or certain other persons to make an unauthorized disclosure.[4] Additionally, a taxpayer who is the subject of an unauthorized disclosure has a right to bring an action within two years for civil damages against a knowingly or

1 In the last reported year, the IRS received 460 whistleblower submissions that appeared to meet the threshold of $2 million in dispute under Internal Revenue Code (IRC) § 7623(b) (allowing appeal to Tax Court), relating to 1,941 taxpayers. *See* IRS Whistleblower Office, *Annual Report to Congress on the Use of Section 7623* (FY 2009) at 5. Additionally, there were 5,678 cases received under IRC § 7623(a) (not applying the $2 million threshold). *See Annual Report*, Table 2 at 8.

2 *See, e.g., Cooper v. Comm'r*, 135 T.C. No. 4 (July 8, 2010).

3 *See* IRC § 6103(a).

4 *See* IRC § 7213 (up to $5,000 or 5 years imprisonment).

negligently responsible person in the amount of $1,000 or, if applicable, actual and punitive damages, costs, and attorney fees.[5]

However, there are statutory exceptions that authorize disclosure. In an administrative or judicial tax proceeding pertaining to tax administration that concerns the treatment of an item on a third party's return, disclosure of relevant return information is authorized.[6] Disclosure in a proceeding before the public (including a person who is not a government employee) can render return information public.[7] These exceptions may apply to the case of a whistleblower.

On the date the claim for award is received from the IRS by the WO after the IRS has taken action against a taxpayer, the WO begins an "administrative proceeding" to review the whistleblower's contribution to the IRS action against the taxpayer and to determine an award to the whistleblower based on that contribution.[8] The extent of disclosure to the whistleblower depends on how much of the third-party taxpayer's return information is relevant to the proceeding for determination of an award by the WO. Necessary disclosures comprise facts sufficient for a whistleblower to understand the basis of the WO's decision on the claim. A Sample Preliminary Award Report and Sample Determination Letter developed by the WO appear to contemplate disclosure of the type of transaction, industry, dates, amounts, tax positions, audit history, and other return information of the third party.[9] At the same time, the WO has issued a Confidentiality Agreement imposing confidentiality of return information on the whistleblower as a condition of participation "in the administrative proceeding leading to the determination of an award by the" WO and pointing to potential re-disclosure as a negative factor in award determination.[10] As a practical matter, this factor would be ineffective after payment.

Current law does not specifically protect the confidentiality of a taxpayer who is the subject of a whistleblower claim, but aspects of existing rules may be instructive. In the case of a criminal or civil judicial proceeding, disclosures in open court are generally in the public domain. Unlike litigation in which the taxpayer as a party could request certain redactions from the record,[11] whistleblower litigation does not include the taxpayer as a party, even though this is also litigation subject to public observation. Although a third-party taxpayer would not be a party in a whistleblower case,[12] the Tax Court has allowed third parties to

5 *See* IRC § 7431.

6 *See* IRC § 6103(h)(4); Internal Revenue Manual (IRM) 11.3.22.19.

7 *See Lampert v. U.S.*, 854 F.2d 335, 337 (9th Cir. 1988) (stating "once return information is disclosed in court, such information is no longer confidential, the taxpayer loses any privacy interests in that information") *cert. den'd* 490 U.S. 1034 (1989). After disclosures authorized by § 6103(c), (k)(6), or (e), restrictions do not apply. *See* Rev. Rul. 2004-53, 2004-1 C.B. 1026.

8 *See* IRM 25.2.2.8(1). This administrative proceeding may follow referral of the whistleblower claim to an IRS subject-matter expert "to determine whether it may materially contribute to the identification, development or resolution of taxpayer liability or collection issues." IRM 27.2.2.7(5).

9 *See* IRM Exhs. 25.2.2-11, -12.

10 *See* IRM Exh. 25.2.2-10.

11 *See, e.g.*, T.C. Rule 27 (allowing redaction for good cause in certain cases); Fed. R. Crim. Proc. 49.1 (allowing redaction for good cause in certain cases).

12 IRC § 7623(b)(4) grants the Tax Court jurisdiction over appeal of a whistleblower award determination.

intervene to protect an otherwise unrepresented interest.[13] Additionally, the tax law authorizes the Tax Court to "make any provision which is necessary to prevent the disclosure of trade secrets or other confidential information," and Tax Court rules allow a request for redaction of information for good cause or a protective order over a trade secret or other information that justice requires to protect a person from embarrassment.[14] The Tax Court rules leave much to the discretion of the judge.

In the case of a Private Letter Ruling (PLR) issued upon taxpayer request, the tax law essentially requires public release, but requires redaction of names, addresses, identifying details, trade secrets, commercial or financial information, and information that if disclosed "would constitute a clearly unwarranted invasion of personal privacy."[15] Moreover, the taxpayer receives "notice of intention to disclose" and an administrative opportunity to request additional or fewer disclosures, with confidential judicial review in the Tax Court.[16]

REASONS FOR CHANGE

Disclosure of third-party tax return information in a whistleblower case is a significant gap in the taxpayer privacy rules and could subject a taxpayer to unwarranted exposure or potentially attract claims for the purpose of exposure. This scenario could detract from the mission of the IRS and Tax Court. Beyond minimal disclosure sufficient for transparent judicial review, it is unclear that disclosure of return information in whistleblower litigation would achieve a particular public interest.[17] On the contrary, a taxpayer's privacy interest generally should not be compromised without consent, which is implicit in civil litigation initiated to contest a tax deficiency or obtain a refund, but not in whistleblower litigation. In the criminal context, considerable procedural protections leading up to a criminal charge and trial that discloses return information, coupled with the significant public interest in obedience to criminal laws, take the place of taxpayer consent.[18] While a whistleblower has an interest in knowing that the IRS correctly determined an award based on information provided, it is unclear to what extent third-party disclosure is necessary to adjudicate a whistleblower claim. The National Taxpayer Advocate has long championed taxpayer privacy rights,[19] which may be unjustifiably abridged here unless explicit protections are enacted.

13 *See Estate of Smith v. Comm'r*, 77 T.C. 326, 334 (1981); *Central Union Trust Co. v. Comm'r*, 18 B.T.A. 300, 303 (1929).

14 *See* I.R.C. § 7461(b)(1); T.C. Rules 27, 103.

15 *See* IRC § 6110.

16 *See* IRC § 6110(f)(3); Treas. Reg. § 301.6110-5; T.C. Rule 220 *et seq*.

17 For oversight, the WO is mandated to deliver to Congress an annual report, which contains aggregate information. *See* Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 406(c) (containing an "off-Code" provision that does not override IRC § 6103(a), which precludes IRS disclosures except as authorized in Tit. 26); IRM 25.2.2.14. If Congress needs return information, generally the tax-writing committees can obtain it under IRC § 6103(f).

18 Even in a criminal trial, a taxpayer as a party could make a motion to protect private information. *See* Fed. R. Crim. Proc. 49.1. A distinct anomaly in a whistleblower case is that, unlike in a criminal or civil tax case, the taxpayer whose return information is disclosed is a third party.

19 *See* National Taxpayer Advocate 2003 Annual Report to Congress 232.

EXPLANATION OF RECOMMENDATION

Legislation would require redaction of the administrative record and any judicial review of a whistleblower proceeding to protect names, addresses, identifying details, trade secrets, commercial or financial information, and information that if disclosed "would constitute a clearly unwarranted invasion of personal privacy" of the third-party taxpayer.[20] Since the whistleblower already knows the identity of the taxpayer, designating the taxpayer by an initial, as in the case of a PLR, should pose no impediment to due process for the whistleblower. With respect to identifying details and other return information, such as dates and income amounts, there may be an exercise of discretion to protect taxpayer confidentiality while affording a full and fair hearing to the whistleblower. Consequently, a confidential administrative and judicial process, beginning with "notice of intention to disclose" to the taxpayer, legislatively designated as a party, would be available separately concerning redaction, but not regarding the merits of the whistleblower claim.

Subsequently, the whistleblower could disclose return information only in judicial or congressional review of the claim.[21] The taxpayer would have a legislatively established right to bring a civil action against the whistleblower within two years of an unauthorized disclosure of return information obtained in the course of an administrative or judicial proceeding, for an amount not less than $1,000, or actual economic damages, including costs and attorney fees.

20 *See* IRC § 6110(c)(5).

21 A whistleblower's disclosure of properly obtained return information to the tax-writing committees of Congress would not be considered to be unauthorized. *See* IRC § 6103(f)(5).

LR #8

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

PROBLEM

Employers are generally required to withhold employment taxes, income tax, and certain types of excise taxes, often referred to as the "trust fund" taxes, from payments to employees.[1] Internal Revenue Code (IRC) § 6672 provides for the assessment of a Trust Fund Recovery Penalty (TFRP) against those deemed responsible persons when these monies are not paid as required.[2] To establish liability under IRC § 6672, the IRS must conclude a person was responsible for withholding and paying over to the IRS payroll taxes and that the failure to do so was willful.[3] The willfulness component of the statute is satisfied if the person had knowledge of the employer's obligation to pay withholding taxes and knew the funds were being used for other purposes.[4] The statute does not contain a reasonable cause exception.[5]

The United States Supreme Court has limited the application of the penalty in cases where a financially troubled company changed ownership and an individual became a responsible person after the liability accrued,[6] to provide the company with "minimum working capital .... to maintain operations and avoid liquidation of the business."[7] However, courts have adopted a rather "harsh" interpretation of the willfulness component of the statute in situations where there was no change in ownership.[8] To avoid TFRP liability, a responsible person must use all available funds to pay off back trust fund taxes and cannot use any

1 *See generally* IRC §§ 3101, 3102, 3111-3113, and 3121-3128 (Federal Insurance Contributions Act); IRC §§ 3201, 3202, 3211, 3221, 3231-3233 and 3241 (Railroad Retirement Tax Act); IRC §§ 3301-3311 (Federal Unemployment Tax Act); IRC §§ 3401-3407 (collection of income at source on wages). For excise taxes, *see, e.g.*, IRC §§ 4251; 4261; 4271. IRC § 7501 provides that taxes withheld from others, which are to be paid to the United States, are held in a special fund in trust for the United States. These taxes are often referred to as the "trust fund" taxes.

2 "Responsible person" is generally defined as an officer or employee of the organization, who has sufficient control and authority to collect, truthfully account for, and pay over the withheld taxes, but willfully fails to do so. IRC §§ 6671(b) and 6672(a). *See also Cline v. U.S.*, 997 F.2d 191 (6th Cir. 1993); *McGlothin v. U.S.*, 720 F.2d 6 (6th Cir. 1983).

3 IRC § 6672 applies to taxes collected and paid over by a third party. It does not apply to taxes directly imposed on the person or entity required to pay them, *e.g.*, it does not apply to the employer's share of FICA or FUTA. IRC §§ 3101 and 3301.

4 *See Hochstein v. U.S.*, 900 F.2d 543, 548 (2d Cir. 1990), *cert. denied*, 504 U.S. 985 (1992). A person has acted with willfulness if his or her actions were voluntary, conscious, and intentional as opposed to being merely negligent.

5 There is a split in circuits on this issue. While most circuits reject the contention that reasonable cause or justifiable excuse plays a part in determining whether the responsible party's actions are willful, the U.S. Court of Appeals for the Fifth Circuit held that, in very limited circumstances, reasonable cause could have an effect on a willfulness determination. *See Harrington v. U.S.*, 504 F.2d 1306 (1st Cir. 1974); *Monday v. U.S.*, 421 F.2d 1210 (7th Cir. 1970); *Olsen v. U.S.*, 952 F.2d 236 (8th Cir. 1991); *Bloom v. U.S.*, 272 F.2d 215 (9th Cir. 1959). *Cf. Newsome v. U.S.*, 431 F.2d 742 (5th Cir. 1970); *McCarty v. U.S.*, 194 Ct. Cl. 42 (1971).

6 *Slodov v. U.S.*, 436 U.S. 238 (1978) (holding that the individual's conduct was not willful when he used after-acquired funds for operating expenses of the business).

7 *In re Rossiter*, 167 B.R. 919 (C.D. Cal. 1994) (applying *Slodov* analysis).

8 *See, e.g.*, *Buffalow v. U.S.*, 109 F.3d 570, 573 (9th Cir. 1997); *Phillips v. U.S.*, 73 F.3d 939, 943 (9th Cir. 1996). *See also* Corrie Lynn Lyle, *The Wrath of IRC § 6672: The Renewed Call for Change – Is Anyone Listening? If You Are a Corporate Official, You Had Better Be*, 74 S. Cal. L. Rev. 1133 (May 2001).

portion of after-acquired funds as a working capital to pay current operating expenses, even if it may result in liquidation of the business.[9] This outcome does not change if the delinquency was caused by a third party bad act, such as mismanagement or embezzlement, by an employee or by a third party payer.[10] Because the assessment of the TFRP can have disastrous economic consequences on those deemed responsible, this rule provides a disincentive for keeping financially struggling businesses afloat by paying businesses' operating expenses and current employment tax liabilities, while repaying past delinquencies in installments.

EXAMPLE

A small construction business incurred a payroll tax liability of about $500,000 as a result of embezzlement by a trusted company controller. As soon as the company's management became aware of the delinquency, it contacted the IRS and arranged to pay past taxes in installments while being current with payment and filing obligations. To keep the business a going concern and generate income to repay the past delinquencies, the management continued to pay current operational expenses, including rent, accounts receivable, suppliers, etc. Although the controller admitted his guilt and was subsequently convicted, the amount of restitution did not cover the accrued delinquencies, nor did the company's business insurance cover the amount embezzled. The IRS assessed TFRPs against corporate officers and filed notices of federal tax lien against their personal assets.[11] As a result, the company lost its line of credit, which was dependent on the creditworthiness of its officers and shareholders. The company went out of business, leaving 15 people, including the officers, unemployed. Although the officers liquidated the remaining assets, the proceeds were insufficient to pay off the liability, and the IRS acted to enforce federal tax liens against the officers' homes.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress 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.

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9 Willfulness exists if the responsible person obtains knowledge of a withholding tax delinquency and continues to permit payments to be made to other creditors. *Monday v. U.S.*, 421 F.2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970); *Gephart v. U.S.*, 818 F.2d 469 (6th Cir. 1987); *Stettler v. U.S.*, 98-1 U.S.T.C. ¶ 50,136 (10th Cir. 1998); *Wright v. U.S.*, 809 F.2d 425 (7th Cir. 1987).

10 *See, e.g., Anuforo v. Comm'r*, 614 F.3d 799 (8th Cir. 2010); *McCloskey v. U.S.*, 104 A.F.T.R.2d (RIA) 6378 (W.D. Pa 2009). *See also Howard v. U.S.*, 711 F.2d 729 (5th Cir. 1983); *Mazo v. U.S.*, 591 F.2d 1151 (5th Cir 1979); *Garsky v U.S.*, 600 F.2d 86 (7th Cir. 1979). *See also* National Taxpayer Advocate 2007 Annual Report to Congress 337, 538 (Most Serious Problem: *Third Party Payers;* Legislative Recommendation: *Taxpayer Protection from Third Party Payer Failures*).

11 The IRS's policy is not to pursue the TFRP so long as there is an installment agreement (IA) in place with the business, unless there are statute of limitations issues or a default on IA is entered. IRS Policy statement 5-14, IRM 1.2.14.1.3(8) (June 9, 2003).

PRESENT LAW

IRC § 6672 imposes a penalty on any person required to collect, truthfully account for, and pay over any tax imposed under the Code where that person willfully fails to do so, or willfully attempts to evade tax. This is referred to as a trust fund recovery penalty, which is also called the 100 percent penalty because the amount is equal to 100 percent of the trust fund taxes evaded, not collected, or not accounted for and paid over.[12] Trust fund taxes include employment taxes, income tax withheld from employees' wages, and certain types of excise taxes.[13] To establish liability under IRC § 6672, the IRS must conclude a person was responsible for withholding and paying over to the IRS payroll taxes and that the failure to do so was willful.[14] The determination of whether a person was responsible for withholding and paying payroll taxes depends on the individual's status, duty, and authority in the context of the business.[15]

The willfulness component of the statute is satisfied if the person had knowledge of the employer's obligation to pay withholding taxes and knew the funds were being used for other purposes.[16] Willfulness does not require specific criminal intent or evil motive.[17] The courts apply these general standards to determine whether a responsible person acted willfully:

- **Deliberate choice –** Willfulness exists where the responsible person makes the deliberate choice to pay withholding taxes to other creditors, instead of paying the taxes over to the IRS;[18]
- **Knowledge of nonpayment of taxes –** Willfulness exists if the responsible person obtains knowledge of a withholding tax delinquency and continues to permit payments to be made to other creditors;[19] and
- **Reckless disregard –** Willfulness exists where the responsible person acts with a reckless disregard of a known or obvious risk that withholding taxes will not be remitted,

12 IRC § 7501 provides that taxes withheld from others, which are to be paid to the United States, are held in a special fund in trust for the United States. The IRS is required to credit the employees for the withheld taxes even if the employer fails to remit them. IRC § 31(a). *See also Slodov v. U.S.*, 436 U.S. 238 (1978).

13 *See generally* IRC §§ 3101, 3102, 3111-3113, and 3121-3128 (Federal Insurance Contributions Act); IRC §§ 3201, 3202, 3211, 3221, 3231-3233 and 3241 (Railroad Retirement Tax Act); IRC §§ 3301-3311 (Federal Unemployment Tax Act); IRC §§ 3401-3407 (collection of income at source on wages). For excise taxes, *see, e.g.*, IRC §§ 4251, 4261, 4271.

14 "Responsible person" is generally defined as an officer or employee of the organization, who has sufficient control and authority to collect, truthfully account for, and pay over the withheld taxes, but willfully fails to do so. IRC §§ 6671(b) and 6672(a). *See also Cline v. U.S.*, 997 F.2d 191 (6th Cir. 1993); *McGlothin v. U.S.*, 720 F.2d 6 (6th Cir. 1983).

15 *Thiboudeau v. U.S.*, 828 F.2d 1499 (11th Cir. 1987), *cert. denied*, 506 U.S. 1050 (1993); *George v. U.S.*, 819 F.2d 1008 (11th Cir. 1987).

16 *See Hochstein v. U.S.*, 900 F.2d 543, 548 (2d Cir. 1990), *cert. denied*, 504 U.S. 985 (1992). A person has acted with willfulness if his or her actions were voluntary, conscious, and intentional as opposed to being merely negligent. *See also Kalb v. U.S.*, 505 F.2d 506, 511 (2d Cir. 1974).

17 *See, e.g., Thomas v. U.S.*, 41 F.3d 1109 (7th Cir. 1994).

18 *See Howard v. U.S.*, 711 F.2d 729 (5th Cir. 1983); *Mazo v. U.S.*, 591 F.3d 1151 (5th Cir. 1979).

19 *See, e.g., Gephart v. U.S.*, 818 F.2d 469 (6th Cir. 1987); *Stettler v. U.S.*, 98-1 U.S.T.C. ¶ 50,136 (10th Cir. 1998); *Monday v. U.S.*, 421 F.2d 1210 (7th Cir. 1970), *cert. denied* 400 U.S. 821 (1970); *Thosteson v U.S.*, 331 F.3d 1294 (11th Cir. 2003), *cert. denied,* 540 U.S. 1105 (2004).

> including failing to investigate or correct mismanagement after being notified that withholding taxes have not been paid.[20]

The statute does not contain a reasonable cause exception.[21] In *Slodov v. U.S.*, the Supreme Court addressed liability of a successor, and limited the application of the penalty in cases where a financially troubled company changes ownership and an individual becomes a responsible person after the delinquency and change of ownership occurred.[22] The court held that the individual's conduct was not willful when he used after-acquired funds for operating expenses of the business after the liability accrued.[23] The reasoning of *Slodov* also applies to individuals who become responsible persons after the taxes accrue, even if no ownership change has occurred.[24] However, to avoid personal liability for past delinquencies, a person deemed responsible must use all unencumbered funds to pay the back taxes after he or she obtains knowledge of a trust fund tax delinquency.[25] This duty extends not only to funds available at the time the responsible person becomes aware of the delinquency, but also to any funds acquired thereafter regardless of why the delinquency occurred.[26]

REASONS FOR CHANGE

As a result of the courts' interpretation of the willfulness component of the statute, in situations where no changes in ownership occurs, the responsible person must use all available funds to pay the delinquency and cannot use any of the funds to pay operating expenses of the business to avoid personal liability for TFRP. This outcome does not change if the delinquency resulted from a third party bad act, such as mismanagement, embezzlement by a trusted employee, or by a third party payer.[27] The taxpayer's willfulness is generally established if he or she pays other creditors instead of paying the IRS after finding out about the embezzlement, even if those payments are made in an effort to keep the business

20 *See, e.g.*, *George v. U.S.*, 819 F.2d 1008 (11th Cir. 1987); *Denbo v. U.S.*, 988 F.2d 1029 (10th Cir. 1993); *Honey v. U.S.*, 963 F.2d 1083 (8th Cir. 1992), *cert. denied*, 506 U.S. 1028 (1992); *Godfrey v. U.S.*, 748 F.2d 1568 (Fed. Cir. 1984); *Mazo v. U.S.*, 591 F.2d 1151 (5th Cir. 1979).

21 There is a split in circuits on this issue. While most circuits reject the contention that reasonable cause or justifiable excuse plays a part in determining whether the responsible party's actions are willful, the U.S. Court of Appeals for the Fifth Circuit held that, in very limited circumstances, reasonable cause could have an effect on a willfulness determination. *See Harrington v. U.S.*, 504 F.2d 1306 (1st Cir. 1974); *Monday v. U.S.*, 421 F.2d 1210 (7th Cir. 1970); *Olsen v. U.S.*, 952 F.2d 236 (8th Cir. 1991); *Bloom v. U.S.*, 272 F.2d 215 (9th Cir. 1959). *Cf. Newsome v. U.S.*, 431 F.2d 742 (5th Cir. 1970); *McCarty v. U.S.*, 194 Ct. Cl. 42 (1971).

22 *Slodov v. U.S.*, 436 U.S. 238 (1978).

23 *Id*.

24 *Mazo v. U.S.*, 591 F.2d 1151 (5th Cir 1979).

25 *Monday v. U.S.*, 421 F.2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970) (the responsible party knew those taxes were due but nevertheless wrote checks to other creditors and suppliers); *Wright v. U.S.*, 809 F.2d 425 (7th Cir. 1987); *Howard v. U.S.*, 711 F.2d 729 (5th Cir. 1983); *Mazo v. U.S.*, 591 F.2d 1151 (5th Cir. 1979). Encumbered funds are money that the taxpayer is legally obligated to use for a purpose other than satisfying the preexisting tax liability. The claim of the other creditor must be superior to the IRS. *Honey v. U.S.*, 963 F.2d 1083 (8th Cir. 1992), *cert. denied*, 506 U.S. 1028 (1992); *U.S. v. Kim*, 111 F.3d 1351 (7th Cir. 1997).

26 *Garsky v. U.S.*, 600 F.2d 86 (7th Cir. 1979); *U.S. v. Kim*, 111 F.3d 1351 (7th Cir. 1997). Even if money intended for payment of taxes was embezzled, the responsible party remains liable for the penalty. *Anuforo v. Comm'r*, 106 A.F.T.R.2d (RIA) 5596 (8th Cir. 2010). *See also Purcell v. U.S.*, 1 F.3d 932 (9th Cir. 1993); *Buffalow v. U.S.*, 109 F.3d 570, 573 (9th Cir. 1997).

27 *Anuforo v. Comm'r*, 106 A.F.T.R.2d (RIA) 5596 (8th Cir. 2010); *McCloskey v. U.S.*, 104 A.F.T.R.2d (RIA) 6378 (W.D. Pa 2009). *See also* National Taxpayer Advocate 2007 Annual Report to Congress 337, 538 (Most Serious Problem: *Third Party Payers*; Legislative Recommendation: *Taxpayer Protection from Third Party Payer Failures*).

going. Thus, during a period of financial hardship, a responsible person must always continue to repay back taxes even when funds to operate the business are not available.[28]

Courts and legal scholars have commented that the current judicial interpretation of willfulness is "harsh," "draconian," and "somewhat counterintuitive," and advocated for change in the statute.[29] This interpretation appears to cause unjust results when a responsible person of a struggling business tries to resolve past tax delinquency, which resulted from an intervening bad act, and agrees to repay the liability in installments instead of liquidating the business.[30]

In the context of a buyout of a struggling company, the Supreme Court in *Slodov* commented that although the IRS "encourage[s] the responsible person to continue operation with the hope of receiving the payment of back taxes, if the attempt fails and the taxes remain unpaid, the IRS insists that the § 6672 personal liability penalty attached upon payment of the first dollar to a supplier."[31] The court also stated that a responsible person has no obligation to liquidate business assets and refused to construe IRC § 6672 to discourage changes of ownership and management of financially troubled companies.[32] In the same context, another court noted that the financially struggling business should be allowed "minimum working capital .... to maintain operations and avoid liquidation of the business."[33]

This reasoning is equally applicable to a financially struggling business that became a victim of a third party bad act. It is in the best interests of the government to encourage business owners to continue in business and pay off the delinquencies in installments rather than liquidate and lay off employees. Because current judicial interpretation of the TFRP willfulness component effectively requires a business owner to stop operating a business and pay all available cash to the IRS, the government may be forced to make outlays in the form of unemployment benefits, food stamps, and the like to the business owner and the laid-off employees. Thus, the strict application of the TFRP willfulness component has the potential to destroy the taxpayer's business, financially damage the taxpayer's family, and simultaneously reduce future federal revenue.

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28 *See, e.g., Sorenson v. U.S.*, 521 F.2d 325, 327 (9th Cir. 1975).

29 *Buffalow v. U.S.*, 109 F.3d 570, 573 (9th Cir. 1997); *Phillips v. U.S.*, 73 F.3d 939, 943 (9th Cir. 1996). *See also* Corrie Lynn Lyle, *The Wrath of IRC § 6672: The Renewed Call for Change – Is Anyone Listening? If You Are a Corporate Official, You Had Better Be*, 74 S. Cal. L. Rev. 1133 (May 2001).

30 For example, in *Baimbridge v. United States* the potentially responsible person attempted to address the willfulness component of the TFRP liability test by arguing that the corporation had entered into an installment agreement for the repayment of the delinquent tax, and therefore, the IRS should be estopped from assessing the penalties because it was fully aware that the business was going to continue operation and satisfy non-IRS creditors. *Baimbridge v. U.S.*, 335 F. Supp. 2d 1084 (S.D. Cal. 2004). The court noted "that serious injustice may result from a penalty assessment being predicated on non-IRS payments which were contemplated by the installment agreement" and denied the IRS's motion for summary judgment on the issue of willfulness, thereby requiring the parties to go to trial.

31 436 U.S. at 252.

32 *Slodov v. U.S.*, 436 U.S. 238 (1978).

33 *In re Rossiter*, 167 B.R. 919 (C.D. Cal. 1994).

EXPLANATION OF RECOMMENDATION

Because courts strictly interpret the willfulness prong of the TFRP, persons deemed responsible are required to use all available funds to pay a tax delinquency after they obtain knowledge of the delinquency, regardless of the reasons why the delinquency occurred. The National Taxpayer Advocate recommends amending 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) makes payment arrangements to satisfy the liability based upon IRS's determination of minimal working capital needs of the business, and (2) remains current with payment and filing obligations.[34]

This legislative change will provide for uniform treatment of similarly situated taxpayers in the context of a financially struggling business, both when change of ownership occurs and when the liability accrues due to an intervening bad act. It will also encourage a responsible person to continue operation of the business and enter into payment arrangements with the IRS on behalf of the business, rather then resign after obtaining knowledge about the liability. This legislative change would not relieve from liability responsible persons who caused the delinquency to accrue.

In addition, the National Taxpayer Advocate recommends that the IRS be given authority to determine minimal working capital needs of a financially struggling business. Similar to the IRC § 7122(d)(2) requirement for allowable living expenses analysis, the IRS should base its determination of minimal working capital needs on a thorough analysis of all facts and circumstances of each taxpayer and ensure that its determination will not leave the taxpayer without adequate funds to meet its basic operating expenses, including current and future tax obligations.[35]

34 Multiple persons may be responsible for TFRP. Therefore, responsible persons who did not apply for a relief under this provision will remain liable for TFRP under current law.

35 In 1995, the IRS developed and implemented the allowable living expenses (ALE) approach to determining an individual taxpayer's financial ability to pay delinquent taxes, which serve as the basis for various collection alternatives, such as installment agreements, CNC determinations, and offers-in-compromise. The IRS Restructuring and Reform Act of 1998 also requires the IRS to prescribe guidelines to determine whether to accept an offer in compromise, which in essence codified the IRS's use of the ALE, Pub. L. No. 105-206, § 3462(a) (1998) (codified at IRC § 7122(d)(2)). The ALE standards are not applicable to corporations, partnerships, LLCs, where the LLC is identified as the liable taxpayer, or any Business MasterFile expenses. IRM 5.15.1.7 (Oct. 2, 2009).

LR #9

Designate that Attorneys' Fees Awarded Pursuant to Internal Revenue Code Section 7430 Are Ineligible for Offset to Satisfy a Litigant's Preexisting Government Debts

PROBLEM

The Internal Revenue Code (IRC) provides that courts may award attorneys' fees to taxpayers who prevail against the United States in connection with the determination, collection, or refund of any tax if certain procedural requirements are met.[1] IRC § 7430 generally permits the prevailing party to be awarded a judgment for reasonable administrative and litigation costs paid or incurred.[2] Fee-shifting provisions like IRC § 7430 are intended to decrease apprehension among those who feel they have been victims of unreasonable government action but who might be reluctant to seek review of or defend against those actions because of the expense involved in securing representation to pursue such a claim. Fee-shifting statutes also support the public policy of encouraging qualified representatives to offer *pro bono* assistance to indigent litigants.[3]

Awards of attorneys' fees under IRC § 7430 may be negatively affected by a recent ruling of the United States Supreme Court. The Court's holding in *Astrue v. Ratliff*[4] calls into question some existing case law, and may result in attorneys' fees awards being offset by the government to satisfy a litigant's preexisting government debt. The Court held that attorneys' fees awards paid under the Equal Access to Justice Act (EAJA) were payable directly to the litigant, rather than to the litigant's attorney, thereby making the award subject to administrative offset. The case may impact IRC § 7430 because the fee shifting statute under the EAJA and IRC § 7430 both contain identical language, providing for an award of fees to a "prevailing party."

EXAMPLE

The IRS issues a statutory notice of deficiency to a taxpayer. The taxpayer disagrees with the proposed deficiency and exhausts all administrative procedures and remedies, but is ultimately unsuccessful and must petition the U.S. Tax Court to hear the case. The taxpayer seeks representation before the Court, but is indigent and approaches an attorney about taking the case on a *pro bono* basis. The attorney is aware of a recent ruling that is controlling precedent in the taxpayer's jurisdiction and would support an argument that the government's position is not substantially justified.

1 IRC § 7430. Under the general provisions of § 7430, a taxpayer will not be awarded attorneys' fees if: i) the government establishes that its position was substantially justified; ii) the taxpayer fails to meet the statutory net worth requirement; iii) the taxpayer does not exhaust administrative remedies; or iv) the taxpayer protracts the administrative or judicial proceedings.

2 IRC § 7430(a).

3 IRC § 7430(c)(3)(B).

4 *Astrue v. Ratliff*, 130 S. Ct. 2521 (2010). *See also* 28 U.S.C. § 2412(d).

The attorney is a struggling solo practitioner, and has limited time to handle reduced fee cases, but feels strongly that the government's position is not substantially justified, and so determines that an award of attorneys' fees under IRC § 7430(c)(3)(A) may be obtainable upon achieving a successful result in the taxpayer's case. Prior to taking the case, the attorney determines that the taxpayer owes the government an unrelated social security debt from two years prior. Even if the taxpayer wins his case, and the court awards attorneys' fees, any fee award may be subject to offset against the taxpayer's social security debt. Now if the attorney wishes to have even the possibility of receiving fees, she is faced with the difficult choice of handling the taxpayer's tax controversy issue to her personal detriment, or telling the taxpayer she cannot provide representation.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 7430 to declare that attorneys' fees are ineligible for offset to satisfy a litigant's pre-existing federal government debt.

PRESENT LAW

Litigants who prevail in a suit against the IRS are able to move for an award of attorneys' fees under IRC § 7430. In order to determine if an attorneys' fee award is merited, the standard typically applied is whether the government's position was substantially justified.[5]

In 1996, Congress passed the Debt Collection Improvement Act (DCIA),[6] and subsequently amended it in 1999 to include a provision establishing the Treasury Department's Offset Program (TOP).[7] The TOP provides for offsetting of certain federal government payments to satisfy other federal government debt owed by an individual. Congress's purpose in enacting the DCIA was to "maximize collections of delinquent debts owed to the Government by ensuring quick action to enforce recovery of debts and the use of all appropriate collection tools."[8] At the time of the DCIA's enactment, some agencies had a regular practice of paying fee awards directly to the attorney, rather than the prevailing party. However, in 2005 the Treasury Department extended the offset program to cover miscellaneous federal payments, including attorneys' fees awards.[9] Some precedent existed at that time holding that attorneys' fees awards under IRC § 7430 could not be offset against debts owed to the government by the taxpayer; the attorney was viewed as the real party in interest, while

5 In order to be eligible for an award of attorneys' fees, taxpayers must also meet other criteria. The taxpayer must fall within a statutory net worth requirement, all administrative remedies must be exhausted, and the taxpayer must not protract administrative or judicial proceedings.

6 Pub. L. No. 104-134, 110 Stat. 1321, 358 (1996).

7 *See* Internal Revenue Manual 21.4.6.4(1) (Oct. 1, 2009).

8 Pub. L. No. 104-134, § 31001(b)(1), 110 Stat. 1321, 358 (1996).

9 Centralized Offset of Federal Payments to Collect Nontax Debts Owed to the United States, 70 Fed. Reg. 3142-01 (Jan. 21, 2005) (codified at 31 C.F. R. pt. 285).

"the prevailing party [was] only nominally the person who receives the award."[10] Only after TOP's expansion did the Treasury universally adopt the position that attorneys' fees awards under the EAJA were appropriately considered the property of the prevailing party, and thus subject to offset to satisfy a litigant's pre-existing government debt.[11]

REASONS FOR CHANGE

Allowing attorneys' fee awards to be offset for a client's government debt impairs the legislative intent of government fee-shifting statutes. In enacting the EAJA, Congress found "that certain individuals, partnerships, corporations, and labor and other organizations may be deterred from seeking review of, or defending against, unreasonable governmental action because of the expense involved in securing the vindication of their rights in civil actions and in administrative proceedings."[12]

According to the legislative history, IRC § 7430 was designed to "deter abusive actions and overreaching by the Internal Revenue Service and [to] enable individual taxpayers to vindicate their rights regardless of their economic circumstances."[13] Reducing the likelihood of obtaining attorneys' fees will have a chilling effect on the availability of low-cost or no-cost legal services for indigent civil litigants.

As Justice Sotomayor pointed out in her concurring opinion in *Ratliff*, without Congressional intervention, "[t]he EAJA's admirable purpose will be undercut if lawyers fear that they will never actually receive attorneys' fees to which a court has determined the prevailing party is entitled. The point of an award of attorneys' fees, after all, is to enable a prevailing litigant to pay her attorney…Subjecting EAJA fee awards to administrative offset for a litigant's debts will unquestionably make it more difficult for persons of limited means to find attorneys to represent them."[14]

Since IRC § 7430 and the EAJA are similarly worded in that both provide for awards to the "prevailing party," *Ratliff* could be applied to support offsetting of awards in section 7430 cases as well.[15] Attorneys' fees awards should be designated as belonging to the litigant's representative, and unavailable for offset to satisfy a pre-existing government debt of the litigant.

10 *Marre v. United States*, 117 F.3d 297 (5th Cir. 1997); *but see Stephens ex rel. R.E. v. Astrue*, 565 F.3d 131, 137 (4th Cir. 2009) (holding that "attorney's fees under the EAJA are payable to the claimant, not the attorney, and thus are subject to administrative offset"); *Reeves v. Astrue*, 526 F.3d 732 (11th Cir. 2008) (finding the language of the EAJA statute to unambiguously direct attorneys' fees awards to the prevailing party, rather than the party's representative, and thus subject to offset).

11 *Ratliff*, 130 S. Ct. at 2532 (J. Sotomayor, concurring) (citations omitted).

12 Pub. L. No. 96-481, § 202(a) of title II, 94 Stat. 2325 (1980).

13 *See* H.R. Rep. No. 404, 97th Cong., 2d Sess. 11 (1982).

14 *Ratliff*, 130 S. Ct. at 2530-31 (J. Sotomayor, concurring) (citations omitted).

15 Although both IRC § 7430 and the EAJA contain the phrase "prevailing party," IRC § 7430 contains a unique section specific to awards of attorneys' fees in the context of *pro bono* services. The last sentence of IRC § 7430(c)(3)(B) specifies that the "subparagraph shall apply only if such award is paid to [the representative] or [the representative's] employer." The argument can be made that this language may forestall offsetting; however, because of the important role fee-shifting provisions play in preserving the fairness of the tax system, particularly in the *pro bono* context, we believe that all attorneys' fees should be unequivocally protected from offset.

EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate's recommendation will ensure that a policy of the Treasury Department does not undermine an important remedy which serves to protect indigent taxpayers against unjustified IRS actions. Allowing litigants to sue the government and seek attorneys' fees eliminates the financial disincentive to challenge unreasonable government actions. Fee-shifting provisions particularly help litigants with limited means to obtain reduced fee or *pro bono* assistance. Subjecting attorneys' fees awards to offset for government debts of the litigant undercuts the purpose of fee-shifting statutes and creates a chilling effect on reduced fee and *pro bono* assistance. For instance, if an attorney becomes aware that her client owes the Government a debt which could result in an award becoming subject to offset, then the attorney is faced with a truly difficult choice; she must choose between making her own livelihood or righting a wrong for someone in need who may be unable to get relief without her assistance. Further, limiting access to an attorney will in turn increase the number of *pro se* litigants and increase the burden on the courts. Awards of attorneys' fees should be protected from offset and payable directly to the attorney providing the representation.

LR #10

Extend the Due Date for S Corporation Elections to Reduce the High Rate of Untimely Elections

PROBLEM

Small business corporations may elect to be treated as flow-through entities by submitting Form 2553, *Election by a Small Business Corporation*, on or before the 15th day of the third month of the taxable year.[1] However, the due date for an S corporation to file Form 1120S, *U.S. Income Tax Return for an S Corporation*, is the 15th day of the third month after the end of its taxable year.[2] Many taxpayers overlook this requirement, subjecting themselves to serious tax consequences that include taxation on the corporate level and the inability to deduct operating losses on shareholders' individual tax returns.[3]

Businesses that wait until the tax return filing date to make this election are deemed to have made the election for the succeeding year, and must seek retroactive relief upon a showing of reasonable cause.[4] In processing years 2008 and 2009, 81,431 and 97,823 S corporation returns could not be processed as filed because of missing or late elections, IRS errors in recognizing or processing a valid election, and an absence of effective relief procedures.[5] These unprocessed returns accounted for nearly 17 and nearly 24 percent of all new S corporation filings, respectively, for those two years.[6]

EXAMPLE

Taxpayers A and B incorporate a small car repair business on January 1, 2008, and choose to use a calendar year for tax purposes. The business does not become profitable until tax year (TY) 2010. To avoid the double taxation of corporate profits, A and B decide to operate the business as an S corporation, but overlook the requirement to file an election on Form 2553, *Election by a Small Business Corporation*, by March 15, 2008, for TY 2008. However, the business timely files its Form 1120S, *U.S. Income Tax Return for an S Corporation*, for tax year 2008. The IRS converts the Form 1120S to Form 1120, *U.S. Income Tax Return for*

1 IRC § 1362(b)(1)(B); Treas. Reg. § 1.1362-6(a)(2). In FY 2009, 4.5 million S corporation returns were filed, accounting for about 64 percent of all corporate returns. IRS, *Data Book 2009*, Table 2, 4.

2 Internal Revenue Code (IRC) §§ 6037 and 6072(b); Treas. Reg. § 1.6037-1(b); Instructions for Form 1120S, *U.S. Income Tax Return for an S Corporation* 3 (2009).

3 *See* Most Serious Problem: *S Corporation Election Process Unduly Burdens Small Businesses*, *supra*.

4 IRC § 1362(b)(3) and (b)(5). Taxpayers may seek relief under one of four revenue procedures or through a private letter ruling (PLR) request. *See* Rev. Proc. 2007-62, 2007-2 C.B. 786; Rev. Proc. 2004-48, 2004-2 C.B. 172; Rev. Proc. 2003-43, 2003-1 C.B. 998; Rev. Proc. 97-48, 1997-2 C.B. 521. The IRS Office of Chief Counsel issued 226 PLRs for late S corporation elections under IRC § 1362 from fiscal year (FY) 2007 to FY 2009, for which the IRS charged a user fee ranging from $625 to $14,000 per request. Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2010-10-106, *Chief Counsel Can Take Actions to Improve the Timeliness of Private Letter Rulings and Potentially Reduce the Number Issued* (Sept. 10, 2010). For PLR procedures and user fees, see Rev. Proc. 2010-1, 2010-1 I.R.B. 1.

5 Business Master File (BMF) Extract from IRS Compliance Data Warehouse (CDW) for Processing Years 2007-2009 (June 2010). If there is no election on file, the return information cannot "post" to the IRS Master File, and the return becomes "unpostable."

6 Prior IRS research reports revealed approximately 20 percent of these returns remain unpostable for multiple years. IRS, Small Business/Self-Employed Division (SB/SE) Research report, *Profile Taxpayers with Unpostable Initial 1120S Returns* (May 2007).

a Corporation, where income is taxed at the corporate level, but because the business had operating losses for the year, the IRS does not assess any tax at the corporate or shareholder level and does not issue a statutory notice of deficiency (SNOD), leaving the taxpayers with the incorrect assumption that the IRS has accepted their 1120S return as filed.[7]

In 2009, the business once again timely files a Form 1120S. Upon receipt of correspondence from the IRS, the business discovers its oversight regarding Form 2553. In July 2010, the business files an election, and the IRS grants an effective date for S corporation filing as of January 1, 2011.[8]

This action creates the potential for taxation of dividend income at the shareholder level in TY 2010 upon distribution, and prevents A and B from deducting any of the business operating losses on their individual returns for 2008 and 2009. The taxpayers are directed by the IRS to amend prior year returns and are left only with the options of seeking reasonable cause relief for a late election under a Revenue Procedure or through a private letter ruling, which may cost up to $14,000. If the business does not qualify for relief under a revenue procedure and cannot afford the PLR user fee, it will not be treated as an S corporation until the 2011 tax year. The business also may be subject to certain special corporate-level taxes,[9] and carry on certain C corporation attributes such as retained earnings, that may be taxable to A and B as a dividend upon distribution, or be limited in the use of any net operating losses arising during the period it was a C corporation.[10]

RECOMMENDATION

The National Taxpayer Advocate recommends 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*.[11]

7 *See* Most Serious Problem: *S Corporation Election Process Unduly Burdens Small Businesses, supra*. If the corporation had a gain, the IRS would assess the tax on the corporate level and is required to issue a SNOD. *See also* Memorandum from Assistant Chief Counsel (Field Service) to District Counsel, Pennsylvania District, SCA 199929036 (May 20, 1999).

8 If an S corporation election is made after the 15th day of the third month of the taxable year and on or before the 15th day of the third month of the following taxable year, then the election is treated as made for the following taxable year. IRC § 1362(b)(3).

9 *See generally* IRC §§ 1374 and 1375.

10 IRC §§ 1368(c); 1374 (a) and (b)(2). IRC § 1374(b)(2) generally provides an exception, allowing certain carryover losses to be used against the built-in gains tax of § 1374(a). If the business has C corporation retained earnings and receives too much of its income in future taxable years from certain passive investment activities, its S corporation election may terminate under § 1362(d)(3).

11 The National Taxpayer Advocate reiterates her legislative recommendations from prior Annual Reports to Congress. *See* National Taxpayer Advocate 2004 Annual Report to Congress 390; National Taxpayer Advocate 2002 Annual Report to Congress 246.

LR # 11 Enact a Uniform Federal Agency External Ombudsman Act

PROBLEM

The external ombudsman function in the federal government expands yearly, through legislation and individual agency initiatives. However, these new offices often lack the basic structure and protections necessary to succeed in their varying ombuds roles. A Federal Agency External Ombudsmen Act would provide, at minimum, a basic structure and set of protections to each new ombudsman.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress enact a Federal Agency External Ombudsmen Act to ensure protections to and create uniformity among all future federal external ombudsmen.

BACKGROUND

External ombudsmen for federal agencies serve specific public populations and fall into three distinct categories: legislative, executive, and advocate.[1] A legislative ombudsman is created by an act of Congress, receives complaints from the public, and may advocate for change to agency policy or procedure. Executive ombudsmen receive complaints from the public and may serve to hold an agency or program accountable, or work with the agency to improve specific areas. Advocate ombudsmen work on behalf of a specific population and may investigate complaints from that population in order to recommend remedies.

EXPLANATION OF RECOMMENDATION

Similar to the Inspector General Act of 1978, a Federal Agency External Ombudsmen Act would detail the general responsibilities, authorities, and duties of all federal external ombudsmen.[2] While the Inspector General Act created an Inspector General (IG) for every federal agency and specified the particular duties and requirements of individual offices, we recommend that the Federal Agency External Ombudsmen Act instead cover the general structure and function of any federal external ombudsman office. Thus, when Congress created a new federal external ombudsman, the Act would automatically be incorporated and Congress would specify the particular duties and requirements of the new office at that time. For example, the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 contained a section establishing the Office of the Inspector Advocate

1 American Bar Association (ABA), *Standards for the Establishment and Operation of Ombuds Offices* (Feb. 9, 2004), *available at* http://meetings.abanet.org/webupload/commupload/AL322500/newsletterpubs/115.pdf (last visited Sept. 20, 2010).

2 Inspector General Act of 1978, Pub. L. No. 95–452, 92 Stat. 1101 (1978).

in the Securities and Exchange Commission.[3] Although the general structure and duties of the new office appear similar to those of previous legislative ombudsmen, an overarching Federal Agency External Ombudsmen Act would have allowed Congress to simply incorporate the general aspects of all ombudsmen offices without the need to rewrite each provision for every new office and only legislate those aspects that are unique for each office.[4]

Crafting new legislation for the general structure and function of each new federal external ombudsman office increases the risk that a crucial function or structural element of the office—for example, one that guarantees confidentially, independence, and impartiality—may be omitted, thereby weakening the office. For example, neither the new Office of the Inspector Advocate nor the National Taxpayer Advocate statutes contain provisions for an independent budget from the parent agency.[5] Requiring the ombudsman to rely on a parent organization for funding can restrict both functional and apparent independence.

A Federal Agency External Ombudsman Act would also provide much-needed protections to ombudsmen created through agency initiatives. Currently, the structures, functions, and authorities of agency-created ombudsmen vary greatly, with the most basic protections of the confidentiality, independence, and impartiality of an ombudsman office not in effect.[6] Thus the Act should require agencies to, at a minimum, establish offices with the structures and protections provided by the Federal Agency External Ombudsman Act when creating a new ombudsman office. This requirement would ensure that the office will function in a confidential, independent, and impartial manner.

3 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

4 *See, e.g.*, IRC § 7803(c) (Office of the Taxpayer Advocate); 6 U.S.C. § 272 (Citizenship and Immigration Services Ombudsmen).

5 *See* Dodd-Frank Wall Street Reform and Consumer Protection Act; IRC § 7803(c).

6 For a discussion of the variations between federal external ombudsmen offices, *see* National Taxpayer Advocate 2009 Annual Report to Congress vol 2, 105-127.

Most Litigated Issues: Introduction

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(X) requires the National Taxpayer Advocate to include in her Annual Report to Congress (ARC) the ten tax issues most litigated in federal courts, classified by the types of taxpayers affected. From the analysis of these issues, the National Taxpayer Advocate may develop recommendations for mitigating disputes that result in litigation.

The Taxpayer Advocate Service (TAS) used commercial legal research databases to identify the ten most litigated issues (Most Litigated Issues) in federal courts from June 1, 2009, through May 31, 2010.[1] For the purposes of this section of the ARC, the term "litigated" means cases in which the court issued an opinion.[2] This year's ten Most Litigated Issues , in order of magnitude, are:

- Summons enforcement (IRC §§ 7602(a), 7604(a), and § 7609(a));
- Collection due process hearings (IRC §§ 6320 and 6330);
- Accuracy-related penalties (IRC § 6662(b)(1) and (2));
- Trade or business expenses (IRC § 162(a) and related Code sections);
- Gross income (IRC § 61 and related Code sections);
- Failure to file penalty (IRC § 6651(a)(1)) and estimated tax penalty (IRC § 6654);
- Frivolous issues penalty and related appellate-level sanctions (IRC § 6673);
- Civil actions to enforce federal tax liens or to subject property to payment of tax (IRC § 7403);
- Family status issues (IRC §§ 2, 24, 32, and 151); and
- Relief from joint and several liability for spouses (IRC § 6015).

These are the same issues identified in 2009, but in a slightly different order.[3] Summons enforcement outpaced collection due process hearings to become the number one most litigated issue.[4] Other notable changes included an increase of almost 24 percent in accuracy-related penalty cases, as well as significant decreases in frivolous penalty cases and civil actions to enforce federal tax liens.[5]

Once TAS identified the ten issues, it analyzed each one in four sections: summary of findings, description of present law, analysis of the litigated cases, and conclusion. Each case

1 Federal tax cases are tried in the United States Tax Court, United States District Courts, the United States Court of Federal Claims, United States Bankruptcy Courts, United States Courts of Appeals, and the United States Supreme Court.

2 We recognize that many cases are resolved before the court issues an opinion. Some taxpayers reach a settlement with the IRS before trial, while the courts dismiss other taxpayers' cases for a variety of reasons, including lack of jurisdiction and lack of prosecution. Additionally, courts can issue less formal "bench opinions," which are not published or precedential.

3 *See* National Taxpayer Advocate 2009 Annual Report to Congress 403-498.

4 Collection due process cases fell from 170 in 2009 to 131 in 2010. *See* National Taxpayer Advocate 2009 Annual Report to Congress 405, Table 3.0.1.

5 Accuracy-related penalty cases rose from 101 to 125 in 2010. Frivolous issues penalty cases dropped from 62 to 46 in 2010. Civil actions to enforce federal tax liens decreased from 61 to 46 in 2010. *See id.*

is listed in Appendix III, and categorized by type of taxpayer (*i.e.*, individual or business).[6] Appendix III also provides the citation for each case, indicates whether the taxpayer was represented at trial or argued the case *pro se*, and lists the court's decision.[7]

Beginning in 2007, TAS expanded the Most Litigated Issues section of the ARC by adding a new "Significant Cases" discussion. This discussion summarizes important judicial decisions that were not included in the top ten issues but that the National Taxpayer Advocate deemed relevant to tax administration.[8]

AN OVERVIEW OF HOW TAX ISSUES ARE LITIGATED

Initially, taxpayers generally have access to four different tribunals in which to litigate a tax matter: the United States Tax Court, United States District Courts, the United States Court of Federal Claims, and United States Bankruptcy Courts. With limited exceptions, taxpayers have an automatic right to appeal decisions of any of these courts.[9]

The Tax Court is generally a "prepayment" forum. In other words, taxpayers can access the court without having to pay the disputed tax in advance. The Tax Court has jurisdiction over a variety of issues, including deficiencies, certain declaratory judgment actions, appeals from collection due process hearings, and relief from joint and several liability.[10]

The federal district courts and United States Court of Federal Claims have concurrent jurisdiction over tax matters in which (1) the tax has been assessed and paid in full,[11] and (2) the taxpayer has filed an administrative claim for refund.[12] The federal district courts, along with the bankruptcy courts in very limited circumstances, provide the only forums in which a taxpayer can receive a jury trial.[13] Bankruptcy courts can adjudicate tax matters that were not adjudicated prior to the initiation of a bankruptcy case.[14]

6 Individuals filing Schedules C, E, or F are deemed business taxpayers for purposes of this discussion even if items reported on such schedules were not the subject of litigation.

7 For purposes of this analysis, we considered the court's decision with respect to the issue analyzed only. A "split" decision is defined as a partial allowance on the specific issue analyzed. The citations also indicate whether decisions were on appeal at the time this report went to print.

8 One or more of the cases discussed in the Significant Cases section of this report were decided outside the June 1, 2009, through May 31, 2010, period used to identify the ten most litigated issues, but we nonetheless have included them because of their impact on tax administration.

9 *See* IRC § 7482, which provides that United States Courts of Appeals have jurisdiction to review the decisions of the Tax Court; 28 U.S.C. § 1294 (appeals from a United States District Court are to the appropriate United States Court of Appeals); 28 U.S.C. § 1295 (appeals from the United States Court of Federal Claims are heard in the United States Court of Appeals for the Federal Circuit); 28 U.S.C. § 1254 (appeals from the United States Courts of Appeals may be reviewed by the United States Supreme Court). There are exceptions to this general rule. For example, IRC § 7463 provides special procedures for small Tax Court cases (where the amount of deficiency or claimed overpayment totals $50,000 or less) for which appellate review is not available.

10 IRC §§ 6214; 7476-7479; 6330(d); 6015(e).

11 28 U.S.C. § 1346(a)(1). *See Flora v. United States*, 362 U.S. 145 (1960), *reh'g denied*, 362 U.S. 972 (1960).

12 IRC § 7422(a).

13 The bankruptcy courts may only conduct a jury trial if the right to a trial by jury applies, all parties expressly consent, and the district court specifically designates the bankruptcy judge to exercise such jurisdiction. 28 U.S.C. § 157(e).

14 *See* 11 U.S.C.A. §§ 505(a)(1) and (a)(2)(A).

ANALYSIS OF *PRO SE* LITIGATION

As in previous years, our analysis indicates that many taxpayers appeared before the courts *pro se*.[15] Table 3.0.1 lists the most litigated issues for the period June 1, 2009, through May 31, 2010, and identifies the number of cases, broken down by issue, in which taxpayers appeared without counsel. As illustrated in the table below, the areas with the highest rates of *pro se* taxpayers are the frivolous issues penalty, family status issues, and summons enforcement. The high percentages of *pro se* taxpayers litigating these issues suggest that there may be an unwillingness on the part of representatives to take these cases, or that the issues affect many low and middle income taxpayers who cannot afford representation. These data may suggest a need for more Low Income Taxpayer Clinics and volunteer clinics to provide free or low cost representation.

TABLE 3.0.1, *Pro Se* Cases By Issue

Most Litigated Issue	Total Number of Litigated Cases Reviewed	*Pro Se* Litigation	Percentage of *Pro Se* Cases
Summons Enforcement	146	115	79%
Collection Due Process	131	84	64%
Accuracy-Related Penalties	125	78	62%
Trade or Business Expenses	119	86	72%
Gross Income	103	74	72%
Failure to File and Estimated Tax Penalties	71	50	70%
Frivolous Issues Penalty (and Analogous Appellate-Level Sanctions)	46	45	98%
Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax	46	29	63%
Family Status Issues	45	39	87%
Joint and Several Liability	36	20	56%
Total	**868**	**620**	**71%**

Table 3.0.2 shows that, in general, taxpayers have a higher chance of prevailing in litigation if they are represented. However, *pro se* taxpayers actually experienced a substantially higher rate of success than represented taxpayers in litigation over family status issues and failure to file and estimated tax penalties. This higher success rate is noteworthy and indicates possible communication barriers between taxpayers and the IRS in the administrative process.

15 *Pro se* means "for oneself; on one's own behalf; without a lawyer." *Black's Law Dictionary* (9th ed. 2009).

TABLE 3.0.2, Outcomes For *Pro Se* And Represented Taxpayers

Most Litigated Issue	*Pro Se* Taxpayers			Represented Taxpayers		
	Total Cases	Taxpayer Prevailed in Whole or in Part	Percent	Total Cases	Taxpayer Prevailed in Whole or in Part	Percent
Summons Enforcement	115	5	4%	31	6	19%
Collection Due Process	84	10	12%	47	5	11%
Accuracy-Related Penalties	78	22	28%	47	17	36%
Trade or Business Expenses	86	30	35%	33	13	39%
Gross Income	74	8	11%	29	11	38%
Failure to File and Estimated Tax Penalties	50	9	18%	21	2	10%
Frivolous Issues Penalty (and Analogous Appellate-Level Sanctions)	45	9	20%	1	1	24%
Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax	29	2	7%	17	4	24%
Family Status Issues	39	10	26%	6	1	17%
Joint and Several Liability	20	6	30%	16	8	50%
Total	**620**	**111**	**18%**	**248**	**68**	**27%**

Significant Cases

The purpose of this section is to describe certain judicial decisions that generally do not involve any of the ten most litigated issues, but nonetheless highlight important issues relevant to tax administration.[1] These decisions are summarized below.

In *Bilski v. Kappos*, the Supreme Court held that while a commodity hedging process was too abstract to be patented, other business methods may be eligible for patent protection even if they fail the Federal Circuit's "machine or transformation" test.[2]

One of the requirements to obtain a patent from the United States Patent and Trademark Office (USPTO) is that the invention or discovery must be a "new and useful process, machine, manufacture, or composition of matter" under 35 U.S.C. § 101. Mr. Bilski submitted a patent application for a process to manage the risk of commodity price fluctuations in energy markets (*i.e.*, hedging). The USPTO rejected his application because the process was not a patentable subject matter under 35 U.S.C. § 101. After the Board of Patent Appeals and Interferences upheld the USPTO's determination, Mr. Bilski appealed to the Court of Appeals for the Federal Circuit. In affirming the Board of Patent Appeals and Interferences, the Federal Circuit explained that a process may constitute a patentable subject matter only if it either (1) is tied to a particular machine or (2) transforms an article into a different state or thing ("machine or transformation" test). The Federal Circuit adopted this machine-or-transformation analysis as the sole test for identifying a patentable "process."[3]

The Supreme Court unanimously held that Mr. Bilski's claims were ineligible for patent protection because they covered an abstract idea. As to what constitutes a patentable "process," however, the Court provided little guidance. While acknowledging the "machine-or-transformation test is a useful and important clue," the Court rejected it as the sole test. The Court reasoned that the statutory language does not so restrict the meaning of "process."

A concurring opinion joined by four justices would have barred patents on business methods, which were not generally thought to be patentable before the 1999 *State Street* decision.[4] According to the concurrence, Congress responded to this unexpected development by establishing "prior use" as a defense against business method patent infringement

1 When identifying the ten most litigated issues, TAS analyzed federal decisions issued during the period beginning on June 1, 2009, and ending on May 31, 2010. For purposes of this section of the report, we generally use the same time period.

2 130 S. Ct. 3218 (2010), *aff'g sub nom. In re Bilski*, 545 F.3d 943 (Fed. Cir. 2008). For recent press coverage, see, *e.g.*, Jeremiah Coder, *Supreme Court Affirms Bilski, Limits Federal Circuit's Reasoning*, 2010 TNT 124-1 (June 29, 2010).

3 *In re Bilski*, 545 F.3d 943, 959-60 (Fed. Cir. 2008), *aff'd sub nom. Bilski v. Kappos*, 130 S. Ct. 3218 (2010). The Federal Circuit rejected its prior test, *i.e.*, whether it produced a "useful, concrete, and tangible result." *See State Street Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998), *cert. denied*, 525 U.S. 1093 (1999).

4 *Bilski*, 130 S. Ct. at 3251(Stevens, J., concurring) (citing legislative history noting "business methods and processes . . . until recently were thought not to be patentable.") (citation omitted). The case in question was *State Street Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998), *cert. denied*, 525 U.S. 1093 (1999).

claims.[5] The majority concluded that holding business method patents unpatentable, as suggested by the concurrence, would render superfluous the "prior use" defense enacted by Congress in 1999. However, the majority explained that nothing in its opinion should be read as endorsing the analysis in *State Street*.[6]

Although this case did not involve a tax issue, it is nonetheless significant because it affects the extent to which tax strategies may be patented. On the one hand, the decision suggests that patenting a tax strategy, which is not tied to a computer or other machine, may be possible. On the other hand, the court pointedly disavowed the *State Street* case and encouraged the Federal Circuit to develop other limiting criteria. Because the Supreme Court decision does not ban tax strategy patents, however, legislation is still needed.[7]

In *Astrue v. Ratliff*, the Supreme Court held that an attorney fee award pursuant to the Equal Access to Justice Act (EAJA) was subject to offset against the litigant's federal debts pursuant to the Treasury Department's Offset Program (TOP).[8]

Ruby Ree, represented by Catherine Ratliff, prevailed on a claim against the United States for Social Security benefits. The District Court granted Ree's motion for attorney fees pursuant to the EAJA.[9] However, the government notified Ree that it would offset the attorney fee award to satisfy Ree's preexisting nontax debt, pursuant to the Treasury Offset Program (TOP).[10] Ratliff intervened to challenge the offset on the basis that EAJA fee awards belong to the litigant's attorney, and thus may not be used to offset a litigant's debts. The District Court held that because EAJA provides for a court to award fees to "a prevailing party," Ratliff, as the litigant's attorney, lacked standing to challenge the proposed offset.[11] The Eighth Circuit reversed, relying on case law to hold that EAJA attorneys' fees are awarded to attorneys, not litigants. The Supreme Court, relying on statutory construction, reversed the Eighth Circuit.

A concurring opinion states, however, that while technically correct, the majority's opinion undermines the purpose of EAJA to eliminate the financial disincentive to challenge unreasonable government actions. Justice Sotomayor argues the majority's holding increases the risk that an attorney will not receive a fee award, inevitably decreasing the willingness of attorneys to undertake representation of low income litigants. She also suggests that

5 *Bilski*, 130 S. Ct. at 3251-52 (Stevens, J., concurring).

6 *Id*. at 3231.

7 For the National Taxpayer Advocate's proposal, see National Taxpayer Advocate 2007 Annual Report to Congress 512 (Key Legislative Recommendation: *Eliminate Tax Strategy Patents*).

8 130 S. Ct. 2521 (2010), *rev'g and remanding* 540 F.3d 800 (8th Cir. 2008).

9 28 U.S.C. § 2412.

10 31 U.S.C. §§ 3711, 3716 (2010); 31 C.F.R. §§ 285.5, 901.3. The Court did not decide if a 2005 amendment to applicable regulations (31 C.F.R. § 285.5(e)(5)) (relating to payments made to representative payees) exempted the payment from offset. *Ratliff*, 130 S. Ct. at 2525 n. 2. The TOP is a centralized offset program, administered by the Financial Management Service's (FMS) Debt Management Services (DMS), to collect delinquent debts owed to federal agencies and states. Pursuant to TOP, FMS offsets such debts against certain federal payments. *See, e.g.,* IRC § 6402(d); 31 U.S.C. § 3720A.

11 28 U.S.C. § 2412(d)(1)(A).

litigants would be better able to repay the government if they could find attorneys to represent them to pursue claims against the government.

This case may be significant for tax attorneys because the tax fee shifting statute under IRC § 7430 is similar to EAJA in providing for an award of fees to "a prevailing party." Moreover, it may call into doubt existing case law that suggests the government cannot offset an award of fees to a taxpayer's attorney under IRC § 7430 against the taxpayer's debts.[12]

In *Fisher v. United States*, the Court of Appeals for the Federal Circuit affirmed the Court of Federal Claims, holding that when a policyholder of a mutual life insurance company received cash upon the company's demutualization, the policyholder could recover tax basis before recognizing gain.[13]

Prior to March of 2000, Sun Life Assurance Company (Sun Life) was a mutual life insurance company owned by its policyholders. In addition to typical insurance contract rights to payment on death of an insured, policies conferred the rights to vote, dividends, and liquidating distributions, if any. In March of 2000, when Sun Life demutualized, it distributed shares of stock in exchange for the ownership rights of the policyholders, who could elect to immediately sell the stock (*i.e.*, receive cash in lieu of stock).

The IRS argued that pursuant to Treasury Regulation § 1.61-6(a), policyholders were required to allocate basis in the policy among the ownership and contract rights in accordance with their relative values when acquired. Thus, a policyholder could only allocate basis to the ownership rights by establishing that they were worth more than zero when acquired.

One policyholder, a trust, argued that, pursuant to the common law "open transaction" doctrine, it should instead be entitled to recover its entire basis in the policy first because the ownership rights were impractical or impossible to value.[14] The United States Court of Federal Claims agreed, holding that the "open transaction" doctrine applied. The Court of Appeals for the Federal Circuit affirmed this decision in an unpublished opinion.[15] The opinion is significant because the Court of Appeals for the Federal Circuit is a court of national jurisdiction, which has reaffirmed the continuing relevance of the "open

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12 One court explained:

> That the statute [IRC § 7430] provides that attorneys' fees are to be awarded to the prevailing party is not controlling....the prevailing party is only nominally the person who receives the award; the real party in interest vis-à-vis attorneys' fees awarded under the statute are the attorneys themselves. . . . For the same reasons, the fact that the district court awarded the attorneys' fees to Marre, and not his attorneys, does not affect our conclusion that, in this particular case, 'the fee once awarded becomes in effect an asset of the attorney, not the client.'

Marre v. United States, 117 F.3d 297, 304 (5th Cir. 1997) (citations omitted), *aff'g in part, rev'g in part* 70 A.F.T.R.2d (RIA) 5,159 (S.D. Tex. 1992).

13 333 Fed. App'x. 572 (Fed. Cir. 2009), *aff'g* 82 Fed. Cl. 780 (2008).

14 The "open transaction doctrine" is a theory pursuant to which the tax consequences of a transaction remain "open" until a contingency is resolved. *See, e.g., Burnet v. Logan*, 283 U.S. 404 (1931), *aff'g sub nom. Logan v. Comm'r*, 42 F.2d 193 (2d Cir. 1930), *rev'g* 12 B.T.A. 586 (1928). *See also Pierce v. United States*, 49 F. Supp. 324 (Ct. Cl. 1943). Taxpayers sometimes rely on this doctrine to defer gains, and the IRS has sometimes relied on it to conclude that losses should be deferred. *See id.*

15 *Fisher v. United States*, 333 Fed. App'x. 572 (Fed. Cir. 2009), *aff'g* 82 Fed. Cl. 780 (2008).

transaction" doctrine. The opinion is also significant because of the impact of the lower court's decision on the tax treatment of demutualization transactions.

In *O'Donnabhain v. Commissioner*, the Tax Court held sex reassignment surgery and hormone therapy incurred by an individual with gender identity disorder were deductible as medical expenses, but costs associated with breast augmentation were not.[16]

O'Donnabhain was diagnosed with gender identity disorder (GID), a condition listed in the Diagnostic and Statistical Manual of Mental Disorders published by the American Psychiatric Association. According to this manual, an individual with GID exhibits a strong desire to be, or belief that he or she is, the opposite sex and has a persistent preoccupation with getting rid of his or her sex characteristics. This condition produces clinically significant distress or impairment in social, occupational, or other important areas of human functioning. According to the World Professional Association for Transgender Health, an association of heath professionals specializing in GID, treatments for GID include hormonal sex reassignment and surgical sex reassignment, including genital and breast surgery. O'Donnabhain's doctors treated the condition with hormone therapy, sex reassignment surgery, and breast augmentation surgery. O'Donnabhain deducted the related expenses, and the IRS disallowed them.

IRC § 213(a) allows a deduction for unreimbursed expenses for "medical care" to the extent they exceed 7.5 percent of adjusted gross income. Medical care is defined as amounts paid for the "treatment . . . of disease, or for the purpose of affecting any structure or function of the body."[17] For purposes of this definition, a "disease" can be a "physical or mental defect or illness."[18] However, the term "medical care" generally does not include "cosmetic surgery or other similar procedures."[19] Cosmetic surgery is any procedure "which is directed at improving the patient's appearance and does not meaningfully promote the proper function of the body or prevent or **treat illness or disease**."[20]

The IRS argued that (1) O'Donnabhain did not have GID, and (2) the expenditures were for cosmetic surgery, did not treat a disease, and were not medically necessary.[21] Based on expert testimony, Judge Gale, writing for the majority in a fully reviewed opinion, first concluded O'Donnabhain had GID. The majority also held that GID is a disease, basing this conclusion on substantial medical authority, including expert testimony, which suggested that mental conditions without known organic causes can be diseases, particularly

16 134 T.C. No. 4 (2010).

17 IRC § 213(d)(1)(A).

18 Treas. Reg. § 1.213-1(e)(1)(ii).

19 IRC § 213(d)(9)(A).

20 IRC § 213(d)(9)(B) (emphasis added).

21 IRS Chief Counsel attorneys previously concluded that this type of surgery was not deductible. CCA 200603025 (Oct. 14, 2005).

if they either significantly impair normal function or are listed in a medical text.[22] In addition, the court held that the expenditures for hormone therapy and sex reassignment surgery were to "treat" GID. The court found, however, that breast augmentation did not "treat" O'Donnabhain's GID because she failed to establish that hormone therapy had an insufficient impact on her breasts and that breast augmentation surgery was necessary. Accordingly, the court held that O'Donnabhain's expenditures for hormone therapy and sex reassignment surgery were deductible, but those for breast augmentation were not.[23]

In *Petaluma FX Partners, LLC v. Commissioner*, the Court of Appeals for the District of Columbia Circuit held that the Tax Court lacked jurisdiction to determine the partners' outside bases and accuracy-related penalties in a partnership-level proceeding.[24]

Taxpayers formed Petaluma FX Partners, LLC (Petaluma) to implement a so-called Son of Boss tax shelter. The shelter was intended to allow the partners to inflate their outside basis in Petaluma and claim tax losses. The IRS issued a Notice of Final Partnership Administrative Adjustment (FPAA) to Petaluma, reducing each line item on Petaluma's return to zero. However, the FPAA also explained that (1) the partnership was disregarded, (2) the partners' outside partnership bases were zero, and (3) the valuation misstatement penalty applied to the partners.

In partnership-level proceedings, the Tax Court generally has jurisdiction only with respect to "partnership items," the allocation of such items, and penalties or additional amounts which relate to an adjustment to a partnership item.[25] Thus, Petaluma argued the Tax Court (and presumably the IRS) had no jurisdiction to make these determinations in partnership-level proceedings, but the Tax Court disagreed.[26]

Petaluma appealed, and the D.C. Circuit agreed with Petaluma. While the court acknowledged the Tax Court had jurisdiction to determine that Petaluma was not a partnership, it held that the Tax Court had no jurisdiction to make a determination with respect to the partners' outside bases. It reasoned that outside basis was an "affected item" and not a "partnership item." Thus, the IRS would need to adjust the partners' outside bases by issuing a notice of deficiency to them (rather than by making a direct computational adjustment), which they could then dispute in the Tax Court. For the same reasons, the court vacated and remanded the Tax Court's decision with respect to partner-level accuracy-related penalties.

22 In concluding GID is a disease, the court also relied on nontax case law, which held that GID constitutes a medical condition of sufficient seriousness that it triggers the Eighth Amendment requirement that prison officials not ignore or disregard it.

23 Several of the judges dissented on the issue of whether the expenditures for breast augmentation were deductible.

24 591 F.3d 649 (D.C. Cir. 2010), *rev'g in part, aff'g in part, vacating and remanding in part* 131 T.C. 84 (2008). The Court of Appeals for the Federal Circuit recently followed *Petaluma* in this regard. *See Jade Trading, LLC v. United States*, 598 F.3d 1372 (Fed. Cir. 2010), *aff'g in part, vacating and remanding in part* 80 Fed. Cl. 11 (2007).

25 IRC § 6226(f).

26 *Petaluma FX Partners, LLC v. Comm'r*, 131 T.C. 84 (2008).

In *Intermountain Insurance Service of Vail, LLC v. Commissioner*, the Tax Court held that a temporary regulation, purporting to retroactively apply the six-year statute of limitations on assessment in IRC § 6501(e), was inapplicable and invalid.[27]

More than three years but less than six years after an LLC filed a partnership return, the IRS determined the return reflected an overstated basis and assessed additional tax.[28] The taxpayer moved for summary judgment, arguing before the Tax Court that the IRS's assessment was time-barred because the three-year statute of limitations period for assessment applied instead of the six-year period applicable to substantial omissions of gross income under IRC § 6501(e). Relying on Ninth Circuit and Supreme Court precedent, the Tax Court held that an overstatement of basis is not an omission of gross income for purposes of IRC § 6501(e) and granted the taxpayer's motion.[29] As a result, the overstatement of basis did not trigger the longer six-year limitations period.

After entry of the Tax Court's order and decision, the IRS issued temporary and proposed regulations stating that an overstatement of basis can constitute a substantial omission.[30] These regulations purport to "apply to taxable years with respect to which the applicable period for assessing tax did not expire before September 24, 2009."[31]

The government filed a motion to vacate and reconsider the decision based on the retroactivity of the temporary regulations. The IRS argued the court should apply the temporary regulations to determine if the statutory period would have lapsed before September 24, 2009. If not, according to the IRS, the temporary regulations applied.

Judge Wherry, writing for the majority in a fully reviewed opinion in which none of the judges dissented, responded that the IRS's argument was "irreparably marred by circular, result-driven logic and the wishful notion that the temporary regulations should apply to this case because Intermountain was involved in what he believes was an abusive tax transaction."[32] The majority reasoned that because the applicable period for assessing the tax expired before September 24, 2009, the temporary regulations did not apply.

The court went on to hold that even if the regulations did apply, they were invalid. It applied the test set forth in *Chevron*, which entitles agency regulations to deference unless (1) they contradict an unambiguous statute, or (2) set forth an unreasonable construction of

27 134 T.C. No. 11 (2010), *supplementing* T.C. Memo. 2009-195, *appeal docketed*, No. 25868-06 (DC Cir. Jul. 27, 2010) (hereinafter *Intermountain*). For additional discussion, see Jeremiah Coder, *News Analysis: IRS Undeterred After Tax Court's Intermountain Decision*, 2010 TNT 94-6 (May 17, 2010).

28 The tax "basis" for determining the gain or loss from the sale or other disposition of property is generally the taxpayer's cost, as adjusted. *See* IRC §§ 1011, 1001. A taxpayer may understate gain on a disposition of property by overstating basis or understating the amount realized in connection with the disposition.

29 *Intermountain Ins. Serv. of Vail, LLC v. Comm'r*, T.C. Memo. 2009-195. For prior coverage of this issue, see National Taxpayer Advocate 2009 Annual Report to Congress 407, 416 (discussing *Bakersfield Energy Partners, LP v. Comm'r*, 568 F.3d 767 (9th Cir. 2009), *aff'g* 128 T.C. 207 (2007)).

30 Temp. Treas. Reg. § 301.6501(e)-1T(a)(1)(iii), T.D. 9466, 74 Fed. Reg. 49,321 (Sept. 28, 2009); 74 Fed. Reg. 49,354 (Sept. 28, 2009).

31 Temp. Treas. Reg. § 301.6501(e)-1T(b), T.D. 9466, 74 Fed. Reg. 49,321, 49,323 (Sept. 28, 2009).

32 *Intermountain*, 134 T.C. No. 11 (2010).

it.[33] The court did not reach the second prong of the test because it determined the statute was unambiguous in light of operative Supreme Court precedent.

In a concurring opinion, several of the Tax Court judges indicated they would have reached the same result on the basis that the regulations were procedurally invalid under the Administrative Procedure Act (APA).[34] The APA requires an agency to publish a regulation not less than 30 days before its effective date unless an exception applies.[35] According to the concurring opinion, the temporary regulations were invalid because the Secretary of the Treasury published them without the requisite 30-day period, and no exception applied.[36]

In *Smith v. Commissioner*, the Tax Court held that it lacked jurisdiction in a deficiency proceeding to redetermine penalties for failure to report involvement in a listed transaction.[37]

The IRS issued a notice of deficiency to the taxpayers (husband and wife) for tax years 2003-2006, reflecting a $133,974 tax deficiency and $37,774 in accuracy-related penalties. The IRS also assessed $300,000 in section 6707A penalties for the 2004-2006 periods ($100,000 per year) for failure to disclose participation in a listed transaction.[38] The taxpayers timely filed a petition challenging the deficiency notice and the notice of assessment.

If a taxpayer files a timely petition after receiving a statutory notice of deficiency, the Tax Court has so-called "deficiency jurisdiction" pursuant to which it is empowered to make a "redetermination of the deficiency."[39] However, the IRS is authorized to assess certain penalties, generally called "assessable" penalties, without issuing a notice of deficiency.[40] The IRS argued the court had no jurisdiction to redetermine the section 6707A penalty because it is an assessable penalty.[41]

The court agreed that it had no jurisdiction but found that the label "assessable penalty" was not dispositive. It reasoned, instead, that the Tax Court lacks deficiency jurisdiction because the section 6707A penalty does not fall within the statutory definition of a deficiency,

33 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

34 5 U.S.C. §§ 551-559.

35 5 U.S.C. § 553(d).

36 While the IRS argued the regulations were exempt from this requirement (under 5 U.S.C § 553(b)) because they were "interpretive rules," the court concluded that no such exception applied because they were "legislative rules."

37 133 T.C. No. 18 (2009). For a discussion of the section 6707A penalty, see National Taxpayer Advocate 2008 Annual Report to Congress 419-422 (Legislative Proposal: *Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact*) and National Taxpayer Advocate 2008 Annual Report to Congress vol. II 1, 21 (*A Framework for Reforming the Penalty Regime*).

38 According to IRC § 6707A(c)(2), a "listed transaction" is "a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011."

39 IRC § 6213(a).

40 Such penalties are located in subchapter B of chapter 68 of the IRC, which is entitled "Assessable Penalties."

41 According to IRC § 6671, assessable penalties are paid upon notice and demand by the Secretary, and are assessed and collected in the same manner as taxes.

is not determined on a notice of deficiency, and does not depend upon the existence of a deficiency (*i.e.*, it may be assessed even if there is an overpayment of tax).[42]

In *Tucker v. Commissioner*, the Tax Court held that IRS Appeals employees charged with conducting collection due process hearings are not "officers" within the meaning of the Appointments Clause of the U.S. Constitution, and thus, do not need to be appointed by the President or the Secretary of the Treasury.[43]

Mr. Tucker filed tax returns reporting tax liabilities, which he did not pay. Before issuing a levy to collect delinquencies, the IRS must offer taxpayers a collection due process (CDP) hearing by an "officer or employee" of the IRS Office of Appeals.[44] Mr. Tucker requested and received a CDP hearing pursuant to which his offer to compromise the tax liability was rejected. As part of his appeal to the Tax Court, Mr. Tucker filed a motion for remand, contending that the persons who conduct CDP hearings – generally appeals officers, settlement officers, and team managers – are appointed in violation of the Appointments Clause of Article II, Section 2 of the U.S. Constitution.

The Appointments Clause provides:

> [The President] shall nominate, and by and with the Advice and Consent of the Senate, shall appoint … all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.[45]

If appeals officers, settlement officers, or team managers are "inferior officers" within the meaning of the Appointments Clause, as Mr. Tucker asserts, they are appointed in violation of it because none are appointed by the President or the Secretary of the Treasury. Instead, they are hired by the IRS Commissioner's delegate pursuant to IRC § 7804(a).

According to the court, to be an inferior officer, rather than an employee who is not an officer (called a "lesser functionary"), an appointee must exercise significant authority pursuant to an office established by law. Because an "officer **or an employee**" (emphasis added) may conduct a CDP hearing, the court reasoned that no particular position was "established by law."[46] Even if a position was established by law, the court concluded that employees who conduct CDP hearings do not have the level of "significant authority," required to qualify as inferior officers. After reviewing the many ways that the outcome of a CDP hearing may

42 IRC § 6211 (defining deficiency). The court noted that it "would presumably have jurisdiction to redetermine a liability challenge asserted by petitioners in a collection due process hearing." *Smith v. Comm'r*, 133 T.C. No. 18 n.6 (2009).

43 135 T.C. No. 6 (2010).

44 *See* IRC § 6330(b)(3) ("The hearing under this subsection shall be conducted by an officer or employee who has had no prior involvement with respect to the unpaid tax . . . ."); IRC § 6320(b)(3) (same with respect to CDP hearings resulting from lien notices).

45 U.S. Const. art. II, § 2.

46 IRC § 6330(b)(3); IRC § 6320(b)(3).

be revisited, modified, or reversed by various officials, it analogized appeals employees to administrative law judges for the Federal Deposit Insurance Corporation, who are lesser functionaries (not inferior officers) even though they take testimony, conduct trials, rule on the admissibility of evidence, enforce discovery orders, and recommend a decision to a board.[47] As a result, the court held that appeals employees who conduct CDP hearings are not inferior officers for purposes of the Appointments Clause, and are not required to be appointed by the Secretary of the Treasury or the President.

In *Gill v. Office of Personnel Management*, the United States District Court for the District of Massachusetts held unconstitutional the application of the Defense of Marriage Act (DOMA) in denying married same-sex couples the benefit of filing joint federal income tax returns.[48]

Seven married same-sex couples and three survivors of same-sex spouses (the plaintiffs), all married in Massachusetts, sought federal benefits commonly available to married persons, including tax benefits associated with filing a joint federal income tax return.[49] A husband and wife are generally entitled to file a joint federal income tax return.[50] DOMA provides, however, that only a man and a woman can be considered married, spouses, or a husband and wife for purposes of federal law.[51] Three of the same-sex couples filed amended tax returns for multiple years, claiming joint filing status, which would produce refunds. The IRS disallowed their refund claims, citing DOMA.

The plaintiffs asserted that DOMA denied them federal marriage-based benefits in violation of the equal protection principles embodied in the Due Process Clause of the Fifth Amendment.[52] Laws involving classifications that discriminate against certain "suspect" classes of similarly situated individuals are subject to "strict scrutiny," the highest level of judicial review.[53] Laws discriminating among other classes of individuals are constitutional if they pass a "rational basis" test.[54] Pursuant to this test, the government need only

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47 The court cited *Landry v. FDIC*, 204 F.3d 1125 (D.C. Cir. 2000).

48 699 F. Supp. 2d 374 (D. Mass. 2010), *appeal docketed*, No. 10-2207 (1st. Cir. Oct. 13, 2010). For a discussion of unanswered federal tax questions posed by state laws governing domestic partnerships, see Most Serious Problem, *State Domestic Partnership Laws Present Unanswered Federal Tax Questions, supra.*

49 A 2004 study by the Government Accountability Office (GAO) found that 1,138 federal statutory provisions tied benefits, protections, rights, or responsibilities to marital status. *See* GAO, GAO-04-353R, *Defense of Marriage Act: Update to Prior Report* (2004).

50 IRC § 6013(a).

51 Section three of DOMA provides that:

> In determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States, the word 'marriage' means only a legal union between one man and one woman as husband and wife, and the word 'spouse' refers only to a person of the opposite sex who is a husband or a wife. DOMA, Pub. L. No. 104-199, § 3, 110 Stat. 2419 (1996) (codified at 1 U.S.C. § 7).

52 *Gill*, 699 F. Supp. 2d at 375.

53 *See, e.g., Adarand Constructors, Inc. v. Peña*, 515 U.S. 200 (1995), *vacating and remanding* 16 F.3d 1537 (10th Cir. 1994), *aff'g* 790 F. Supp. 240 (D. Colo. 1992).

54 Rational basis review usually leads to a ruling favorable to the government, as courts normally show deference to any legitimate governmental interest. *See* Gayle L. Pettinga, *Rational Basis with Bite: Intermediate Scrutiny by Any Other Name*, 62 Ind. L.J. 779 (Summer 1987).

show that the challenged classification is rationally related to a legitimate governmental interest.[55]

The court did not need to decide if discrimination between same and different-sex married persons was a type of discrimination that would be subject to strict scrutiny because it concluded "there exists no fairly conceivable set of facts that could ground a rational relationship between DOMA and a legitimate government objective."[56] Thus, it held that DOMA failed a rational-basis inquiry and violated the equal protection principles embodied in the Fifth Amendment.[57]

55 *See, e.g., FCC v. Beach Comm'ns*, 508 U.S. 307 (1993), *vacating and remanding* 16 F.3d 1537 (10th Cir. 1994), *aff'g* 790 F. Supp. 240 (D. Colo. 1992).

56 Prior to the enactment of DOMA, federal law incorporated each state's marital status determinations. *Gill*, 699 F. Supp. 2d at 384. The government asserted that Congress enacted DOMA to preserve the *status quo* definitions of "marriage" and "spouse" in time of debate when the status of same-sex marriage and related definitions in individual states were changing. *Id*. The court determined that DOMA does not advance the congressional objectives intended at its enactment to encourage responsible procreation, defend heterosexual marriage and traditional notions of morality, and conserve scarce resources. *Id*.

57 In a companion case, the district court held that DOMA was unconstitutional under the Tenth Amendment (reserving unenumerated powers to the states) and the Spending Clause. *See Commonwealth of Mass. v. Dep't of Health & Human Services (HHS)*, 698 F. Supp. 2d 234 (D. Mass. 2010).

MLI #1 Summons Enforcement Under Internal Revenue Code Sections 7602, 7604, and 7609

SUMMARY

The IRS may examine any books, records, or other data relevant to an investigation of a civil or criminal tax liability.[1] To obtain this information, the IRS may serve a summons directly on the individual who is the subject of the investigation or any third party who may possess relevant information.[2]

A person who has a summons served upon him or her may contest the legality of the summons if the government petitions a court to enforce it.[3] If the IRS serves a summons upon a third party, any person entitled to notice of the summons may challenge its legality by filing a motion to quash or by intervening in any proceeding regarding the summons.[4] Generally, the burden on the taxpayer to establish the illegality of the summons is formidable.[5] We reviewed 146 cases in federal court that included issues of IRS summons enforcement and were litigated between June 1, 2009, and May 31, 2010. The parties contesting the summonses prevailed in full in only four of these cases, with seven cases resulting in split decisions, one resulting in no decision, and the IRS prevailing in the remaining 134 cases.

PRESENT LAW

The IRS has broad authority under IRC § 7602 to issue a summons to examine a taxpayer's books and records or demand testimony under oath.[6] Further, the IRS may obtain information related to an investigation from a third party if, subject to the exceptions of IRC § 7609(c), it provides notice to those identified in the summons.[7] However, the IRS may not issue a summons *after* referring the matter to the Department of Justice (DOJ).[8] If the recipient fails to comply with a summons, the IRS may commence an action under IRC § 7604 in the appropriate United States District Court to compel production or testimony.[9] If the IRS files a petition to enforce the summons, the taxpayer may contest the validity of the summons in that proceeding.[10] Also, if the summons is served upon a third party, any

1 Internal Revenue Code (IRC) § 7602(a)(1); Treas. Reg. § 301.7602-1.

2 IRC § 7602(a).

3 *U.S. v. Powell*, 379 U.S. 48, 58 (1964).

4 IRC § 7609(b).

5 *Bodensee Fund, LLC v. U.S. Dept. of Treasury-IRS*, 101 A.F.T.R.2d (RIA) 2092 (E.D. Pa. 2008).

6 IRC § 7602(a). *See also LaMura v. U.S.*, 765 F.2d 974, 979 (11th Cir. 1985) (citing *U.S. v. Bisceglia*, 420 U.S. 141, 145-46 (1975)).

7 IRC § 7602(a). Those entitled to notice of a third party summons (other than the person summoned) must be given notice of the summons within three days of the day on which the summons is served to the third party, but no later than the 23rd day before the day fixed on the summons on which the records will be reviewed. IRC § 7609(a).

8 IRC § 7602(d). This restriction applies to "any summons, with respect to any person if a [DOJ] referral is in effect with respect to such person." IRC § 7602(d)(1).

9 IRC § 7604.

10 *U.S. v. Powell*, 379 U.S. 48, 58 (1964).

person entitled to notice may initiate a petition to quash the summons in an appropriate U.S. District Court, or may intervene in any proceeding regarding the enforceability of the summons.[11]

A person named in a third-party summons is generally entitled to notice,[12] but several exceptions may apply. First, the IRS is not required to give notice if the summons is issued to aid in the collection of "an assessment made or judgment rendered against the person with respect to whose liability the summons is issued."[13] This exception reflects congressional recognition of a difference between a summons issued in an attempt to compute the taxpayer's taxable income, and a summons issued after the IRS has made an assessment or obtained a judgment (and is attempting to determine, for example, whether the taxpayer has an account in a certain bank and whether the account has sufficient funds to pay the tax). Giving taxpayers notice in the latter case would seriously impede the IRS's ability to collect the tax.[14] The courts have interpreted the "aid of collection" exception to apply only where the taxpayer owns a legally identifiable interest in the account or other property for which records are summoned.[15] Second, also to facilitate tax collection, a summons issued by an IRS criminal investigator in connection with a criminal investigation is exempt from IRC § 7609 notice procedures if the summons is served on any person who is not a third-party record keeper.[16]

Regardless of whether the taxpayer contests the summons in a motion to quash or a response to an IRS petition to enforce, the legal standard is the same.[17] In *United States v. Powell*, the Supreme Court set forth four threshold requirements that must be satisfied to enforce an IRS summons:

- The investigation must be conducted for a legitimate purpose;
- The information sought must be relevant to that purpose;
- The IRS must not already possess the information; and
- All required administrative steps must have been taken.[18]

11 IRC § 7609(b). The petition to quash must be filed not later than the 20th day after the date on which notice was served. IRC § 7609(b)(2)(A).

12 IRC § 7609(a)(1).

13 IRC § 7609(c)(2)(D)(i). The exception also applies to the collection of a liability of "any transferee or fiduciary of any person referred to in clause (i)." IRC § 7609(c)(2)(D)(ii).

14 H.R. Rep. No. 94-658, at 310, *reprinted in* 1976 U.S.C.C.A.N. at 3206. *See also* S. Rep. No. 94-938, pt. 1, at 371-72, *reprinted in* 1976 U.S.C.C.A.N. at 3800-3801 (containing essentially the same language).

15 *Ip v. U.S.*, 205 F.3d 1168, 1172-76 (9th Cir. 2000).

16 IRC § 7609(c)(2)(E). A third party record keeper is broadly defined and includes: banks, consumer reporting agencies, persons extending credit by credit cards, brokers, attorneys, accountants, enrolled agents, and owners or developers of computer source code but only when the summons "seeks the production of the source or the program or data to which the source relates." IRC § 7603(b)(2).

17 *Phillips v. Comm'r*, 99 A.F.T.R.2d (RIA) 3487 (D. Ariz. 2007).

18 *U.S. v. Powell*, 379 U.S. 48, 57-58 (1964).

The IRS bears the initial burden of establishing that these requirements have been met.[19] However, this burden is minimal, as the government need only introduce a sworn affidavit of the agent who issued the summons declaring that each of the *Powell* requirements has been satisfied.[20] The burden then shifts to the person contesting the summons to demonstrate that the IRS did not meet the requirements or that enforcement of the summons would be an abuse of process.[21]

A taxpayer may also allege that the information requested is protected by a statutory or common-law privilege, such as the:

- Attorney-client privilege;[22]
- Work-product privilege;[23] or
- Tax practitioner privilege.[24]

However, these privileges are limited. For example, they extend to "tax advice" but not tax return preparation materials.[25] Another limitation is the "tax shelter" exception, which permits discovery of communications between a tax practitioner and client that promote participation in any tax shelter.[26]

ANALYSIS OF LITIGATED CASES

Summons enforcement has appeared as a Most Litigated Issue in the National Taxpayer Advocate's Annual Report to Congress every year since 2005. At that time, we identified only 44 cases but predicted the number would rise as the IRS became more aggressive in its enforcement initiatives. Our prediction was accurate, as the volume of cases grew to 101 in 2006, 109 in 2007, 146 in 2008, and 158 in 2009 before declining to 146 in 2010.[27] A detailed list of this year's cases appears in Table 1 in Appendix lll.

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19 *Fortney v. U.S.*, 59 F.3d 117, 119-20 (9th Cir. 1995).

20 *U.S. v. Dynavac, Inc.*, 6 F.3d 1407, 1414 (9th Cir. 1993).

21 *Id.*

22 The attorney-client privilege generally provides protection from discovery of information where:

> (1) legal advice of any kind is sought, (2) from a professional legal advisor in his or her capacity as such, (3) the communication is related to this purpose, (4) made in confidence, (5) by the client, (6) and at the client's insistence protected, (7) from disclosure by the client or the legal advisor, (8) except where the privilege is waived. *U.S. v. Evans*, 113 F.3d 1457, 1461 (7th Cir. 1997) (citing John Henry Wigmore, *Evidence in Trials at Common Law* § 2292 (John T. McNaughten rev. 1961)).

23 The work product doctrine protects against the discovery of documents and other tangible materials prepared in anticipation of litigation. Fed. R. Civ. P. 26(b)(3); *see also Hickman v. Taylor*, 329 U.S. 495 (1947).

24 IRC § 7525 extends the protection of the common law attorney-client privilege to federally authorized tax practitioners in federal tax matters. Criminal tax matters and communications regarding tax shelters are exceptions to the privilege. IRC § 7525 (a)(2), (b). The tax practitioner privilege is interpreted based on the common law rules of the attorney-client privilege. *U.S. v. BDO Seidman, LLP*, 337 F.3d 802, 810-12 (7th Cir. 2003), *petition for cert. denied, Roes v. U.S.*, 540 U.S. 1178 (2004).

25 *U.S. v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999), *petition for cert. denied*, 528 U.S. 1154 (2000).

26 IRC § 7525(b); *Valero Energy Corp. v. U.S.*, 569 F.3d 626 (7th Cir. 2009), *aff'g* 2008 U.S. Dist. LEXIS 105609 (N.D. Ill. 2008).

27 National Taxpayer Advocate 2009 Annual Report to Congress 430-437; National Taxpayer Advocate 2008 Annual Report to Congress 488-494; National Taxpayer Advocate 2007 Annual Report to Congress 588-593; National Taxpayer Advocate 2006 Annual Report to Congress 582-588.

The IRS prevailed in full in 134 cases. Taxpayers prevailed in only four cases, seven ended in split decisions, and one case resulted in no decision. Attorneys represented taxpayers in 31 cases, while taxpayers appeared *pro se* (*i.e.*, without counsel) in the other 115. One hundred twenty-six cases involved individual taxpayers, while the remaining 20 involved business taxpayers (17 of which had representation). The arguments the litigants raised against IRS summonses generally fell into the following categories:

***Powell* Requirements:** Although we identified no cases in which the taxpayer successfully challenged the government's *prima facie* showing, taxpayers frequently argued that one or more of the *Powell* requirements had not been met. For example, a court found the IRS had authority to investigate U.S. Virgin Islands residents under IRC §§ 932(c)(4) and 7651(1) to determine whether the taxpayers were *bona fide* Virgin Islands residents and whether the U.S. Virgin Islands was a source of their income.[28] However, in *Nero Trading*, despite the IRS's broad investigative authority, the Eleventh Circuit found that the district court's failure to explain its reasons for denying the taxpayer's request for an evidentiary hearing resulted in the taxpayer not being afforded a meaningful opportunity to question the IRS about its reasons for issuing the summonses.[29] Because the Eleventh Circuit could not ascertain from the record whether the summonses were issued for a proper purpose, it remanded the case to the district court for further proceedings consistent with the opinion.[30]

As long as a matter has not been referred to the DOJ, the IRS can issue a summons for the purpose of determining criminal liability.[31] Taxpayers in some cases argued the summonses were overly broad, but failed to support their claims with evidence that the information sought was irrelevant.[32] Taxpayers also claimed the IRS already possessed the requested documents, but courts found that the IRS could seek documents directly from the summoned party even if other sources may provide similar information.[33] For example, in *Twin Palms Resort*, the district court held that the IRS was entitled to obtain records from third parties to establish the accuracy of records that the taxpayer had already provided.[34] Courts found that all necessary administrative steps were completed where a delegation

28 *Twin Palms Resort, LLC v. U.S.*, 676 F. Supp. 2d 1350 (S.D. Fla. 2009) (the IRS derives its investigative powers from its authority to enforce U.S. tax law in the Virgin Islands under IRC § 7651(1), and from the requirement of IRC § 932(c)(4) that Virgin Islands residents file U.S. tax returns if they have not fully reported their income and fully paid their taxes to the U.S. Virgin Islands Bureau of Internal Revenue); *see also St. Claire v. U.S.*, 105 A.F.T.R.2d (RIA) 1569 (S.D. Cal. 2010) (finding a summons was issued for a proper purpose even though the IRS Revenue Agent did not immediately return the taxpayer's phone calls). For a discussion of tax issues pertaining to the U.S. Virgin Islands, see the National Taxpayer Advocate 2009 Annual Report to Congress 391-399.

29 *Nero Trading, LLC v. U.S.*, 570 F.3d 1244 (11th Cir. 2009), *reversing and remanding* 104 A.F.T.R.2d (RIA) 5205 (N.D. Ga. 2007).

30 *Id.*

31 *Seay v. U.S.*, 105 A.F.T.R.2d (RIA) 1103 (W.D.N.C. 2010); *U.S. v. Little*, 104 A.F.T.R.2d 7473 (E.D. Ky. 2009).

32 *Twin Palms Resort, LLC v. U.S.*, 676 F. Supp. 2d 1350 (S.D. Fla. 2009); *Sugarloaf Funding v. U.S. Dep't of Treasury*, 584 F.3d 340 (1st Cir. 2009).

33 *Marcon, Inc. v. U.S.*, 105 A.F.T.R.2d (RIA) 460 (D. Idaho 2009) (IRS may verify existence of bank account by use of summons instead of relying on witness's report that the account exists); *U.S. v. Elmes*, 104 A.F.T.R.2d (RIA) 7676 (S.D. Fla. 2009), *reconsideration denied by* 105 A.F.T.R.2d (RIA) 322 (S.D. Fla. 2009), *sanctions denied by* 105 A.F.T.R.2d (RIA) 666 (S.D. Fla. 2010), *petition dismissed by* 2010 U.S. Dist. LEXIS 10234 (S.D. Fla. 2010).

34 *Twin Palms Resort, LLC v. U.S.*, 676 F. Supp. 2d 1350 (S.D. Fla. 2009).

order authorized IRS Special Agents to issue summonses without the separate approval or signature of a supervisory official.[35]

Criminal Referral: Taxpayers argued that because the IRS issued the summons pursuant to a possible criminal investigation, it violated the IRC § 7602(d) restriction on issuing a summons after referring the matter to the DOJ. However, the courts were careful to distinguish between a *referral* to the DOJ, which prevents the IRS from issuing a summons, and a *criminal investigation* by the IRS, which does not.[36] Additionally, the IRC § 7602(d) restriction on issuing a summons after DOJ referral applies only when the IRS has referred a taxpayer whose tax liabilities are under investigation to the DOJ.[37]

Constitutional Arguments: Taxpayers asserted several unsuccessful constitutional arguments. For example, courts have long stated that taxpayers cannot use the Fourth Amendment as a defense against a third-party summons.[38] Furthermore, although taxpayers may have a valid Fifth Amendment claim regarding specific documents or testimony, the courts routinely rejected blanket assertions of a Fifth Amendment privilege.[39] A court acknowledged that no Fifth Amendment rights exist in respect to documents prepared in a representative capacity as a taxpayer's agent or employee, unless related testimony could personally incriminate the preparer.[40] Fifth Amendment rights are not applicable to subpoenaed documents that are not of the type created by the taxpayer, such as bank statements, checkbooks, deeds, vehicle registrations, and insurance policies. However, the Ninth Circuit found the Fifth Amendment privilege applied to documents related to offshore credit card accounts where the government failed to show knowledge, at the time it issued the summonses, that the taxpayers controlled these accounts.[41] Courts have rejected arguments asserting violation of taxpayers' privacy rights,[42] and protections by the Eleventh

35 *Bohall v. U.S.*, 339 Fed. App'x. 661 (8th Cir. 2009); *Neilson v. U.S.*, 674 F. Supp. 2d 248 (D.D.C. 2009).

36 *Sanders v. U.S.*, 105 A.F.T.R.2d (RIA) 2013 (D. Ariz. 2010); *Kern v. U.S.*, 105 A.F.T.R.2d (RIA) 1526 (E.D. Mich. 2010), *adopting* 105 A.F.T.R.2d (RIA) 1520 (E.D. Mich. 2010); *Seay v. U.S.*, 105 A.F.T.R.2d (RIA) 1103 (W.D.N.C. 2010); *U.S. v. Allen*, 105 A.F.T.R.2d (RIA) 887 (S.D. Ohio 2009); *U.S. v. Little*, 104 A.F.T.R.2d 7473 (E.D. Ky. 2009).

37 *Seay v. U.S.*, 105 A.F.T.R.2d (RIA) 1103 (W.D.N.C. 2010).

38 *Hibben v. U.S.*, 104 A.F.T.R.2d (RIA) 6623 (S.D. Ohio 2009) *adopting* 104 A.F.T.R.2d (RIA) 6621 (S.D. Ohio 2009) (citing *Donaldson v. U.S.*, 400 U.S. 517, 522 (1971)).

39 *U.S. v. Lanoie*, 105 A.F.T.R.2d (RIA) 844 (10th Cir. 2010); *U.S. v. Elmes*, 104 A.F.T.R.2d (RIA) 7676 (S.D. Fla. 2009), *reconsideration denied by* 105 A.F.T.R.2d (RIA) 322 (S.D. Fla. 2009), *sanctions denied by* 105 A.F.T.R.2d (RIA) 666 (S.D. Fla. 2010), *petition dismissed by* 2010 U.S. Dist. LEXIS 10234 (S.D. Fla. 2010); *U.S. v. Griggs*, 103 A.F.T.R.2d (RIA) 922 (D. Ariz. 2009), *magistrate's recommendation* 2009-2 T.C. (CCH) ¶ 50768 (D. Ariz. 2009), *accepted by* 104 A.F.T.R.2d (RIA) 7695 (D. Ariz. 2009), *reconsideration denied by* 105 A.F.T.R.2d (RIA) 744 (D. Ariz. 2009), *stay denied by* 105 A.F.T.R.2d (RIA) 859 (D. Ariz. 2009), *motion granted by* 105 A.F.T.R.2d (RIA) 1525 (D. Ariz. 2010) (Fifth Amendment privilege abandoned where taxpayer asserted the privilege in response to specific questions but refused to explain basis for the objections and to submit relevant documents for *in camera* review).

40 *U.S. v. Little*, 104 A.F.T.R.2d 7473 (E.D. Ky. 2009); *Collins v. Provost* (Andre), 104 A.F.T.R.2d (RIA) 7382 (E.D. Cal. 2009), *adopted by* 104 A.F.T.R.2d (RIA) 7778 (E.D. Cal. 2009).

41 *U.S. v. Bright*, 596 F.3d 683 (9th Cir. 2010), *aff'g in part* 102 A.F.T.R.2d (RIA) 6183 (D. Haw. 2008).

42 *Metz v. U.S.*, 104 A.F.T.R.2d (RIA) 7228 (M.D. Fla. 2009) (finding no invasion of privacy where taxpayer makes no effort to show how his right of privacy is violated); *Neilson v. U.S.*, 674 F. Supp. 2d 248 (D.D.C. 2009) (The Right to Financial Privacy Act does not apply to summonses issued pursuant to IRC § 7609 and did not preclude the IRS from issuing third-party summons to financial institutions in connection with taxpayer.).

Amendment[43] and First Amendment,[44] emphasizing that the First Amendment does not protect false commercial speech.[45] Finally, the courts held that where the taxpayer received notice and was given an opportunity to respond, no due process violation occurred.[46]

Privilege: Courts generally rejected blanket claims of attorney-client privilege.[47] Despite a circuit split on the work-product privilege,[48] the Supreme Court denied certiorari in *United States v. Textron, Inc.*[49] The Court left intact a 3-2 *en banc* ruling by the First Circuit that the work product doctrine did not protect tax accrual work papers prepared by in-house lawyers and accountants to support Textron's calculation of tax reserves for its audited financial statements. The First Circuit concluded that the work product privilege extends only to documents prepared for use in actual or anticipated litigation, not documents created to comply with financial reporting rules. The dissenting opinion argued that the court had quietly abandoned the "because of" standard, which was the standard previously adopted by this circuit,[50] to create a new "prepared for" test and pointed out that the majority failed to acknowledge that the documents were protected under the "because of" standard in their opinion.

In addition to the work-product privilege, taxpayers may use the attorney-client or taxpayer-client privileges as defenses to summons enforcement.[51] Nonetheless, bank records of a client's trust account are not the type of documents protected by attorney-client privilege unless a limited exception, "the last link doctrine," applies.[52] The last link doctrine excludes from disclosure a person's identity if it would also reveal the client's motive for seeking

43 *U.S. v. Allen*, 105 A.F.T.R.2d (RIA) 887 (S.D. Ohio 2009) (the Eleventh Amendment confers immunity on states, not on individuals).

44 *U.S. v. Worley*, 104 A.F.T.R.2d (RIA) 5974 (M.D. Pa. 2009), *reconsideration denied by* 2009 U.S. Dist. LEXIS 79208 (M.D. Pa. 2009), *mandamus denied by* 331 Fed. App'x. 948 (3d Cir 2009), *appeal dismissed by* 347 Fed. App'x. 744 (3d Cir. 2009) (necessity of orderly collection of tax revenues required a taxpayer to comply with a summons and list his assets even if compliance may have conflicted with the taxpayer's religious beliefs not to boast of his wealth and material possessions).

45 *U.S. v. Allen*, 105 A.F.T.R.2d (RIA) 887 (affirming that the First Amendment does not confer immunity from operation of the federal tax law); *Pragovich v. I.R.S.*, 104 A.F.T.R.2d (RIA) 7625 (E.D. Mich. 2009), *accepted by* 676 F. Supp. 2d 557 (E.D. Mich. 2009) (6th Cir. 2009) (communication, which facilitates frivolous lawsuits against the IRS, is false or misleading speech not protected by the First Amendment).

46 *Bohall v. U.S.*, 339 Fed. App'x. 661 (8th Cir. 2009) (no denial of due process found where taxpayer had opportunity to respond to motions to dismiss); *Kern v. U.S.,* 105 A.F.T.R.2d (RIA) 1520 (E.D. Mich. 2010), *adopted by* 105 A.F.T.R.2d (RIA) 1526 (E.D. Mich. 2010) (no due process violation resulting from lack of notice where taxpayer not entitled to notice under IRC § 7609).

47 *U.S. v. Bernhoft*, 104 A.F.T.R.2d (RIA) 7059 (E.D. Wis. 2009) (blanket claim of attorney-client privilege failed where taxpayer did not provide privilege log or affidavits specifying how privilege applies to each document).

48 Courts have diverged on the appropriate standard for assessing whether a document was prepared in anticipation of litigation. Some courts have followed the Fifth Circuit's "primary purpose" test, which provides that if the "primary motivating purpose behind the creation of the document was to aid in possible future litigation", the documents are privileged. *U.S. v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982). Other courts have adopted the "because of" standard, where the "relevant inquiry is whether the document was prepared or obtained 'because of' the prospect of litigation." *U.S. v. Adlman*, 134 F.3d 1194, 1205 (2d Cir. 1998); *see also U.S. v. Deloitte, LLP*, 2010-1 U.S.T.C. (CCH) ¶ 50487 (D.C. Cir. 2010), *affirming in part, vacating in part, remanding* 623 F. Supp. 2d 39 (D.D.C. 2009); *In re Grand Jury Subpoena*, 357 F.3d 900, 907-08 (9th Cir. 2004); *PepsiCo, Inc. v. Baird, Kurtz & Dobson LLP*, 305 F.3d 813, 817 (8th Cir. 2002); *Logan v. Commercial Union Ins. Co.*, 96 F.3d 971, 976-77 (7th Cir. 1996).

49 577 F.3d 21 (1st Cir. 2009) *(en banc), cert. denied*, 176 L. Ed. 2d 1219 (2010).

50 *Maine v. United States Dep't of the Interior*, 298 F.3d 60 (1st Cir. 2002) (citing *U.S. v. Adlman*, 134 F.3d 1194 (2d Cir. 1998)).

51 *U.S. v. Textron, Inc. and Subsidiaries*, 577 F.3d 21 (1st Cir. 2009) *(en banc), cert. denied*, 176 L. Ed. 2d 1219 (2010); *Valero Energy Corp. v. U.S.*, 569 F.3d 626 (7th Cir. 2009), *aff'g* 2008 U.S. Dist. LEXIS 105609 (N.D. Ill. 2008).

52 *In re Grand Jury (Lipnack)*, 831 F.2d 225 (11th Cir. 1987).

legal advice.[53] The taxpayer-client privilege exists to the extent the communication would be considered a privileged communication if it took place between a taxpayer and an attorney and was for the purpose of obtaining tax advice from a federally authorized tax practitioner.[54] The privilege does not, however, apply to communications in connection with the promotion of the direct or indirect participation of a taxpayer in any tax shelter.[55] Under the tax shelter exception, the tax practitioner privilege does not apply to any written communication between a federally authorized tax practitioner and "any person, any director, officer, employee, agent, or representative of the person, or any other person holding a capital or profits interest in the person" and "in connection with the promotion of the direct or indirect participation of the person in any tax shelter."[56] A tax shelter is defined as "a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, if a significant purpose of such partnership, entity, plan or arrangement is the avoidance or evasion of Federal income tax."[57]

The IRS prevailed in 27 of the 30 cases initiated by filing motions to quash summonses, in part because the courts lacked jurisdiction to hear the cases. The courts dismissed these cases for lack of jurisdiction for the following reasons:

Lack of Jurisdiction Due to Procedural Requirements: The United States is immune from suit unless Congress has expressly waived its sovereign immunity.[58] Since a motion to quash service of an IRS summons is a suit against the United States, a court has jurisdiction only when Congress has expressly waived sovereign immunity.[59] When a taxpayer wishes to challenge an IRS summons issued to a third party, federal law sets forth the exclusive method by which a taxpayer may proceed.[60] A taxpayer may initiate a proceeding in the U.S. District Court in which the third party resides, no later than 20 days from the date the notice of summons was given.[61] For example, a court dismissed a *pro se* taxpayer's motion to quash for lack of jurisdiction because the taxpayer filed the motion 18 days after the 20-day limitation period had expired.[62]

Lack of jurisdiction due to notice requirements: Courts denied several motions to quash because the parties contesting the summonses were not entitled to notice of the

53 *Sunshine Behavioral Health Svcs. v. U.S.*, 104 A.F.T.R.2d (RIA) 5104 (M.D. Fla. 2009) (finding that the taxpayers had not demonstrated that the information fell within this limited exception).

54 IRC § 7525(a)(1). *See Valero Energy Corp. v. U.S.*, 569 F.3d 626 (7th Cir. 2009), *aff'g* 2008 U.S. Dist. LEXIS 105609 (N.D. Ill. 2008).

55 IRC § 7525(b). *See Valero Energy Corp. v. U.S.*, 569 F.3d 626 (7th Cir. 2009), *aff'g* 2008 U.S. Dist. LEXIS 105609 (N.D. Ill. 2008).

56 IRC § 7525(b).

57 IRC § 6662(d)(2)(C)(ii).

58 *U.S. v. Dalm*, 494 U.S. 596, 608 (1990).

59 *Navarro v. I.R.S.*, 105 A.F.T.R.2d (RIA) 2587 (2d Cir. 2010); *Hollywood Svcs., Inc. v. I.R.S.*, 105 A.F.T.R.2d (RIA) 1883 (D. Colo. 2010).

60 IRC § 7609(b)(2)(A). *See Hollywood Svcs., Inc. v. I.R.S.*, 105 A.F.T.R.2d 1883 (D. Colo. 2010); *Atl. Ave. D.B. Fin./Legal Support Group v. U.S.*, 104 A.F.T.R.2d (RIA) 5586 (S.D. Fla. 2009).

61 IRC § 7609(b)(2)(A); *Andrikopoulis v. U.S.*, 105 A.F.T.R.2d (RIA) 1085 (D. Colo. 2010), *adopted by* 105 A.F.T.R.2d (RIA) 1087 (D. Colo. 2010); *Neilson v. U.S.*, 674 F. Supp. 2d 248 (D.D.C. 2009).

62 *Andrikopoulos v. U.S.*, 105 A.F.T.R.2d 1085 (D. Colo. 2010).

summons due to one of the IRC § 7609(c) exceptions, and therefore lacked standing to contest the validity of the summons.[63] In *Fisher v. United States*,[64] the taxpayers asserted that a third-party summons delivered by fax to PayPal was not properly served. The court acknowledged that although taxpayers can generally raise issues relevant to their interest in nondisclosure of information, IRC § 7609 does not give them standing to assert issues of meaningful concern only to third parties. The court held that it lacked subject matter jurisdiction over a petition to quash the summons, concluding that service of summons on PayPal affected only PayPal's interests, and not the taxpayers' interests. In *Sunshine Behavioral Health Services v. United States*,[65] however, the court did not agree with a broad interpretation of IRC § 7609,[66] finding that if the summons seeks documents belonging to a third party, the third party had standing to contest the validity of the summons. In this case, the IRS issued a collection summons to a bank, seeking bank statements for an attorney's trust account where the attorney had represented the taxpayer in a bankruptcy proceeding. The court held that the taxpayer's attorney had standing to challenge the summons because the IRC § 7609(c)(2)(D) exception-to-notice provision did not apply. On the other hand, in *Viewtech, Inc. v. United States*,[67] the court found the IRC § 7609(c)(2)(D) exception applied because the government introduced sufficient evidence that the taxpayer had a recognizable legal interest in the third-party company whose bank account records were summoned. The court held that the taxpayer was not entitled to notice of a summons to the company because he received company funds to his personal bank account and was sole and majority shareholder for two consecutive years.

CONCLUSION

The IRS may issue a summons to obtain information needed to determine the correctness of a tax return, determine if a return should have been filed, determine a taxpayer's tax liability, or collect a liability.[68] Accordingly, the IRS may request documents and testimony from taxpayers who have failed to provide that information to the IRS voluntarily. Taxpayers and third parties continue to contest IRS summonses, but rarely succeed due to the significant burden of proof and strict procedural requirements. It appears that as the IRS employs a more aggressive enforcement policy, it will continue to rely heavily on the summons enforcement tool. We expect the courts will continue to see these cases litigated.

63 IRC § 7609(c)(2)(D)(i); *Hollywood Svcs., Inc. v. I.R.S.*, 105 A.F.T.R.2d 1883 (D. Colo. 2010); *Kern v. U.S.*, 105 A.F.T.R.2d (RIA) 1520 (E.D. Mich. 2010), *adopted by* 105 A.F.T.R.2d (RIA) 1526 (E.D. Mich. 2010); *Viewtech, Inc. v. U.S.*, 104 A.F.T.R.2d (RIA) 7101 (S.D. Cal. 2009); *Atl. Ave. D.B. Fin./Legal Support Group v. U.S.*, 104 A.F.T.R.2d (RIA) 5586 (S.D. Fla. 2009).

64 676 F. Supp. 2d 1165 (W.D. Wash. 2009).

65 104 A.F.T.R.2d (RIA) 5104 (M.D. Fla. 2009).

66 Several circuit courts have interpreted broadly the IRC § 7609(c)(2)(D) exception to notice to find that "as long as the third-party summons is issued to aid in the collection of any assessed tax liability the notice exception applies." *Huffman v. U.S.*, 100 A.F.T.R.2d 7089 (S.D. Fla. 2007) (citing *Barmes v. U.S.*, 199 F.3d 386 (7th Cir. 1999); *U.S. v. First Bank*, 737 F.2d 269 (2d Cir. 1984)).

67 104 A.F.T.R.2d (RIA) 7101 (S.D. Cal. 2009).

68 IRC § 7602(a).

MLI #2

Appeals From Collection Due Process Hearings Under Internal Revenue Code Sections 6320 and 6330

SUMMARY

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 (Appeals) of the decision to file a Notice of Federal Tax Lien (NFTL) or the IRS's proposal to undertake a levy action. In other words, a CDP hearing gives taxpayers an opportunity for a meaningful hearing before the IRS issues its first levy or immediately after it files its first lien with respect to a particular tax liability. At the CDP hearing, the taxpayer has the statutory right to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy, including the appropriateness of collection action, collection alternatives, spousal defenses, and under certain circumstances, the underlying tax liability.[2]

Taxpayers have the right to judicial review of Appeals' determinations provided that they timely request the CDP hearing and timely petition the Tax Court.[3] Generally, the IRS suspends levy actions during a levy hearing and any judicial review that may follow.[4]

Since 2003, CDP has been one of the federal tax issues most frequently litigated in the federal courts and analyzed for the National Taxpayer Advocate's Annual Report to Congress. The trend continues this year, with the courts issuing 131 opinions during the review period of June 1, 2009, through May 31, 2010.[5] The cases discussed below demonstrate CDP serves an important function by providing taxpayers with a forum to raise legitimate issues before the IRS deprives them of property. Many of these decisions provide guidance on substantive issues. Where taxpayers attempted to use the process inappropriately, courts imposed sanctions or warned taxpayers about the possibility of sanctions being imposed in the future.

1 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3401, 112 Stat. 685 (1998).

2 Internal Revenue Code (IRC) §§ 6320(c) (lien) and 6330(c) (levy). IRC § 6320(c) generally requires Appeals to follow the levy hearing procedures under IRC § 6330 for the conduct of the lien hearing and the review requirements.

3 IRC § 6330(d) (setting forth the time requirements for obtaining judicial review of Appeals' determination); IRC §§ 6320(a)(3)(B) and 6330(a)(3)(B) (setting forth the time requirements for requesting a CDP hearing for lien and levy matters, respectively).

4 IRC § 6330(e)(1) provides that generally, levy actions are suspended during the CDP process (along with a corresponding suspension in the running of the limitations period for collecting the tax). However, IRC § 6330(e)(2) allows the IRS to resume levy actions during judicial review upon a showing of "good cause," if the underlying tax liability is not at issue.

5 For a list of all of the cases reviewed, see Appendix III, Table 2, *infra*.

PRESENT LAW

Current law provides taxpayers an opportunity for independent review of an NFTL filed by the IRS, or of a proposed levy action.[6] As noted above, the purpose of CDP rights is to give taxpayers adequate notice of IRS collection activity and a meaningful hearing *before* the IRS deprives them of property.[7] The hearing allows taxpayers an opportunity to raise issues relating to the collection of the subject tax, including:

- Appropriateness of collection actions;[8]
- Collection alternatives such as an installment agreement (IA), offer in compromise (OIC), posting a bond, or substitution of other assets;[9]
- Appropriate spousal defenses;[10]
- The existence or amount of the underlying tax liability, but only if the taxpayer did not receive a notice of deficiency or did not otherwise have an opportunity to dispute the tax liability;[11] and
- Any other relevant issue relating to the unpaid tax, the NFTL, or the proposed levy.[12]

A taxpayer may not raise an issue considered at a prior administrative or judicial hearing if the individual participated meaningfully in that hearing or proceeding.[13]

Procedural Collection Due Process Requirements

The IRS must provide a CDP notice to the taxpayer after it has filed the first NFTL or before its first intended levy for the particular tax and tax period. The notice must be provided not more than five business days after the day of filing the lien notice, or at least 30 days before the day of the proposed levy.[14] In a lien filing, the notice must inform the taxpayer of his or her right to request a CDP hearing within the 30-day period that begins on the day after the end of the five-business-day period after the filing of the NFTL.[15] In the case of a levy, the notice must inform the taxpayer of his or her right to request a hearing within the 30-day period beginning on the day after the date on the CDP notice.[16]

6 IRC §§ 6320 and 6330. *See* RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998).

7 Prior to the enactment of RRA 98, the U.S. Supreme Court had held that a post-deprivation hearing was sufficient to satisfy due process concerns in the tax collection arena. *See U.S. v. National Bank of Commerce*, 472 U.S. 713, 719-722 (1985); *Phillips v. Comm'r*, 283 U.S. 589, 595-601 (1931).

8 IRC § 6330(c)(2)(A)(ii).

9 IRC § 6330(c)(2)(A)(iii).

10 IRC § 6330(c)(2)(A)(i).

11 IRC § 6330(c)(2)(B).

12 IRC § 6330(c)(2)(A); Treas. Reg. §§ 301.6320-1(e) and 301.6330-1(e).

13 IRC § 6330(c)(4).

14 IRC § 6320(a)(2) or § 6330(a)(2). The CDP notice can be provided to the taxpayer in person, left at the taxpayer's residence or dwelling, or sent by certified or registered mail (return receipt requested) to the taxpayer's last known address.

15 IRC § 6320(a)(3)(B); Treas. Reg. § 301.6320-1(b)(1).

16 IRC § 6330(a)(3)(B); Treas. Reg. § 301.6330-1(b)(1).

Requesting a CDP Hearing

Under both lien and levy procedures, the taxpayer must return a signed and dated written request for a CDP hearing within the applicable period.[17] Taxpayers who fail to timely request a CDP hearing will be afforded an "equivalent hearing," which is similar to a CDP hearing, but without judicial review.[18] The regulations require taxpayers to provide their reasons for requesting a hearing (preferably using Form 12153, *Request for a Collection Due Process or Equivalent Hearing*). Failure to provide the basis for the hearing may result in a denial of a face-to-face hearing.[19] The regulations provide that taxpayers must request an equivalent hearing within the one-year period beginning the day after the five-business-day period following the filing of the NFTL, or with respect to a levy, within the one-year period beginning the day after the date of the CDP notice. [20]

Conduct of a CDP Hearing

The IRS generally will suspend levy action throughout a CDP hearing involving an intent to levy, unless it determines the collection of tax is in jeopardy, the collection resulted from a levy on a state tax refund, or the IRS has served a disqualified employment tax levy.[21] The IRS also suspends collection activity throughout any judicial review of Appeals' determination, unless the underlying tax liability is not at issue and the IRS can demonstrate to the court good cause to resume collection activity.[22]

CDP hearings are informal. When a taxpayer requests a CDP hearing with respect to both a lien and a proposed levy, Appeals will attempt to conduct one hearing.[23] Courts have determined that a CDP hearing need not be face-to-face but can take place by telephone or correspondence.[24] The Office of Appeals presumptively establishes telephonic CDP hearings, so it is incumbent on the taxpayer to request a face-to-face session.[25] The CDP regulations state that taxpayers who provide non-frivolous reasons for opposing the IRS

17 IRC §§ 6330(a)(3)(B) and 6320(a)(3)(B); Treas. Reg. §§ 301.6320-1(c)(2) A-C1(ii) and 301.6330-1(c)(2) A-C1(ii).

18 Treas. Reg. §§ 301.6320-1(i)(2) Q&A-I16 and 301.6330-1(i)(2) Q&A-I16; *Orum v. Comm'r*, 123 T.C. 1 (2004); *Moorhous v. Comm'r*, 116 T.C. 263 (2001).

19 IRC §§ 6320(b)(1) and 6330(b)(1); Treas. Reg. §§ 301.6320-1(c)(2) A-C1, 301.6330-1(c)(2) A-C1, 301.6320-1(d)(2) A-D8 and 301.6330-1(d)(2) A-D8. The regulations require the IRS to provide the taxpayer an opportunity to "cure" any defect in a timely filed hearing request, including providing a reason for the hearing. In conjunction with issuing regulations, the IRS revised Form 12153 to include space for the taxpayer to identify collection alternatives that he or she wants Appeals to consider. The current form also includes a description of common alternatives so taxpayers can apply them to the specific facts of their cases. *See* IRS Form 12153, *Request for a Collection Due Process or Equivalent Hearing* (Rev. 11-2006).

20 Treas. Reg. §§ 301.6320-1(i)(2) A-17 and 301.6330-1(i)(2) A-17.

21 IRC § 6330(e)(1) provides the general rule for suspending collection activity. IRC § 6330(f) provides that if collection of the tax is deemed in jeopardy, the collection resulted from a levy on a state tax refund, or the IRS served a disqualified employment tax levy, IRC § 6330 does not apply, except to provide the opportunity for a CDP hearing within a reasonable time after the levy. *See Clark v. Comm'r*, 125 T.C. 108, 110 (2005) (citing *Dora v. Comm'r*, 119 T.C. 356 (2002)). A disqualified employment tax levy is any levy to collect employment taxes for any taxable period if the person subject to the levy (or any predecessor thereof) requested a CDP hearing with respect to unpaid employment taxes arising in the most recent two-year period before the beginning of the taxable period with respect to which the levy is served. IRC § 6330(h).

22 IRC §§ 6330(e)(1) and (e)(2).

23 IRC § 6320(b)(4).

24 *Katz v. Comm'r*, 115 T.C. 329, 337-38 (2000) (finding that telephone conversations between the taxpayer and the appeals officer constituted a hearing as provided in IRC § 6320(b)).

25 Treas. Reg. §§ 301.6320-1(d)(2) A-D6, A-D8 and 301.6330-1(d)(2) A-D6, A-D8. *See, e.g.*, Appeals Letter 4141 (rev. Sept. 2009) acknowledges the taxpayer's request for a CDP hearing, and provides information on the availability of a face-to-face conference.

collection action will generally be offered, but not guaranteed, a face-to-face conference. Taxpayers making frivolous arguments are not entitled to a face-to-face conference.[26] A taxpayer will not be granted a face-to-face conference concerning a collection alternative, such as an installment agreement or OIC, unless other taxpayers would be eligible for the alternative under similar circumstances.[27] For example, a taxpayer who proposes an offer in compromise as the only issue to be addressed at the hearing, but who has failed to file all required returns and is therefore ineligible for an offer, will not be granted a face-to-face conference. Appeals may, however, in its discretion, grant a face-to-face conference where it determines it is appropriate to explain the requirements to become eligible for a collection alternative.[28]

The CDP hearing is to be held by an impartial officer from Appeals, who is barred from engaging in *ex parte* communication with IRS employees regarding the substance of the case and who has had "no prior involvement" in the case.[29] In addition to the issues raised by the taxpayer, the Appeals officer must verify that the IRS has met the requirements of all applicable laws and administrative procedures.[30] In its determination, Appeals must weigh the issues raised by the taxpayer and decide whether the proposed collection action balances the need for efficient collection of taxes with the legitimate concern of the taxpayer that any collection be no more intrusive than necessary.[31]

On December 6, 2006, Congress passed the Tax Relief and Health Care Act of 2006 (TRHCA).[32] Section 407 of the TRHCA changed the CDP process by providing that the IRS may disregard any portion of a hearing request that is based on a position identified as frivolous by the IRS or reflects a desire to delay or impede the administration of federal tax laws.[33] Section 407 also amended IRC § 6702 to create a frivolous submission penalty

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26 Treas. Reg. §§ 301.6320-1(d)(2) A-D7 and 301.6330-1(d)(2) A-D7. Appeals Letter 3846 (Rev. July 2008) provides that to be allowed a face-to-face conference about collection alternatives the taxpayer must have filed all required returns.

27 Treas. Reg. §§ 301.6320-1(d)(2) A-D8 and 301.6330-1(d)(2) A-D8.

28 Treas. Reg. §§ 301.6320-1(d)(2) A-D8 and 301.6330-1(d)(2) A-D8. *See also* Appeals Interim Guidance, *Face -to-Face Collection Due Process Conferences in the Absence of a Collection Information Statement*, (Oct. 12, 2010), *available at* http://www.irs.gov/pub/irs-utl/ap-08-1010-06.pdf. The guidance addresses how Appeals should handle a request for a face-to-face conference when the taxpayer has not produced the collection information necessary to evaluate the collection alternative. Consistent with the regulations, the guidance states Appeals should "[g]rant a face-to-face request if it is necessary to explain the requirements for becoming eligible for a collection alternative. Taxpayers may be better able to understand the requirements for becoming eligible for a collection alternative if they are able to meet with an Appeals employee face-to-face. Examples include a taxpayer with a hearing impairment, who speaks little or no English, or who lacks sophistication."

29 IRC §§ 6320(b)(1), 6320(b)(3), 6330(b)(1) and 6330(b)(3). *See also* Rev. Proc. 2000-43, 2000-2 C.B. 404. *See, e.g., Industrial Investors v. Comm'r*, T.C. Memo. 2007-93; *Moore v. Comm'r*, T.C. Memo. 2006-93, *action on dec.*, 2007-2 (Feb. 27, 2007); *Cox v. Comm'r*, 514 F.3d 1119, 1124-1128 (10th Cir. 2008).

30 IRC § 6330(c)(1); *Hoyle v. Comm'r*, 131 T.C. No. 13 (2008).

31 IRC § 6330(c)(3)(C).

32 Pub. L. No. 109-432, 120 Stat. 2922 (2006). The provisions set forth in section 407 are effective for submissions made and issues raised after the date on which the IRS first prescribed a list of frivolous positions. Notice 2007-30, 2007-1 C.B. 883, which was published on or about April 2, 2007, provided the first published list of frivolous positions. Notice 2010-33, 2010-17 I.R.B. 609, provides the current list of frivolous positions.

33 IRC § 6330(g).

for such requests.[34] A CDP hearing request is subject to the penalty if any portion of the request "(i) is based on a position which the Secretary has identified as frivolous…or (ii) reflects a desire to delay or impede the administration of the Federal tax laws."[35]

Section 407 also amended IRC §§ 6320(b)(1) and 6330(b)(1) to require taxpayers to include the grounds for requesting the hearing in writing in their CDP hearing requests. Section 6330(c)(4) was amended to provide that an issue may not be raised at a hearing if the issue is based on a position identified as frivolous by the IRS or reflects a desire to delay or impede the administration of federal tax laws.

On May 25, 2007, Congress again modified CDP procedures for employment tax liabilities by amending IRC § 6330(f) to permit a levy to collect employment taxes without first giving a taxpayer a pre-levy CDP notice if the levy is a "disqualified employment tax levy."[36] A disqualified employment tax levy is

> [A]ny levy in connection with the collection of employment taxes for any taxable period if the person subject to the levy (or any predecessor thereof) requested a hearing under this section with respect to the unpaid employment taxes arising in the most recent 2-year period before the beginning of the taxable period with respect to which the levy is served.[37]

Judicial Review of CDP Determination

Within 30 days of Appeals' determination, the taxpayer may petition the United States Tax Court for judicial review.[38] Where the validity of the underlying tax liability is properly at issue in the CDP hearing, the court will review the amount of the tax liability on a *de novo* basis.[39] Where the appropriateness of the collection action is at issue, the court will review the IRS's administrative determination for abuse of discretion.[40]

ANALYSIS OF LITIGATED CASES

CDP was the second-most frequently litigated tax issue in the federal court system between June 1, 2009, and May 31, 2010. We reviewed 131 CDP court opinions, a 23 percent decrease from the 170 cases in last year's analysis. However, these 131 opinions do not

34 The frivolous submission penalty applies to the following submissions: CDP hearing request, offer in compromise, installment agreement request, and application for a taxpayer assistance order.

35 IRC § 6702(b)(2)(a). Before assertion of the penalty, the IRS must notify the taxpayer that it has determined that the taxpayer filed a frivolous hearing request. The taxpayer then has 30 days to withdraw the submission in order to avoid assertion of the penalty. IRC § 6702(b)(3).

36 Pub. L. No. 110-28, § 8243(a), (b), 121 Stat. 112, 200 (2007). This amendment is effective for such levies served on or after September 22, 2007.

37 IRC § 6330(h).

38 IRC § 6330(d)(1). Prior to October 17, 2006, the taxpayer could also petition the federal district court if the Tax Court did not have jurisdiction over the underlying tax liability (*e.g.*, if the matter involved an employment tax liability).

39 The legislative history of RRA 98 addresses the standard of review courts should apply in reviewing the Appeals' CDP determinations. H.R. Rep. No. 105-99, at 266 (Conf. Rep.). The term *de novo* means anew. Black's Law Dictionary, 447 (7th ed. 1999).

40 *See, e.g.*, *Murphy v. Comm'r*, 469 F.3d 27 (1st Cir. 2006).

reflect the full number of CDP cases filed because the court does not issue an opinion in all cases. Some are resolved through settlements, and in other cases taxpayers do not pursue litigation after filing a petition with the court, resulting in dismissal of the action prior to the court issuing an opinion. Additionally, the Tax Court disposes of some cases by issuing unpublished orders. Table 2 in Appendix III provides a detailed list of the CDP opinions reviewed, including specific information about the issues, the types of taxpayers involved, and the outcomes of the cases.

Litigation Success Rate

Taxpayers prevailed in full in 13 of the 131 cases reviewed (approximately ten percent), and prevailed in part in two cases.[41] Taxpayers with representation received full relief in four cases and partial relief in one case,[42] while *pro se* taxpayers prevailed in nine cases and partial relief in one case.[43]

Table 3.2.1 below compares litigation success rates in CDP cases reported in the 2003 through 2010 Annual Reports to Congress.[44]

TABLE 3.2.1, SUCCESS RATES IN CDP CASES[45]

Court Decision	2003	2004	2005	2006	2007	2008	2009	2010
Decided for IRS	96%	95%	89%	90%	92%	90%	92%	89%
Decided for Taxpayer	1%	4%	8%	8%	5%	8%	4%	10%
Split Decision[46]	3%	1%	3%	2%	3%	2%	4%	2%
Neither[47]	N/A	N/A	N/A	N/A	Less than 1%	N/A	N/A	N/A

Issues Litigated

The cases discussed below are those that the National Taxpayer Advocate believes are significant or noteworthy. The outcomes of these cases can provide important information to Congress, the IRS, and taxpayers about the rules and operation of CDP hearings. Equally important, all of the cases reviewed offer the opportunity to look for ways to improve the collection process, in both application and execution.

41 *See, e.g., Barnes v. Comm'r*, T.C. Memo. 2010-30; *Blair v. Comm'r*, T.C. Memo. 2009-232; *Blank v. Comm'r*, T.C. Summ. Op. 2010-10; *Selph v. Comm'r*, T.C. Summ. Op. 2010-20.

42 *See, e.g., Fairlamb v. Comm'r*, T.C. Memo. 2010-22; *Judge v. Comm'r*, T.C. Memo. 2009-135; *Ken Ryan, Inc. v. Comm'r*, T.C. Summ. Op. 2010-18; *Michael v. Comm'r*, 133 T.C. No. 10 (2009).

43 *See, e.g., Medical Practice Solutions LLC v. Comm'r*, T.C. Memo. 2009-214; *Selph v. Comm'r, T.C. Summ.* Op. 2010-20; *Vinatieri v. Comm'r*, 133 T.C. No. 16 (2009).

44 *See* National Taxpayer Advocate 2008 Annual Report to Congress 482, Table 3.2.1, for 2003, 2004, 2005, 2006, 2007, and 2008 statistics.

45 Numbers have been rounded to nearest percentage.

46 A "split" decision refers to a case with multiple issues where both the IRS and the taxpayer prevail on one or more substantive issues.

47 A "neither" decision refers to a case where the court's decision was not in favor of either party.

Procedural Rulings

IRS practices and actions, such as assessing taxes, are governed by procedural rules set out in statutes and regulations. The IRS's failure to follow these procedural rules can result in unreasonable actions. The Tax Court may review CDP hearings to make sure that Appeals Officers have properly reviewed IRS procedural actions or have themselves correctly followed all required procedures.

Vinatieri v. Commissioner

In *Vinatieri v Commissioner*,[48] the IRS sent the taxpayer a Final Notice of Intent to Levy and Notice of Your Right to a Hearing on September 13, 2007, with respect to the taxpayer's tax liability for 2002. The taxpayer timely requested a hearing on September 24, 2007, which was conducted through correspondence and by telephone with the settlement officer. The settlement officer asked the taxpayer whether she wanted to enter into an installment agreement, and the taxpayer stated, "she has nothing." The taxpayer was a single mother who could only work part time because she had pulmonary fibrosis.

During the review of the taxpayer's case, the settlement officer discovered the taxpayer had not filed a return for 2005. The taxpayer explained to the settlement officer that the payroll company responsible for completing her 2005 Form W-2, *Wage and Tax Statement*, was no longer in business, and that she had attempted to get the tax information from the IRS, but the IRS had no information regarding her 2005 income.

The settlement officer told the petitioner that she might be able to have her account placed in currently not collectible (CNC) status, but would need her to submit a Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, and a diagnosis regarding her current health condition. The taxpayer submitted a completed Form 433-A, indicating she had monthly income of $800 and expenses of $800, had $14 cash on hand, and owned a 1996 Toyota Corolla four-door sedan with 243,000 miles that was valued at $300. The taxpayer was unable to obtain a written diagnosis of her medical condition from her physician because her physician would only provide the documentation in a claim for workers' compensation.

In light of the taxpayer's financial information, which showed that she relied on her car to get to work and would not be able to pay her basic living expenses if her wages were levied upon, the settlement officer concluded in her log that the levy would create an economic hardship. However, the settlement officer issued a notice of determination, which was approved by the Appeals team manager, finding that it was appropriate to proceed with the levy, because collection alternatives such as an installment agreement, an OIC, or reporting the account as CNC, were not available because the petitioner had not filed her 2005 and 2007 returns. The taxpayer appealed to the Tax Court.

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48 133 T.C. No. 16 (2009).

The Tax Court ruled that upholding the levy was "unreasonable because IRC § 6343 would require its immediate release, and the determination to do so was arbitrary." The court observed that pursuant to IRC § 6343(a)(1)(D),[49] a levy that creates an economic hardship for a taxpayer must be released. Because the settlement officer had determined that the taxpayer met these hardship requirements with respect to CNC status, the taxpayer must have similarly met the economic hardship requirements of IRC § 6343(a)(1)(D). Thus, proceeding with the levy was unreasonable because IRC § 6343(a)(1)(D) would have required its immediate release. The Court denied the IRS's motion for summary judgment.

In response to this case, the National Taxpayer Advocate in March 2010 issued guidance to TAS employees discussing the *Vinatieri* decision and the Internal Revenue Manual (IRM) provisions that could lead to levies required to be immediately released.[50] In addition, TAS submitted draft language to the IRS recommending changes to the misleading IRM provisions, and is actively engaging the IRS in discussion.[51] As of October 1, 2010, the IRS had not implemented any of the suggested changes.[52] Thus, taxpayers continue to encounter the same situation as Mrs. Vinatieri and some of them have come to TAS for help.[53]

Szulczewski v. Commissioner

In *Szulczewski v. Commissioner*,[54] the IRS failed to meet its burden of proving that it properly mailed a statutory notice of deficiency to the taxpayer's last known address. The IRS bears the burden of proof in this case because it could not produce a notice of deficiency. When the IRS cannot produce a notice of deficiency it must provide evidence that shows that the notice was delivered to the Postal Service for mailing. In this case, the IRS was unable to provide a copy of the notice of deficiency at trial or a PS Form 3877, which shows the name and address of taxpayers who have been sent a notice of deficiency for a particular day. The IRS relied on the stipulation of facts and the testimony of a paralegal

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49 IRC § 6343(a)(1)(D) requires the release of a levy if the levy is creating an economic hardship for the taxpayer. Treasury Regulation § 301.6343-1(b)(4)(i) provides that economic hardship is present if "satisfaction of the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses."

50 TAS Interim Guidance Memorandum (IGM), *Interim Guidance on Handling Collection Cases Where Economic Hardship Is Present but the Taxpayer Has Not Filed All Required Returns* (Mar. 23, 2010), *available at* http://www.irs.gov/pub/foia/ig/tas/tas-13_1-0110-01.pdf.

51 E-mail from Special Counsel to the National Taxpayer Advocate, Office of Chief Counsel, to Director, Collection Policy (Mar. 24, 2010); E-mail from TAS Collection Technical Liaison to Supervisory Revenue Officer, Small Business/Self Employed (SB/SE) Collection Policy (Sept. 16, 2010).

52 According to the Wage & Investment (W&I) division, "there is not a need to make additional changes to the IRM guidance or training material as it relates to addressing economic hardship situations." W&I response to TAS research request (July 9, 2010) (response to question 3). However, on Aug. 20, 2010, W&I issued a Servicewide Electronic Research Program (SERP) Alert 100440, *Vinatieri Decision: Guidance When a Taxpayer Who Has Been Levied Indicates that the Levy Is Creating a Hardship* (Aug. 20, 2010), reminding its employees of two circumstances in which accounts can be closed without securing an unfiled return, and that accounts can be referred for Substitute for Return (SFR) processing or the delinquent return module can be sent to the queue. According to SB/SE, "Since the *Vinatieri* decision...analysts have been working on an IRM revision CNC procedures for the IRM 5.19.1. Any changes will be incorporated in the IRM rewrite." SB/SE response to TAS research request (July 13, 2010) (response to question 2).

53 As of Sept. 9, 2010, TAS had issued 62 Operations Assistance Requests to the IRS operating divisions, advocating for taxpayers suffering from economic hardship when the IRS has issued a notice of levy or a Final Notice of Intent to Levy but will not place the account in CNC status or release a levy because of unfiled returns. While often the required returns are ultimately secured, TAS successfully advocated for placing the taxpayer's account in CNC status in five cases despite unfiled returns and successfully advocated for a levy release in 11 cases (one of these cases is included in the five CNC cases), despite unfiled returns. This issue was also raised in the National Taxpayer Advocate's FY 2011 Objectives Report to Congress.

54 *Szulczewski v. Comm'r*, T.C. Summ. Op. 2009-136.

to support its assertion that that the notice was sent. Regarding the stipulation of facts, the parties stipulated that the IRS mailed the notice of deficiency, by certified mailed, to petitioner's last known address on August 31, 2004. However, in the next sentence the parties stipulated that "Petitioner claims he did not receive the Statutory Notice dated August 31, 2004." After weighing the testimony offered during trial and the stipulation of facts, the Court concluded that the IRS had not met its burden of proving that the notice of deficiency was properly mailed.

Judge v. Commissioner

In *Judge v. Commissioner*,[55] the court held that the settlement officer's denial of a short extension of time was an abuse of discretion. The taxpayer timely requested a CDP hearing and stated he would pursue a collection alternative. Appeals requested a completed Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, which the taxpayer submitted on July 2, 2007. When the settlement officer received the case file, he could not find the Form 433-A. In an October 11, 2007, letter, the settlement officer requested that the taxpayer submit Form 433-A, a signed 2006 return, and proof of 2007 estimated tax payments, within 14 days. The settlement officer did not tell the taxpayer that he could not find the Form 433-A previously submitted. The taxpayer's representative told the settlement officer that he believed the taxpayer's income was overstated on the Form 433-A and requested a short extension of time to prepare a revised form. The settlement officer denied the request. On November 19, 2007, the respondent issued a notice of determination sustaining the levy for the years at issue. The Tax Court held that it was unreasonable of the settlement officer to deny the taxpayer's request for a brief extension to file the Form 433-A. The matter was remanded back to Appeals for the Appeals Officer to consider an OIC or another collection alternative.

Fairlamb v. Commissioner

In *Fairlamb v. Commissioner*,[56] the Court held that Appeals' determination rejecting the taxpayer's OIC was insufficient to determine if the rejection was an abuse of discretion. The taxpayer failed to timely file federal tax returns for taxable years 1998 through 2004. The IRS filed substitutes for returns for these years, and after assessment of tax, it sent the taxpayer a Letter 1058, *Final Notice-Notice of Intent to Levy and Notice of Your Right to a Hearing*, regarding the 2002, 2003, and 2004 liabilities. The taxpayer then submitted a timely Form 12153, *Request for a CDP Hearing*, on which he stated that enforcement action would create a hardship and he intended to submit an OIC. The taxpayer submitted two offers that the IRS rejected, followed by a third one when he was 65 years old. This time, the settlement officer initially recommended acceptance, but the officer's manager rejected the offer because the amount did not appear to equal or exceed the taxpayer's reasonable collection potential (RCP). The manager's RCP calculation was based on the general rule of

[55] T.C. Memo. 2009-135.

[56] T.C. Memo. 2010-22.

adding the value of the taxpayer's assets to the taxpayer's future income for the number of months remaining on the statutory period for collection, rather than the taxpayer's future income over the next five years until retirement. However, the Court questioned why Appeals did not consider IRM 5.8.5.5(3), which instructs Appeals to consider the taxpayer's overall situation, mental status, number and age of dependents, education level, and work experience. The Court further questioned why Appeals did not consider IRM 5.8.5.5(5), which provides for flexibility in special circumstances where future income may differ from current or past income, especially when "a taxpayer is elderly, in poor health, or both and the ability to continue working is questionable." The Court remanded the case and directed Appeals to clarify its decision and to allow the taxpayer to propose a new collection alternative.

Appeals Impartiality

IRC §§ 6320(b)(3) and 6330(b)(3) require CDP hearings to be conducted by an "impartial" Appeals officer or employee – one "who has had no prior involvement with respect to the unpaid tax" before the first CDP lien or levy hearing. The National Taxpayer Advocate is concerned about a lack of independence of the Office of Appeals from other IRS functions.[57] In this year's and previous reports, the National Taxpayer Advocate has focused on cases where employees engage in *ex parte* communications that can compromise Appeals' independence.[58] The case below, however, clarifies what independence means in the context of reviewing collection alternatives in a CDP hearing.

Hartmann v. Commissioner

In *Hartmann v. Commissioner*,[59] the taxpayer appealed the Tax Court's decision, arguing that it was improper to have the same appeals officer review and make a determination on the taxpayer's OIC as well as conduct the CDP hearing. The Court of Appeals for the Third Circuit affirmed the Tax Court stating that it was not improper for the same IRS agent to conduct both the CDP hearing and review the taxpayer's OIC, which the taxpayer submitted during the CDP hearing as a collection alternative. The Court pointed out that IRC § 6330(b)(3) provides that a CDP hearing "shall be conducted by an officer or employee who has had no prior involvement with respect to the unpaid tax specified." The Court determined that the IRS agent had no "prior involvement" with the case and reviewing the OIC did not fall within this provision.

57 *See* Legislative Recommendation: *Require the IRS Office of Appeals to Maintain Its Independence and Have at Least One Appeals Officer in Each State, supra*; National Taxpayer Advocate 2006 Annual Report to Congress 266 (Most Serious Problem: *Concerns with the IRS Office of Appeals*); National Taxpayer Advocate 2005 Annual Report to Congress 136 (Most Serious Problem: *Appeals Campus Centralization*); National Taxpayer Advocate 2004 Annual Report to Congress 264 (Most Serious Problem: *Independence of the Office of Appeals*).

58 *See* Most Serious Problem: *Appeals' Failure to Adequately Document Prohibited Ex Parte Communications Inadvertently Violate Taxpayer Rights and Damage the Public's Perception of its Independence, supra*.

59 351 Fed. Appx. 624 (3d Cir. 2009).

The Administrative Record

When reviewing the appropriateness of a CDP hearing determination, the Tax Court limits its review to the administrative record, except in cases where the Court considers the underlying tax liability on a *de novo* basis. The administrative record includes the case file, written communication by the taxpayer, or his representative, the Appeals Officer's notes, any notation of oral communication between the taxpayer and Appeals Officer, and any other materials relied upon by the Appeals Officer in making his or her determination.[60] The administrative record is significant, because, except for limited exceptions, the Tax Court will not review evidence outside the record.[61] On occasion, the Tax Court has found that Appeals Officers have failed to consider or analyze all material facts in the administrative record appropriately. Below is an example of this type of error.

Marlow v. Commissioner

In *Marlow v. Commissioner*,[62] a husband and wife timely filed a joint return for 2004 and 2005. The IRS sent the taxpayers a Final Notice of Intent to Levy and Your Right to a Hearing and the taxpayers requested a CDP hearing. The IRS stated it did not send a notice of deficiency for the subject tax years because the taxpayers signed Forms 4549, *Income Tax Examination Changes,* and 870, *Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment*, agreeing to the additional tax and waiving the notice of deficiency. During the CDP hearing, the taxpayers testified they did not recall signing these forms. Further, there were no entries in the IRS history indicating (1) the revenue agent received Forms 4549 from the taxpayers, signed or unsigned; (2) the taxpayers ever signed Forms 4549 agreeing that additional taxes were owed for 2004 and 2005; or (3) the taxpayers agreed on Forms 4549 and Forms 870 or in any other writing to waive the restrictions on assessment of the deficiencies.

At the hearing, the taxpayers were told they could not challenge the underlying tax liability, because they had signed Forms 4549 and 870 agreeing to it. The settlement officer, relying on the certificate of assessment and payments (Form 4340) of the taxpayers' account, determined that the IRS followed all requirements of applicable law and administrative procedure and that the petitioners had agreed to the assessments of additional tax. However, when the taxpayers requested the administrative file after the hearing to see the signed forms, the IRS was unable to locate the file. The Court held that the settlement officer did not obtain proper verification that all requirements of applicable law and administrative

60 Treas. Reg. §§ 301.6320-1(f)(2).

61 *Murphy v. Comm'r*, 469 F.3d 27 (1st Cir. 2006) (evidence outside administrative record is permissible if the a failure to explain administrative action frustrates effective judicial review); *Robinette v. Comm'r*, 439 F.3d 455, 461 (8th Cir. 2004) ("Of course, where a record created in informal proceedings does not adequately disclose the basis for the agency's decision, then it may be appropriate for the reviewing court to receive evidence concerning what happened during the agency proceedings.") (citations omitted). *See also James Madison Ltd. By Hecht v. Ludwig*, 82 F2d 1085, 1096 (D.C. Cir. 1996) (courts may "need to resolve factual issues regarding the process the agency used in reaching its decision.... Although these facts are usually established by the administrative record or are otherwise undisputed, parties may occasionally raise an issue requiring district courts to engage in independent fact-finding.").

62 T.C. Memo. 2010-113. The taxpayer in Marlow was represented by a low income taxpayer clinic (LITC). The LITC program serves individuals who have a problem with the IRS and whose income is below a certain level. LITCs are independent from the IRS.

procedure had been met. Although reliance on a Form 4340 generally is sufficient for verification, if a taxpayer disputes the accuracy of the Form 4340, further verification may be necessary, and in this instance, the IRS could not produce evidence sufficient to establish that the taxpayers signed the waiver forms. The court held that remand was not necessary and would not be productive, because the IRS was unable to locate the forms even for trial. Thus, the Court affirmatively held that the tax assessments were invalid, because the IRS had made them without first issuing notices of deficiency.

Imposition of Sanctions

Over the past few years, one notable issue that began emerging from the review of CDP decisions was the extent to which the courts imposed sanctions on taxpayers for frivolous positions. Section 6673(a)(1) authorizes the Tax Court to impose sanctions when it appears that proceedings have been instituted or maintained primarily for delay or when the taxpayer's position is frivolous or groundless.[63] These penalties are used to deter the filing of frivolous CDP hearing requests. However, penalties to deter frivolous requests were imposed significantly less often this year than last. Of the 131 cases decided during the review period, the courts imposed sanctions in only five cases, or four percent.[64] Last year, with 170 cases decided, the courts imposed sanctions in 22 cases, or 13 percent.[65] This significant decline in CDP cases in which the IRC § 6673 penalty was applied may be attributable to recently enacted IRC § 6330(g),[66] which allows the IRS to disregard a frivolous hearing request and precludes judicial review of such requests. The National Taxpayer Advocate will continue to analyze this issue in future reports and is interested to learn whether this is a one-time decrease in sanctions, or a new trend.

Pro Se Analysis

Pro se taxpayers, those without benefit of counsel, litigated 84 (or 64 percent) of the 131 cases brought before the courts, a decrease from 72 percent in the previous year, but still up compared to 58 percent in 2008.[67] Table 3.2.2 shows the breakdown of *pro se* and represented cases and the decisions rendered by the court, indicating that approximately 12 percent of *pro se* taxpayers received some relief on judicial review while approximately 11 percent of represented taxpayers received full or partial relief.

63 For a more detailed discussion of IRC § 6673, see Most Litigated Issue: *Frivolous Issues Penalty and Related Appellate Level Sanctions Under Internal Revenue Code Section 6673, infra.*

64 *See e.g., Kay v. Comm'r*, T.C. Memo. 2010-59

65 *See e.g., Maga v. Comm'r*, T.C. Memo. 2008-162; *Taylor v. Comm'r*, T.C. Memo. 2008-151; *Williams v. Comm'r*, T.C. Memo. 2008-173.

66 Pub. L. No. 109-432, 120 Stat. 2922 (2006).

67 National Taxpayer Advocate 2008 Annual Report to Congress 486.

TABLE 3.2.2, *PRO SE* AND REPRESENTED TAXPAYER CASES AND DECISIONS

Court Decisions	*Pro Se* Taxpayers		Represented Taxpayers	
	Volume	Percentage of Total	Volume	Percentage of Total
Decided for IRS	74	88%	42	89%
Decided for Taxpayer	9	11%	4	9%
Split Decisions	1	1%	1	2%
Totals:	**84**		**47**	

CONCLUSION

CDP hearings continue to provide an invaluable opportunity for taxpayers to meaningfully address the appropriateness of IRS collection actions. Given the important protection that CDP hearings offer, it should be of little surprise that CDP remains one of the most frequently litigated tax issues in the federal courts – a trend unlikely to change anytime soon. The cases reviewed illustrate the critical importance of the IRS's rigorous compliance with the fundamental CDP requirements, such as verification under IRC § 6330(c)(1) and balancing of harm to the taxpayer, and of taxpayers being both be timely and forthright with respect to their CDP requirements. Because of the important role of CDP hearings in protecting taxpayer rights, taxpayers and their representatives will likely continue to pursue their CDP rights in court and CDP will most likely continue to be a heavily litigated issue in years to come.

MLI #3 Accuracy-Related Penalties Under Internal Revenue Code Sections 6662(b)(1) and (2)

SUMMARY

Internal Revenue Code (IRC) §§ 6662(b)(1) and (2) authorize the IRS to impose a penalty if under § (b)(1) a taxpayer's negligence or disregard of rules or regulations caused an underpayment of tax, or if under § (b)(2) an underpayment of tax exceeded a computational threshold called a substantial understatement. IRC § 6662(b) also authorizes the IRS to impose three other accuracy-related penalties.[1] However, during our review period of June 1, 2009, through May 31, 2010, taxpayers litigated these penalties less frequently than the negligence and substantial understatement penalties; therefore our analysis does not address the three other accuracy-related penalties.

PRESENT LAW

The amount of an accuracy-related penalty equals 20 percent of the portion of the underpayment attributable to the taxpayer's negligence or disregard of rules or regulations, or a substantial understatement.[2]

The IRS may assess penalties under both subsections of the accuracy-related statute. The total penalty rate, however, may not exceed 20 percent (*i.e.*, the penalties are not "stackable").[3] Generally, taxpayers are not subject to the accuracy-related penalty if they establish that they had reasonable cause for the underpayment and acted in good faith.[4] In addition, a taxpayer will only be subject to the negligence component of the penalty on the portion of the underpayment attributable to negligence. For example, if a taxpayer erroneously reports multiple items of income, some items may be justifiable mistakes while others might be the result of negligence, and the penalty would only apply to the latter.

Negligence

The IRS may impose the IRC § 6662(b)(1) negligence penalty if it concludes a taxpayer's negligence or disregard of the rules or regulations caused the underpayment.[5] Negligence includes a failure to make a reasonable attempt to comply with internal revenue laws, including a failure to keep adequate books and records or to substantiate items that gave rise

1 IRC § 6662(b)(3) authorizes a penalty for any substantial valuation misstatement for income taxes; IRC § 6662(b)(4) authorizes a penalty for any substantial overstatement of pension liabilities; and IRC § 6662(b)(5) authorizes a penalty for any substantial valuation understatement of estate or gift taxes.

2 IRC § 6662(b)(1) (negligence/disregard of rules or regulations) and IRC § 6662(b)(2) (substantial understatement).

3 Treas. Reg. § 1.6662-2(c). The penalty rises to 40 percent if any portion of the underpayment is due to a gross valuation misstatement. *See* IRC § 6662(h)(1).

4 IRC § 6664(c)(1).

5 IRC § 6662(c) defines negligence as "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."

to the underpayment.[6] Strong indicators of negligence include instances where a taxpayer failed to report income on a tax return that a payor reported on an information return as defined in IRC § 6724(d)(1),[7] or a taxpayer failed to make a reasonable attempt to ascertain the correctness of a deduction, credit, or exclusion.[8] The IRS can also consider various other factors in determining whether the taxpayer's actions were negligent.[9]

Substantial Understatement

In general, an "understatement" is the difference between (1) the correct amount of tax and (2) the amount reported on the return, reduced by any rebate.[10] Understatements are generally reduced by the portion of an understatement attributable to (1) an item for which the taxpayer had substantial authority; or (2) any item if the taxpayer adequately disclosed the relevant facts affecting the item's tax treatment in the return or in an attached statement, and the taxpayer had a reasonable basis for the tax treatment of the item.[11] For individuals, the understatement of tax is substantial if it exceeds the greater of $5,000 or ten percent of the correct amount of tax required to be shown on the return.[12] For corporations (other than S corporations or personal holding companies), an understatement is substantial if it exceeds the lesser of ten percent of the tax required to be shown on the return or $10,000,000.[13]

For example, if the correct amount of tax should have been $10,000 and the individual taxpayer reported $6,000, the substantial understatement penalty under IRC § 6662(b)(2) would not apply because although the $4,000 shortfall is more than the ten percent test ($1,000 is ten percent of $10,000), it is less than the fixed $5,000 threshold. Conversely, if the same individual taxpayer reported a tax of $4,000, the substantial understatement penalty would apply because the $6,000 shortfall is more than $1,000 (ten percent of $10,000), and is also greater than $5,000.

6 Treas. Reg. § 1.6662-3(b)(1).

7 IRC § 6724(d)(1) defines an information return by cross-referencing various other sections of the Code that define information returns (*e.g.*, IRC § 6724(d)(1)(A)(ii) references IRC § 6042(a)(1) for reporting of dividend payments).

8 Treas. Reg. § 1.6662-3(b)(1)(i) and (ii).

9 These factors include the taxpayer's history of noncompliance; the taxpayer's failure to maintain adequate books and records; actions taken by the taxpayer to ensure the tax was correct; and whether the taxpayer had an adequate explanation for underreported income. Internal Revenue Manual (IRM) 4.10.6.2.1 (May 14, 1999).

10 IRC § 6662(d)(2)(A).

11 IRC § 6662(d)(2)(B). No reduction is permitted, however, for any item attributable to a tax shelter. *See* IRC § 6662(d)(2)(C)(i).

12 IRC § 6662(d)(1)(A)(i) and (ii).

13 IRC § 6662(d)(1)(B)(i) and (ii).

Reasonable Cause

The accuracy-related penalty does not apply to any portion of an underpayment where the taxpayer acted with reasonable cause and in good faith.[14] A reasonable cause determination takes into account all of the pertinent facts and circumstances.[15] Generally, the most important factor is the extent of the taxpayer's effort to determine the proper tax liability.[16]

Penalty Assessment and the Litigation Process

In general, the IRS proposes the accuracy-related penalty as part of its examination process[17] and through its Automated Underreporter (AUR) computer system.[18] Before a taxpayer receives a notice of deficiency, he or she has opportunities to engage the IRS on the merits of the penalty.[19] Once the IRS concludes an accuracy-related penalty is warranted, it must follow the same deficiency procedures it uses with other assessments, *i.e.*, IRC §§ 6211-6213.[20] Thus, the IRS must send a notice of deficiency with the proposed adjustments and inform the taxpayer that he or she has 90 days to petition the United States Tax Court.[21] Alternatively, taxpayers may seek judicial review through refund litigation.[22] Under certain circumstances, a taxpayer can request an administrative appeal of IRS collection procedures (and the underlying liability, including the imposition of the IRC § 6662 penalties) through a Collection Due Process (CDP) hearing.[23]

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14 IRC § 6664(c)(1).

15 Treas. Reg. § 1.6664-4(b)(1). For a discussion of problems related to the IRS's administration of the reasonable cause penalty, see Most Serious Problem: *Over-Reliance on the Reasonable Cause Assistant Leads to Inaccurate Penalty Abatement Determinations, supra*.

16 Treas. Reg. § 1.6664-4(b)(1).

17 IRM 20.1.5.3(1) and (2) (July 1, 2008).

18 The AUR is an automated program that identifies discrepancies between amounts that taxpayers reported on a tax return and amounts that payors reported via Form W-2, Form 1099, and other information returns. *See* IRM 4.19.2 (Sept. 1, 2009). IRC § 6751(b)(1) provides the general rule that IRS employees must have written supervisory approval before assessing any penalty. However, IRC § 6751(b)(2)(B) allows an exception for situations where the IRS can calculate a penalty automatically "through electronic means." The IRS interprets this exception as allowing it to use its AUR system to propose the substantial understatement and negligence components of the accuracy-related penalty without human review. If a taxpayer responds to an AUR-proposed assessment, then at that point the IRS first involves its employees to determine whether the penalty is appropriate. If the taxpayer does not respond timely to the notice, the computers then automatically convert the proposed penalty to an assessment. National Taxpayer Advocate 2007 Annual Report to Congress 259 ("Although automation has allowed the IRS to more efficiently identify and determine when such underreporting occurs, the IRS's over-reliance on automated systems rather than personal contact has led to insufficient levels of customer service for taxpayers subject to AUR. It has also resulted in audit reconsideration and tax abatement rates that are significantly higher than those of all other IRS examination programs").

19 For example, when the IRS proposes to adjust a taxpayer's liability, including additions to tax such as the accuracy-related penalty, it typically sends a notice ("30-day letter") of proposed adjustments to the taxpayer. The taxpayer has 30 days to contest the proposed adjustments to IRS Appeals, during which time he or she may raise issues related to the deficiency, including the reasonable cause exception. If the issue is not resolved after the 30-day letter, the IRS sends a statutory notice of deficiency ("90-day letter") to the taxpayer. *See* IRS Pub. 5, *Your Appeal Rights and How to Prepare a Protest If You Don't Agree* (Jan. 1999); IRS Pub. 3498, *The Examination Process* (Nov. 2004).

20 IRC § 6665(a)(1).

21 IRC § 6213(a). Note that a taxpayer has 150 days instead of 90 to petition the Tax Court if the IRS sent the notice of deficiency to an address outside the United States.

22 Taxpayers may litigate an accuracy-related penalty by paying the tax liability (including the penalty) in full, filing a timely claim for refund, and then instituting a refund suit in the appropriate United States District Court or the Court of Federal Claims. 28 U.S.C. § 1346(a)(1); IRC § 7422(a); *Flora v. U.S.*, 362 U.S. 145 (1960) (requiring full payment of tax liabilities as a prerequisite for jurisdiction over refund litigation).

23 IRC §§ 6320 and 6330 provide for due process hearings in which a taxpayer may raise a variety of issues including the underlying liability, provided the taxpayer did not receive a statutory notice of deficiency or did not otherwise have an opportunity to dispute such liability. IRC § 6330(c)(2).

Burden of Proof

In court proceedings, the IRS bears the initial burden of production regarding the accuracy-related penalty.[24] The IRS must first present sufficient evidence to establish that the penalty is warranted. The burden of proof then shifts to the taxpayer to establish any exception to the penalty, such as reasonable cause.[25]

ANALYSIS OF LITIGATED CASES

For the period from June 1, 2009, through May 31, 2010, we identified 125 cases where taxpayers litigated the negligence/disregard of rules or regulations, or substantial understatement components of the accuracy-related penalty. The IRS prevailed in full in 86 cases (69 percent), taxpayers prevailed in full in 30 cases (24 percent), and nine cases (seven percent) resulted in split decisions. Thus, taxpayers prevailed partially or fully in 31 percent of the penalty disputes.

Taxpayers appeared *pro se* (without representation) in 78 of the 125 cases (62 percent). *Pro se* taxpayers convinced the court to dismiss or reduce the penalty in 22 cases (28 percent of *pro se* cases).[26] Taxpayers appeared with representation in 47 of the 125 cases (38 percent). Represented taxpayers achieved full or partial relief from the penalty in 17 cases (36 percent of represented cases).

In some cases, the court was unclear on which subsection, (b)(1) or (b)(2), of the accuracy-related penalty applied. Where possible, in Table 3 of Appendix III, we indicate which subsection was at issue. Regardless of the subsection, the analysis of reasonable cause is the same. Therefore, we have combined our analyses of reasonable cause for the negligence and substantial understatement cases.

Reasonable Cause

Adequacy of Records and Substantiation of Deductions for Reasonable Cause and as Proof of Taxpayer's Good Faith

Taxpayers were most successful in establishing a defense for an underpayment when they produced adequate records. Taxpayers are required to maintain records sufficient to establish the amount of gross income, deductions, and credits claimed on a return.[27] For example, in *Manning v. Commissioner*,[28] the court found that although the taxpayers (a husband and wife) mistakenly claimed two deductions in 2003 for items not paid until the following year, the taxpayers kept accurate records and were otherwise thorough. Therefore,

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24 IRC § 7491(c) provides that "the Secretary shall have the burden of production in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed by this title."

25 *Id*. *See also* Tax Court Rule 142(a).

26 In determining the taxpayer success rates, we included those cases that were split between the taxpayer and the IRS because the taxpayer achieved a reduction in penalties.

27 IRC § 6001; Treas. Reg. § 1.6001-1(a).

28 T.C. Memo. 2009-157.

the taxpayers had shown that they acted with reasonable cause and good faith, and were not liable for the penalty.

In other cases, the court found the taxpayer did not show good faith in attempting to comply with tax laws, and had no reasonable cause when presenting inadequate records or insufficient substantiation. For example, in *Ramirez v. Commissioner*,[29] the U.S. Tax Court sustained the IRS in denying deductions and imposing accuracy-related penalties, because the taxpayer failed to keep adequate records to substantiate deductions. The taxpayer failed to comply with record-keeping requirements for deductions and did not provide requested information.

Reliance on Advice of Tax Professional for Reasonable Cause

Reliance on a tax professional was the second most commonly litigated example of reasonable cause. To qualify for reliance on a tax professional under the reasonable cause exception for accuracy-related penalties, the taxpayers must establish that: (1) they provided all necessary information to the tax professional; (2) the tax professional was competent with sufficient expertise; and (3) the taxpayers relied in good faith on the tax professional's opinion or tax return preparation.[30]

Cases in which the taxpayer was successful in claiming reliance on a tax professional include:

- A taxpayer who was a recreational gambler failed to substantiate the gambling wins and losses she claimed on her return. The court found that although she could not claim the deductions without sufficient substantiation, her reliance on the attorney who prepared her return was reasonable and in good faith.[31]
- The taxpayer, a partnership that was a shareholder in a corporation, attempted to claim a deduction for business expenses of the corporation that were capital investments. Although the court found against the taxpayer on the issue of the deductions, the court held that the taxpayer's reliance on the advice of a CPA, who was also an attorney, was reasonable and in good faith.[32]
- The taxpayer, a company, was found to have attempted to comply with the law because it sought advice from accountants and attorneys, and had hired tax professionals to write opinions on an issue that was a matter of first impression. Therefore, the reliance on a tax professional was reasonable cause and in good faith.[33]

Most Litigated Issues

29 T.C. Memo. 2010-108.

30 *Neufeld v. Comm'r*, T.C. Memo. 2008-79; *Neonatology Associates, P.A. v. Comm'r*, 115 T.C. 43, 99 (2000) (citations omitted), *aff'd*, 299 F.3d 221 (3d Cir. 2002); Treas. Reg. § 1.6664-4(c)(1).

31 *Laplante v. Comm'r*, T.C. Memo. 2009-226.

32 *Canterbury Holdings LLC v. Comm'r*, T.C. Memo. 2009-175.

33 *Southgate Master Fund v. U.S.*, 104 A.F.T.R.2d (RIA) 6053 (N.D. Tex. 2009).

Examples of cases where the taxpayers were unsuccessful in claiming reliance on a tax professional include:

- The taxpayer's estate failed to report income from Social Security, dividends, and interest on a return. The court found the estate's reliance on a tax professional was not reasonable because the executor neither provided his preparer with necessary documentation nor examined the return before filing it.[34]
- The taxpayers, a husband and wife, claimed deductions for noncash charitable contributions which the IRS disallowed for failure to substantiate. The court found that the couple had failed to show that their reliance on their CPA's advice was reasonable cause or in good faith because they did not show that he was a tax expert and they failed to provide him with necessary information.[35]
- The taxpayers, a husband and wife, argued that they relied on their preparer to correctly prepare personal and corporate returns. The Tax Court held that the taxpayers failed to show that they reasonably or in good faith relied on the preparer because the husband lacked the records to substantiate deductions.[36]

Although reliance on a tax professional may be evidence of acting reasonably and in good faith, it does not necessarily entitle the taxpayer to escape liability for accuracy-related penalties. The taxpayer must also exercise diligence and prudence. In *Prudhomme v. Commissioner*,[37] the court found taxpayers' reliance on their accountants' expertise was not reasonable because one of the accountants was a last-minute replacement for their regular accountant and the taxpayers had failed to disclose to either accountant that they had previously sold their business.

Other Circumstances for Reasonable Cause

Tax Sophistication of the Taxpayer

A taxpayer's education and sophistication in business and tax issues are taken into account when determining whether a taxpayer acted with reasonable cause and in good faith.[38] For taxpayers with special knowledge or experience in tax law, courts often sustained the penalty because the taxpayers should have known better. For example, the Tax Court held that taxpayers sophisticated in business or tax matters lacked reasonable cause and did not act in good faith in the following instances:

- A tax attorney with 35 years of experience liquidated his partnership interest and attempted to classify it as long-term capital gain instead of ordinary income. He also failed to use the proper mechanism to report the income, doing so inconsistently with

34 *Estate of Stiel v. Comm'r*, T.C. Memo. 2009-278.

35 *Friedman v. Comm'r*, T.C. Memo. 2010-45.

36 *Rosser v. Comm'r*, T.C. Memo. 2010-6.

37 345 Fed. Appx. 6 (5th Cir. 2009), *aff'g* T.C. Memo. 2008-83.

38 Treas. Reg. § 1.6664-4(b)(1).

the manner in which the partnership reported the liquidation on the partnership return. The Tax Court held that a tax attorney of his standing should have known how to report the inconsistency and therefore, he did not act reasonably or in good faith.[39]

- The taxpayer, a former IRS employee, attempted to take several deductions that the IRS disallowed, including a net operating loss carryfoward and a long-term capital loss for amounts from an uncollected judgment that were discharged in a bankruptcy. The court held that as a tax service representative with the IRS for more than ten years, the taxpayer "had a wider range of knowledge of tax matters than do members of the general public."[40] Consequently, in light of the taxpayer's experience and knowledge, the taxpayer and his wife were liable for the penalty.[41]
- A CPA who had a master's degree in accounting and majored in tax claimed unsubstantiated deductions on his return, filed as single while he was married, and attempted to deduct amounts paid in a personal lawsuit as a business expense. The Tax Court found that, considering his training and experience, he failed to act with reasonable cause or in good faith.[42]
- Several taxpayers attempted to take business deductions for dog breeding and raising horses. They failed to show that their reliance on advice of a tax professional was reasonable because they were sophisticated business persons who failed to keep adequate records of their expenses. In addition, the tax professional had warned at least one of the taxpayers of the possible repercussions if the activities were found to be hobbies.[43]

In contrast, taxpayers fared better when they lacked specialized tax knowledge. For example, the Tax Court in *Derby v. Commissioner* held that although the taxpayer was not eligible for the deductions, given his lack of experience and knowledge of tax law, reliance on his bookkeeper to prepare his return was reasonable and he acted in good faith.[44]

Taxpayers Facing Complex Issues or Circumstances

The court found reasonable cause to dismiss a penalty when taxpayers litigated a complex issue or circumstances created a misunderstanding of law. For example, in *Anderson v. Comm'r*,[45] a fisherman who was part of a crew of fewer than ten members failed to report self-employment tax for work done on a boat because he believed he was not self-employed.[46] The court held that although the taxpayer was self-employed, he was not liable for the accuracy-related penalty because he had received compensation for additional boat

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39 *Wallis v. Comm'r*, T.C. Memo. 2009-243.

40 *Green v. Comm'r*, T.C. Memo. 2010-109 (citation omitted).

41 *Green v. Comm'r*, T.C. Memo. 2010-109.

42 *Argyle v. Comm'r*, T.C. Memo. 2009-218.

43 *Smith v. Comm'r*, 104 A.F.T.R.2d (RIA) 7830 (9th Cir. 2009), *aff'g* T.C. Memo. 2007-368.

44 T.C. Memo. 2010-66.

45 T.C. Memo. 2010-1.

46 *See* IRC § 3121(b)(20). An individual working on a boat for catching fish or other aquatic animals, and whose pay is determined by the amount of the catch, is not considered an employee if the boat normally has less than ten persons working on it.

repairs and had been required to pay lobbying fees, and under those circumstances, his belief that he was not self-employed was reasonable. Therefore, the taxpayer acted in good faith and with reasonable cause.

Penalties in Settlement Cases

Several taxpayers attempted to exclude settlement payments from gross income under IRC §104(a)(2).[47] In cases where the court found the amount of the settlement payment should be included in gross income, the accuracy-related penalty often was not upheld. For example, in *Espinoza v. Commissioner*,[48] the Tax Court found the taxpayer's reliance on the advice of her personal injury attorney, that the amount of the settlement was not includible in gross income, was reasonable and the taxpayer acted in good faith. Similarly, in *Longoria v. Commissioner*,[49] the Tax Court held that, although the taxpayer failed to show that the settlement award was for personal injuries, he was not liable for an accuracy-related penalty because he acted in good faith and reasonably relied on his CPA's advice that the award payment was not includible.

On the other hand, courts have found other taxpayers liable for the accuracy-related penalty for not including settlement payments in gross income. For example, in *Campbell v. Commissioner*,[50] the taxpayer received a "*qui tam*" settlement payment as a result of two lawsuits he brought under the False Claims Act.[51] The taxpayer included the net proceeds of the settlement payment, less attorney's fees, on his return as "other income" but failed to include any of the proceeds when computing taxable income. In sustaining the IRS's determination to impose the substantial understatement component of the accuracy-related penalty, the court concluded that the taxpayer did not have substantial authority or reasonable basis for excluding the settlement payment from gross income, and did not adequately disclose the net proceeds. The court held that because the taxpayer was sophisticated in accounting and business, his failure to seek a tax professional's advice was not reasonable.

Tax Shelter Penalty Litigation

In the majority of cases where accuracy-related penalties were assessed for tax shelters, they were upheld.[52] When an underpayment is related to an item reflected on the return of a pass-through entity, to discern whether the taxpayer acted with reasonable case or good faith, one may look at all circumstances, including the actions of the taxpayer and

47 IRC § 104(a)(2) excludes from gross income damage awards received "on account of personal physical injuries or physical sickness." Damage awards received for other injuries or reasons must generally be included in gross income.

48 T.C. Memo. 2010-53.

49 T.C. Memo. 2009-162.

50 134 T.C. No. 3 (2010).

51 The False Claims Act allows a private citizen to bring a *qui tam* action on behalf of the United States. *See* 31 U.S.C. §§ 3729-3733. *Qui tam* is "[a]n action brought under a statute that allows a private person to sue for a penalty, part of which the government or some specified public institution will receive." Black's Law Dictionary 1282 (8th ed. 2004).

52 IRC § 6662(d)(2)(C). A tax shelter is an entity or arrangement whose "significant purpose…is the avoidance or evasion of Federal income tax."

the entity.[53] For example, in *Enbridge Energy Company Inc. v. United States*,[54] the taxpayer created a corporation solely to purchase another company for the purpose of acquiring the other company's assets. The court found that the conduit transaction[55] was a tax shelter because its only purpose was to avoid tax liability. Thus, neither the substantial authority nor the adequate disclosure/reasonable basis exceptions to reduce the amount of the understatement were applicable.

Where taxpayers attempt to assert a defense of reliance on the advice of a tax professional in the tax shelter context, the courts have sometimes held this defense to be unreasonable. For example, in *Nevada Partners Fund LLC v. United States*,[56] the court sustained the accuracy-related penalties because it found that the taxpayers' reliance on the advice of a tax professional was not reasonable or in good faith. There was substantial authority that instructed the taxpayers against entering into the transaction. In addition, the court looked at the sophistication of the parties, and concluded that their reliance on their tax advisor was not reasonable, given that the parties knew that the advisor was under investigation for such transactions.

CONCLUSION

In the cases reviewed for this report, deficiency determinations or a portion of the deficiency determined by the IRS were generally upheld. However, the court at times overruled the IRS, in full or in part, in regard to the accuracy-related penalties. In 31 percent of the cases, the court reduced or dismissed the penalty. The success rate was greater for taxpayers who were represented by counsel than for those who appeared *pro se*.

The cases indicate that when the taxpayers were incorrect on the underlying tax issue, they often escaped liability for the penalty if they made a legitimate attempt to ascertain the correct amount of tax. Adequacy of records and reliance on tax professionals were the preeminent bases for a finding of reasonable cause. The courts also considered factors such as the knowledge or sophistication of the taxpayer and the complexity of the circumstances. The IRS should review the cases where the court found against the IRS's determinations to impose a penalty and incorporate the courts' rationale into employee training, the Internal Revenue Manual, and the Reasonable Cause Assistant (RCA).[57]

53 Treas. Reg. § 1.6664-4(e).

54 354 Fed. Appx. 15 (5th Cir. 2009), *aff'g* 553 F. Supp. 2d 716 (S.D. Tex. 2008).

55 A conduit transaction is "[a] sale by one person ... transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title." *See Comm'r v. Court Holding Corp.*, 324 U.S. 331 (1945).

56 105 A.F.T.R.2d (RIA) 2133 (S.D. Miss. 2010).

57 For a full discussion of problems with the RCA, see Most Serious Problem, *Over-Reliance on the Reasonable Cause Assistant Leads to Inaccurate Penalty Abatement Decisions, supra.*

MLI #4 Trade or Business Expenses Under Internal Revenue Code Section 162 and Related Sections

SUMMARY

The deductibility of trade or business expenses is perennially among the ten most litigated tax issues in the federal courts. We identified 119 cases that included a trade or business expense issue and were litigated between June 1, 2009, and May 31, 2010. The courts affirmed the IRS position in the majority (approximately 64 percent) of cases, while taxpayers prevailed about seven percent of the time.[1] The remaining cases resulted in split decisions.

PRESENT LAW

Internal Revenue Code (IRC or the "Code") § 162 allows deductions for ordinary and necessary trade or business expenses paid or incurred during a taxpayer's taxable year. Rules regarding the practical application of IRC § 162 have evolved largely from case law and administrative guidance. The IRS, the Department of the Treasury, Congress, and the courts continue to provide legal guidelines about whether a taxpayer is entitled to certain trade or business expense deductions. The cases analyzed for this report illustrate that this process is ongoing and involves the analysis of facts and circumstances. When a taxpayer seeks judicial review of the IRS's determination of a tax liability stemming from the deductibility of a particular trade or business expense, the courts must often address a series of questions, including those discussed below.

What is a trade or business expense under IRC § 162?

Although "trade or business" is one of the most widely used terms in the IRC, neither the Code nor any Treasury Regulation provides a definition.[2] The definition of "trade of business" comes from common law, where the concepts have been developed and refined by the courts.[3] The United States Supreme Court has interpreted "trade or business" for purposes of IRC § 162 to mean an activity conducted "with continuity and regularity" and with the primary purpose of earning income or making a profit.[4]

What is an ordinary and necessary expense?

IRC § 162(a) requires a trade or business expense to be both "ordinary and necessary" in relation to the taxpayer's trade or business in order to be deductible. In *Welch v. Helvering*, the Supreme Court stated that the words "ordinary" and "necessary" have different

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1 The IRS prevailed in full in 74 of the 119 cases, while taxpayers prevailed in full in only nine cases.

2 In 1986, the term "trade or business" appeared in at least 492 subsections of the Code and 664 Treasury Regulations. *See* F. Ladson Boyle, *What Is a Trade or Business?* 39 Tax Law. 737 (Summer 1986).

3 Carol Duane Olson, *Toward a Neutral Definition of "Trade of Business" in the Internal Revenue Code*, 54 U. Cin. L. Rev. 1199 (1986).

4 *Comm'r v. Groetzinger*, 480 U.S. 23, 35 (1987).

meanings, and both must be satisfied for a taxpayer to benefit from the deduction.[5] The Supreme Court describes an "ordinary" expense as customary or usual and of common or frequent occurrence in the taxpayer's trade or business,[6] and a "necessary" expense as appropriate and helpful for the development of the business.[7]

Common law also requires that the amount of the expense be reasonable for an ordinary and necessary business expense to be deductible. In *Commissioner v. Lincoln Electric Co.*, the Court of Appeals for the Sixth Circuit held that "the element of reasonableness is inherent in the phrase 'ordinary and necessary.' Clearly it was not the intention of Congress to automatically allow as deductions operating expenses incurred or paid by the taxpayer in an unlimited amount."[8]

Is the expense a currently deductible expense or a capital expenditure?

A currently deductible expense is one that is ordinary and necessary, and is paid or incurred during the taxable year in the course of carrying on a trade or business.[9] No deductions are allowed for the cost of acquisition, construction, improvement, or restoration of an asset expected to last more than one year.[10] Instead, such capital expenditures may be subject to amortization, depletion, or depreciation over the useful life of the property.[11]

Whether to deduct expenditures under IRC § 162(a) or to capitalize them under IRC § 263 is a question of fact. Thus, courts have adopted a case-by-case approach to applying principles of capitalization and deductibility.[12]

When is an expense paid or incurred during the taxable year?

IRC § 162(a) requires an expense to be "paid or incurred during the taxable year" to be deductible. The Code also requires a taxpayer to maintain books and records that substantiate income, deductions, and credits – including adequate records to substantiate deductions claimed as trade or business expenses.[13] If a taxpayer cannot substantiate deductions by documentary evidence (*e.g.*, an invoice, paid bill, or canceled check) but can establish that he or she had some deductible business expenses, the courts may opt to employ the *Cohan* rule to grant deductions of reasonable amounts.

5 290 U.S. 111, 113 (1933).

6 *Deputy v. du Pont*, 308 U.S. 488, 495 (1940) (citation omitted).

7 *Comm'r v. Tellier*, 383 U.S. 687, 689 (1966) (citations omitted).

8 176 F.2d 815, 817 (6th Cir. 1949) (citation omitted), *cert. denied*, 338 U.S. 949 (1950).

9 IRC § 162(a).

10 IRC § 263. *See also INDOPCO, Inc. v. Comm'r*, 503 U.S. 79 (1992).

11 IRC § 167.

12 *See PNC Bancorp, Inc. v. Comm'r*, 212 F.3d 822 (3d Cir. 2000); *Norwest Corp. v. Comm'r*, 108 T.C. 265 (1997).

13 IRC § 6001. *See also* Treas. Reg. §§ 1.6001-1 and 1.446-1(a)(4).

The *Cohan* rule is a rule of "indulgence" established in 1930 by the Court of Appeals for the Second Circuit in *Cohan v. Commissioner*.[14] The court held that the taxpayer's business expense deductions were not adequately substantiated, but "the [Tax Court] should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent."[15]

The *Cohan* rule may not be utilized in circumstances where IRC § 274(d) applies. Section 274(d) provides that unless a taxpayer complies with strict substantiation rules, no deduction is allowable for:

1. Travel expenses (including meals and lodging while away from home);
2. Entertainment, amusement, or recreation expenses;
3. Gifts; or
4. Certain "listed property."[16]

A taxpayer must substantiate a claimed IRC § 274(d) expense with adequate records or sufficient evidence to corroborate the taxpayer's statement that establishes the amount, time, place, and business purpose of the expense.[17]

Who has the burden of proof in a substantiation case?

Generally, a taxpayer bears the burden of proving that he or she is entitled to the business expense deductions, and that the IRS's proposed determination of tax liability is incorrect.[18] IRC § 7491(a) shifts the burden of proof to the IRS when a taxpayer:

- Introduces credible evidence with respect to any factual issue relevant to ascertaining the taxpayer's liability;
- Complies with the requirements to substantiate deductions;
- Maintains all records required under the Code; and
- Cooperates with reasonable requests by the IRS for witnesses, information, documents, meetings, and interviews.[19]

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14 39 F.2d 540 (2d Cir. 1930).

15 *Cohan v. Comm'r*, 39 F.2d 540, 544 (2d Cir. 1930).

16 "Listed property" means any passenger automobile; any property used as a means of transportation; any property of a type generally used for purposes of entertainment, recreation, or amusement; any computer or peripheral equipment (except when used exclusively at a regular business establishment and owned or leased by the person operating such establishment); any cell phones (or similar telecommunications equipment); or other property specified by regulations. IRC § 280F(d)(4)(A) and (B).

17 Treas. Reg. § 1.274-5T(b).

18 *See Welch v. Helvering*, 290 U.S. 111, 115 (1933) (citations omitted); U.S. Tax Court Rules of Practice and Procedure, Rule 142(a).

19 IRC § 7491(a)(1) applies to a court proceeding in which the examination started after July 22, 1998, and if there is no examination, to the taxable period or events which started or occurred after July 22, 1998.

ANALYSIS OF LITIGATED CASES

Trade or business expenses have been one of the ten most litigated tax issues in the federal courts since the first edition of the National Taxpayer Advocate's Annual Report to Congress in 1998. For this year's report, we reviewed 119 cases involving various trade or business expense issues litigated in federal courts from June 1, 2009, through May 31, 2010. Table 4 in Appendix III lists those cases and the issues involved. Table 3.4.1 (below) categorizes the main issues raised by taxpayers. Cases involving more than one issue are included in more than one category. In *Wolfgram v. Commissioner*,[20] for example, the taxpayer raised four distinct trade or business expense issues, so *Wolfgram* appears in four categories in Table 3.4.1.

TABLE 3.4.1, TRADE OR BUSINESS EXPENSE ISSUES IN CASES REVIEWED

Issue	Type of Taxpayer	
	Individual	Business (including sole proprietors)
Substantiation of expenses, including application of the Cohan rule[21]	24	43
Profit objective[22]	0	14
Ordinary and necessary trade or business expenses[23]	1	11
Personal vs. business expenses[24]	19	31
Business expenses vs. capital expenditures[25]	0	6
Education expenses[26]	4	0
Did the taxpayer establish the carrying on of a trade or business?	0	23

20 T.C. Memo. 2010-69.

21 IRC § 6001 and Treas. Reg. § 1.6001-1 require a taxpayer to maintain books and records that substantiate income, deductions, and credits. Treas. Reg. § 1.162-17 provides guidance regarding maintaining adequate records to substantiate deductions claimed as trade or business expenses in connection with the performance of services as an employee. The *Cohan* rule allows courts to estimate certain expenses not properly substantiated. *See Cohan v. Comm'r*, 39 F.2d 540, 544 (2d Cir. 1930). IRC § 274(d) and Treas. Reg. § 1.274-5T(b) set strict substantiation rules for business expenses for travel, entertainment, gifts, and certain listed property as defined in IRC § 280F(d)(4).

22 IRC § 183(a) provides that no deduction attributable to an activity engaged in by an individual or an S corporation shall be allowed if such activity is not engaged in for profit. The nine-factor test to determine whether an activity is engaged in for profit includes: (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned from the activity; (8) the financial status of the taxpayer; and (9) the elements of personal pleasure or recreation. *See* Treas. Reg. § 1.183-2(b)(1)-(9). All facts and circumstances are to be taken into account and no single factor or set of factors is determinative. Treas. Reg. § 1.183-2(b).

23 IRC § 162(a) allows deductions for ordinary and necessary trade or business expenses paid or incurred during the taxable year.

24 IRC § 262(a) provides that personal, living, and family expenses are generally not deductible.

25 Under IRC § 263(a), generally no deduction is allowed for capital expenditures, where capital expenditures include any amount paid for permanent improvements made to increase the value of any property. Under IRC § 195(a), startup expenditures generally cannot be deducted unless a taxpayer makes an expense/amortization election according to IRC § 195(b). Taxpayers who make the election may generally deduct up to $5,000 of startup expenditures in the tax year in which an active trade or business begins and amortize any excess expenditures over 180 months. The $5,000 deduction is reduced by a dollar for every dollar that total start-up expenditures exceed $50,000. *See* IRC § 195(b)(1)(A), (B).

26 Treas. Reg. § 1.162-5(a) provides that a taxpayer may deduct educational expenses under IRC § 162(a) if the education maintains or improves skills required by the individual in his or her employment or other trade or business, or meets the express requirements of the individual's employer.

Approximately 72 percent of the taxpayers litigating trade or business deduction issues represented themselves (*pro se*). In terms of percentage, taxpayers represented by counsel were about as successful as their *pro se* counterparts in obtaining relief. Taxpayers with representation received full or partial relief in approximately 39 percent of litigated cases (13 of 33), while *pro se* taxpayers received full or partial relief in approximately 35 percent of litigated cases (30 of 86).

Individual Taxpayers

None of the 30 decisions involving individual taxpayers was issued as a regular opinion of the Tax Court.[27] All but four of these taxpayers appeared *pro se*, and one individual taxpayer received full relief, although 11 of the 30 cases resulted in split decisions. The most prevalent issue for individual taxpayers was the substantiation of the claimed trade or business expense deductions, which appeared in 24 cases.

For example, in *Freeman v. Commissioner*,[28] a split decision, the Tax Court allowed a courier for an auto parts delivery company to deduct travel expenses for his 234-mile daily route based on the taxpayer's credible testimony. The taxpayer's mileage log was lost in a fire confirmed by state authority. Despite the strict substantiation requirements of IRC § 274(d), the court allowed the taxpayer to substantiate his deductions by reasonable reconstruction because the taxpayer's records were lost in circumstances beyond his control. Yet, the court denied business mileage expenses to the taxpayer's wife, whose only evidence that she delivered for the same company was her husband's unsupported testimony. In *Tarpo v. Commissioner*,[29] another split decision, the taxpayers (a husband and wife) claimed a number of deductions related to an elaborate scheme to route ordinary income into an offshore trust. The Tax Court acknowledged it could estimate some expenses under the *Cohan* rule. Nevertheless, the court refused to apply the *Cohan* rule because it found the taxpayers' unsupported self-serving affidavits were an insufficient basis for a reasonable estimate. The Tax Court allowed only a licensing fee deduction because it was convinced the fee was actually paid and necessary to the wife's beauty consultant business.

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27 Tax Court reported decisions fall into three categories: regular decisions, memorandum decisions, and small tax case ("S") decisions. The regular decisions of the Tax Court include cases which have some new or novel point of law, or in which there may not be general agreement, and therefore have the most legal significance. In contrast, memorandum decisions generally involve fact patterns within previously settled legal principles and therefore are not as legally significant. Finally, "S" case decisions (for disputes involving $50,000 or less) are not appealable and, thus, have no precedential value. *See* IRC § 7463(b). *See also* U.S. Tax Court Rules of Practice and Procedure, Rules 170-175. Seventy percent of the cases involving individual taxpayers were "S" cases (21 of 30).

28 T.C. Memo. 2009-213.

29 T.C. Memo. 2009-222.

In several cases, the IRS disallowed significant deductions because of taxpayers' employment status, regardless of adequate substantiation.[30] In *Rosemann v. Commissioner*,[31] for example, the Tax Court classified a traveling salesman as a common-law employee and precluded him from deducting business expenses on Schedule C. Consequently, the taxpayer's expenses were subject to the two percent adjusted gross income limitation of IRC § 67(a). In *Martin v. Commissioner*,[32] a taxpayer incorporated his real estate sales business and sought to fully deduct expenses that the corporation paid on his behalf. The Tax Court recharacterized the deductions as wage expenses. The court explained that classifying the taxpayer as an employee was proper because the corporation's income was generated from the substantial services he performed, and the taxpayer was the corporation's officer and only employee.[33]

Courts denied travel expense deductions to taxpayers who traveled for work extensively but were not "away from home."[34] For example, in *Minick v. Commissioner*,[35] a field engineer who traveled out of state while working at assigned construction sites failed to establish any business relationship with the state of his personal residence, and that his residence was not his tax home for purposes of IRC § 162. The Tax Court held that the taxpayer's camper and motel expenses were dictated by a choice to maintain his personal residence rather than the exigencies of his engineering trade.

Business Taxpayers

Eighty-nine of the 119 litigated trade or business expense cases involved business taxpayers. These taxpayers were slightly more successful than individual taxpayers in obtaining a favorable outcome, receiving full or partial relief in approximately 35 percent of cases (31 of 89) compared to 40 percent for individuals (12 of 30). Notably, however, seven business taxpayers obtained full relief, while one individual taxpayer (*Singleton*) prevailed in full. In ten favorably decided cases, business taxpayers were represented by counsel.

30 The significance of employee classification arises from the amount of business expenses a taxpayer may deduct. Common-law employees must report their deductions on Form 2106, *Employee Business Expenses*, and Schedule A of Form 1040. They may deduct only business expenses unreimbursed by the taxpayer's employer subject to a two percent limitation for miscellaneous itemized deductions. *See* IRC §§ 67(a), (b). Independent contractors, business owners, and statutory employees may deduct reasonable business expenses in full on Schedule C of Form 1040. *See* IRC § 3121(d) for the definition of an "employee."

31 T.C. Memo. 2009-185.

32 T.C. Memo. 2009-234.

33 Employee classification affects business taxpayers as well as individual taxpayers. In *Stahl*, a district court found that a § 501(d) religious organization was not entitled to deduct as business expenses the value of meals and medical care provided to a member. *See Stahl v. United States*, 673 F. Supp. 2d 1233 (E.D. Wash. 2009). The court concluded that the organization's founding member was not an employee because his relationship with the organization was based not on job performance but on shared religious commitments.

34 *See* IRC § 162(a); Treas. Reg. § 1.162-2. Generally, a taxpayer's tax home is the taxpayer's principal place of employment. The place of a taxpayer's personal residence may become the taxpayer's tax home, in exception to the rule, when the taxpayer accepts temporary, and not indefinite, employment away from the taxpayer's personal residence. This exception applies only if exigencies of the taxpayer's trade or business rather than the taxpayer's personal choice drive the taxpayer's decision to maintain the same place of personal residence while traveling.

35 T.C. Memo. 2010-12.

As with individual taxpayers, substantiation of expenses was the most prevalent issue,[36] and in some instances the courts denied business taxpayers' deductions for failure to substantiate.[37] On the other hand, courts allowed business taxpayers' deductions when they were properly substantiated.[38] For example, in *Foster v. Commissioner*,[39] the Tax Court estimated deductible wage expenses based on a taxpayer's credible testimony that two project managers were the taxpayer's employees and he paid them weekly wages. The court also approximated deductions for rental expenses for a joint lease based on the taxpayer's testimony and a worksheet that detailed reimbursements.

Another common issue litigated by business taxpayers was the question of whether the business expense deductions were attributable to a legitimate "for profit" activity constituting a trade or business. In *Helmick v. Commissioner*,[40] the Tax Court held that the taxpayers' horse–breeding and boarding operation, though unprofitable, was an activity engaged in with intent of making a profit. Despite their shoebox record keeping, the taxpayers conducted the operation in a businesslike manner, had a business strategy, and invested in the construction of an indoor riding arena and additions to their barn. The taxpayers' middle-class status meant that they could not afford to maintain the horse-breeding activity without prospects for profit.[41] The court found it unlikely and even absurd that the taxpayers would spend a substantial amount of time performing dawn-to-dusk strenuous labor and lose thousands of dollars simply for pleasure.

In *Chow v. Commissioner*,[42] the Tax Court acknowledged that an expectation of profit is a product of subjective intent that need not be reasonable, and took an uncommon position in finding that taxpayers pursued gambling activity with a profit objective.[43] The court reasoned that the taxpayers could not sustain indefinitely the losses they had incurred and distinguished them from casual gamblers who rely on other sources of income and have no expectation of profit. Yet, the Tax Court cautioned that this was a close case, and the taxpayers would be prudent to abandon gambling as a potential source of income.

The Court of Appeals for the Second Circuit faced an issue of first impression in *Robinson Knife*[44] and reversed the Tax Court to allow current deduction of a trademark licensee's royalty payments. The taxpayer incurred third-party trademark royalties only upon sale of inventory and thus calculated them as a percentage of net sales revenue from inventory.

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36 Substantiation of expenses issue appeared in 24 of 89 cases involving business taxpayers.

37 *See, e.g., Bennett v. Comm'r*, T.C. Memo. 2010-114; *Willock v. Comm'r*, T.C. Memo. 2010-75.

38 *See, e.g., Houston v. Comm'r*, T.C. Memo. 2009-286; *Derby v. Comm'r*, T.C. Memo. 2010-66.

39 T.C. Memo. 2009-274.

40 T.C. Memo. 2009-220.

41 The Tax Court expressly distinguished the taxpayers' operation from the stereotypical abusive scenario involving horse breeding where a wealthy businessman owns a "gentleman's farm" as a weekend retreat for the recreation of family and friends. *Helmick*, T.C. Memo. 2009-220.

42 T.C. Memo. 2010-48.

43 IRC § 165(d) trumps the general language of IRC § 162(a) to limit a deduction for gambling losses to the amount of gambling winnings. *See* IRC §§ 162(a); 165(d).

44 *Robinson Knife Mfg. Co. v. Comm'r*, 600 F.3d 121 (2d Cir. 2010), *rev'g* T.C. Memo. 2009-9.

The Second Circuit determined that these sales-based royalties did not require capitalization because they were not incurred "by reason of" production activities and were not properly allocable to the property produced by the taxpayer.[45]

Courts scrutinized at length acquisition of property interests to determine whether ownership was genuine so that related business expenses would qualify as deductible.[46] The Eighth Circuit affirmed the Tax Court's holdings to disallow depreciation and other deductions in a series of cases where the taxpayers did not acquire genuine tax ownership of ATM and payphone equipment.[47] The relevant purchase and service agreements indicated that the benefits and burdens of owning the equipment had not passed to the taxpayers because their contractual counterparties retained a high degree of control over the equipment, including choosing the locations for installation; performing the installation, maintenance, and repairs; paying insurance and other expenses; and retaining the majority of the profits. Thus, the Tax Court held that the taxpayers did not engage in a trade or business related to handling ATM and payphone equipment and were not eligible to deduct professional and legal expenses.

In *Consolidated Edison of New York v. United States*,[48] the Court of Federal Claims subjected the taxpayer's LILO (Lease-In-Lease-Out) transaction[49] to a rigorous conjunctive test and allowed the taxpayer's business expense deductions.[50] The test required that the transaction have both economic substance and a legitimate business purpose independent of tax benefits. The court found the LILO transaction was motivated by a legitimate business purpose because it helped the company reach its strategic goals. In addition, the transaction demonstrated the attributes of a genuine lease and even exceeded the Supreme Court's standard for true ownership.[51] The Court of Federal Claims recognized that risk of investment loss and reasonable opportunity to profit are among the benefits and burdens requisite for ownership of a leveraged leasehold interest, and the company's management deliberately evaluated the many benefits and risks of entering the transaction when reviewing potential investment opportunities. The transaction's potential for a realistic residual value created a true possibility to obtain a significant profit, and the taxpayer's investment remained subject to market risk and currency fluctuation throughout the life of

45 Treas. Reg. § 1.263A-1(e)(3)(i); *Robinson Knife Mfg. Co. v. Comm'r*, 600 F.3d 121, 131 (2d Cir. 2010), *rev'g* T.C. Memo. 2009-9.

46 A taxpayer is entitled to depreciation and other business expense deductions only if the benefits and burdens of owning the property have passed to the taxpayer. *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978). Mere transfer of legal title does not create property ownership where the transferor retains significant control over the property. *Frank Lyon Co. v. United States*, 435 U.S. 561, 572-73 (1978).

47 *Doherty v. Comm'r*, 105 A.F.T.R.2d (RIA) 2181 (8th Cir. 2010), *aff'g* T.C. Memo. 2009-99; *Loveland v. Comm'r*, 105 A.F.T.R.2d (RIA) 2182 (8th Cir. 2010), *aff'g* T.C. Memo. 2009-98; *Snyder v. Comm'r*, 105 A.F.T.R.2d (RIA) 2180 (8th Cir. 2010), *aff'g* T.C. Memo. 2009-97.

48 90 Fed. Cl. 228 (2009).

49 The taxpayer invested in a state of the art electricity-generating plant located in The Netherlands and sought to deduct related rent and interest expenses.

50 A taxpayer must qualify as a true owner of a leasehold interest in property to realize tax benefits of ownership and be eligible for deductions related to a leveraged lease, such as a LILO or SILO (Sale-In-Lease-Out) transaction provided that the transaction is a genuine lease. *See Consolidated Edison of New York v. United States*, 90 Fed. Cl. 228, at *126-27 (2009) (citing *Frank Lyon Co. v. United States*, 435 U.S. 561, 584 (1978); *Coltec Indus., Inc. v. United States*, 454 F.3d 1340, 1355-57 (Fed. Cir. 2006)).

51 *See Frank Lyon Co. v. United States*, 435 U.S. 561, 572-73 (1978) (noting that the Supreme Court is "not so much concerned with the refinements of title as it is with actual command over the property taxed – the actual benefit for which the tax is paid").

the lease. The opportunity to reach company goals through the LILO transaction created an additional positive cash flow benefit of not having to incur alternate costs. Moreover, the company would realize millions of dollars in pre-tax and after-tax cash profits if the sublease purchase options were exercised. Ultimately, the court acknowledged that each leasing transaction must be evaluated on its own merits.

By contrast, in *Altria Group, Inc. v. United States*,[52] a jury returned a verdict denying deductions related to a taxpayer's LILO and SILO transactions[53] because it concluded that the transactions failed to transfer ownership. When the taxpayer challenged the jury instructions and sought a new trial, the court held that the jury's finding – that the transaction lacked legitimate business purpose – was sufficient to support the verdict of lack of economic substance. In addition, the court pointed out that the transactions were motivated not by a reasonable opportunity to profit, but by tax avoidance, because the present value of the investments' pre-tax returns was negative, and the present value of after-tax returns was barely positive. Significant to the denial of the deductions was the conjunctive test the court applied where lack of either legitimate business purpose or reasonable opportunity to profit indicated the transaction lacked economic substance.

CONCLUSION

Taxpayers continued to challenge the IRS's denials of trade or business expense deductions. Surprisingly, represented taxpayers did not fare significantly better than others who litigated *pro se*. While the IRS generally prevailed, the courts did not always favor the IRS's application of the law to the taxpayers' facts and circumstances. Thus, the definition of an allowable trade or business expense remains open to interpretation and is highly fact-specific.

Many of these cases demonstrate taxpayer confusion over the legal requirements. The IRS can encourage compliance and minimize litigation by helping self-employed and small business taxpayers understand these requirements. Through education, outreach, and collaboration with stakeholders, the IRS can help taxpayers understand what trade or business expense deductions are allowable and how to substantiate them. By providing clear guidance on the deductibility of trade or business expenses, the IRS can minimize litigation.

52 2009 U.S. Dist. LEXIS 27463 (S.D.N.Y. 2009), *motion for new trial denied by* 2010 U.S. Dist. LEXIS 25160 (S.D.N.Y. 2010).

53 The taxpayer leased a Dutch wastewater treatment plant, two domestic power plants, and a domestic railroad maintenance facility from tax indifferent parties. The deductions in question were for depreciation, amortization, interest, and transaction expenses.

MLI #5

Gross Income Under Internal Revenue Code Section 61 and Related Sections

SUMMARY

When preparing tax returns, taxpayers must complete the crucial calculation of gross income for the taxable year to determine the tax they must pay. Gross income has been among the Most Litigated Issues in each of the National Taxpayer Advocate's Annual Reports to Congress.[1] For this report, we reviewed 103 cases decided between June 1, 2009, and May 31, 2010. Some gross income issues in these cases include:

- Damage awards;
- Foreign earned income; and
- Discharge of indebtedness.

PRESENT LAW

Internal Revenue Code (IRC) § 61 broadly defines gross income as "all income from whatever source derived."[2] The U.S. Supreme Court has defined gross income as any accession to wealth.[3] However, over time, Congress has carved out numerous exceptions and exclusions from this broad definition of gross income, and has based other elements of tax law on the definition.[4]

ANALYSIS OF LITIGATED CASES

In the 103 opinions involving gross income issued by the federal courts and reviewed for this report, gross income issues most often fall into two categories: (1) what is included in gross income under IRC § 61, and (2) what can be excluded under other statutory provisions. A detailed list of all cases analyzed appears in Table 5 of Appendix III.

In 29 cases (28 percent), taxpayers were represented, while the rest were *pro se* (without counsel). Eleven of the 29 represented taxpayers (about 31 percent) prevailed in full or in part in their cases whereas *pro se* taxpayers prevailed in full in just three cases, and in part in five others. Overall, taxpayers prevailed in full or in part in 19 of 103 cases (less than 18 percent). The vast majority of gross income cases this year involved taxpayers failing to report items of income, including some specifically mentioned in IRC § 61 such as wages,[5]

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1 *See, e.g.*, National Taxpayer Advocate 2008 Annual Report to Congress 470-475; National Taxpayer Advocate 2009 Annual Report to Congress 445-450.

2 IRC § 61(a).

3 *Comm'r v. Glenshaw Glass*, 348 U.S. 426, 431 (1955) (interpreting § 22 of the Internal Revenue Code of 1939, the predecessor to IRC § 61).

4 *See, e.g.*, IRC §§ 104 (compensation for injuries or sickness); 105 (amounts received under accident and health plans); 108 (income from discharge of indebtedness); 6501(limits on assessment and collection, determination of "substantial omission" from gross income).

5 IRC § 61(a)(1). *See, e.g., Nino v. Comm'r*, T.C. Memo. 2009-293.

interest,[6] and pensions.[7] In the context of items that can be excluded from gross income, the cases raised the following issues.

Damage Awards

Taxation of damage awards continues to generate litigation. This year, at least 11 taxpayers (about 11 percent of the cases reviewed) challenged the inclusion of damage awards in their gross income, and only one taxpayer prevailed on the issue. IRC § 104(a)(2) specifies that damage awards and settlement proceeds[8] are taxable as gross income unless the award was received "on account of personal physical injury or physical sickness."[9] Congress added the "physical injury or physical sickness" requirement in 1996;[10] until then, the word "physical" did not appear in the statute. The legislative history of the 1996 amendments to IRC § 104(a)(2) provides that "[i]f an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness…[but] emotional distress is not considered a physical injury or physical sickness."[11] Thus, damage awards for emotional distress are not considered as received on account of physical injury or physical sickness, even if the injury is emotional distress resulting in "insomnia, headaches, [or] stomach disorders."[12]

To justify exclusion from income under IRC § 104, the taxpayer must show settlement proceeds are in lieu of damages for physical injury or sickness.[13] In *Domeny v. Commissioner*, the taxpayer petitioned the U.S. Tax Court to exclude from her income a settlement award from a hostile work environment suit.[14] Prior to her employment and the subsequent suit, the taxpayer was diagnosed with multiple sclerosis (MS), and she chose her new employer with the understanding that the promised work environment would mitigate her symptoms. Following a change in management that led to a contentious and stressful work environment, the taxpayer's MS symptoms began to worsen. Her doctor recommended that she take leave from work, explaining that the taxpayer was experiencing "shooting pain up her legs, fatigue, burning eyes, spinning head, vertigo, and lightheadedness."[15] She was subsequently fired for failing to timely return to work. The taxpayer eventually settled her suit and received several payments, with no express statement of their purpose, including

6 IRC § 61(a)(4). *See, e.g., Evans v. Comm'r*, T.C. Memo. 2010-62.

7 IRC § 61(a)(11). *See, e.g., Green v. Comm'r*, T.C. Memo. 2010-109.

8 *See* Treas. Reg. § 1.104-1(c) (damages received, for purposes of IRC § 104(a)(2), means amounts received "through prosecution of a legal suit or action based upon tort or tort type rights or through a settlement agreement entered into in lieu of such prosecution").

9 IRC § 104(a)(2).

10 Pub. L. No. 104-188, § 1605(a), 110 Stat. 1755, 1838 (1996).

11 H.R. Rep. No. 104-586, at 143-44 (1996).

12 H.R. Conf. Rep. No. 104-737, at 301 (1996). Note, however, that IRC § 104(a)(2) excludes from income damages, up to the cost of medical treatment under IRC § 213, for mental or emotional distress causing physical injury.

13 *See, e.g., Green v. Comm'r*, 507 F.3d 857 (5th Cir. 2007), *aff'g* T.C. Memo. 2005-250.

14 T.C. Memo. 2010-9.

15 *Domeny v. Comm'r*, T.C. Memo. 2010-9.

a sum documented by a Form W-2, *Wage and Tax Statement*, a sum documented by a Form 1099-MISC, *Miscellaneous Income*, and one undocumented sum.

Because the settlement agreement was ambiguous, the court looked to the payor's intent, as evidenced by the facts and circumstances surrounding the litigation.[16] Even though the settlement agreement contained a blanket release and "had no specific or express statement of the payor's intent," the court determined that intent can be inferred from the manner of payment; here the payor divided the settlement into three payments with varying tax treatments.[17] This inference, combined with the payor's knowledge of the taxpayer's medical condition prior to terminating her employment, led the Tax Court to hold that the payor was aware that at least part of the recovery may not be subject to tax as compensation for exacerbating her acute illness. Thus, the taxpayer was able to show that a portion of the settlement proceeds was in lieu of damages for physical injury. Consequently, the portion of the payment evidenced by the Form 1099-MISC, was excluded from her gross income.[18]

In another case, *Save v. Commissioner*, the taxpayer argued that her settlement payments were received on account of a physiological illness caused by her emotional distress, thus satisfying the "physical illness" requirements of IRC § 104(a)(2).[19] The Tax Court rejected the taxpayer's claim because she provided neither a clear allocation in the settlement agreement between taxable payments and nontaxable payments tied to the personal injury claims, nor any evidence that the payor intended to compensate her for a physical injury.[20] The court refused outright to determine what amount of the settlement was paid as a personal injury claim, "absent proof of a specific payment for tortlike personal physical injuries or physical sickness."[21]

As illustrated by these cases, the question of when damage awards can be excluded from taxable income continues to confuse taxpayers. Even when taxpayers seek legal advice before filing a complaint for damages or accepting settlement proceeds, they may not understand how to characterize the damages in the complaint in order for them to be excludible under IRC § 104(a)(2), or may be confused about the proper tax treatment of the proceeds. For example, in *Espinoza v. Commissioner*, the taxpayer's attorney informed the taxpayer and her family that her settlement proceeds would not be taxed.[22] Even though the taxpayer received Form 1099-MISC from the payor, she did not realize she would be taxed on the settlement award until she received a notice of deficiency.[23] To reduce

16 *Domeny v. Comm'r*, T.C. Memo. 2010-9 (citing *Kurowski v. Comm'r*, 917 F.2d 1033, 1036 (7th Cir. 1990), *aff'g* T.C. Memo, 1989-149).

17 *Id.*

18 *Id.*

19 T.C. Memo. 2009-209.

20 *Save v. Comm'r*, T.C. Memo. 2009-209.

21 *Id. See also Hellesen v. Comm'r*, T.C. Memo. 2009-143 (holding that without an allocation of a specific amount of the settlement as compensation for physical injuries or physical sickness, no amount of the settlement could be excluded from gross income under IRC § 104(a)(2)).

22 T.C. Memo. 2010-53.

23 *Espinoza v. Comm'r*, T.C. Memo. 2010-53.

litigation in this area, the National Taxpayer Advocate has proposed that Congress amend IRC §104(a)(2) to exclude from gross income any payments received as a settlement or judgment for mental anguish, emotional distress, or pain and suffering.[24]

Foreign Earned Income

In the 2008 Annual Report to Congress, we highlighted 96 cases in which taxpayers raised the issue of excluding income earned in Antarctica under IRC § 911.[25] IRC § 911 permits taxpayers to exclude, within statutory limits, income they earned while residing in a foreign country.[26] Only a territory under the sovereignty of a foreign nation is considered a "foreign country."[27] The Tax Court determined that Antarctica does not qualify as a foreign country under IRC § 911, and the IRS prevailed in all 96 cases.

These Antarctica cases significantly inflated the number of gross income cases in the 2008 Annual Report. In the 2009 report, we located only three cases where taxpayers argued income should be excluded from gross income under IRC § 911; this year, we identified only one case containing an IRC § 911 argument (and this was not an "Antarctica" case).[28] While taxpayers did not litigate a significant number of cases over foreign earned income this year, IRC § 911 may continue to raise questions from Americans working abroad.

Discharge of Indebtedness

We reviewed ten cases in which taxpayers disputed the IRS's determination that a discharge of indebtedness was taxable income. Taxpayers prevailed in full in only two of these cases. Generally, a taxpayer must include discharges of indebtedness in gross income.[29] However, in certain circumstances, cancellation of indebtedness income may be excluded. IRC § 108(a) provides that a taxpayer may exclude, subject to limitations, income from the discharge of indebtedness if the discharge occurs in a bankruptcy case, when the taxpayer is insolvent, or if the indebtedness is qualified farm or business real estate debt or qualified principal residence indebtedness.[30]

The burden of proof is on the taxpayer to show that any of the exceptions in IRC § 108(a) apply.[31] For example, in *Felt v. Commissioner*, the taxpayer had discharge of debt income from an unrepaid loan from both a bank and his (now defunct) fully-owned corporate entity, which was used to purchase a savings and loan company in 1983.[32] The taxpayer did not dispute the amount of the debt, but argued he qualified for the insolvency exception in

24 *See* National Taxpayer Advocate 2009 Annual Report to Congress 351-356.

25 *See, e.g., Booth v. Comm'r*, T.C. Memo. 2007-253; *Charpentier v. Comm'r*, T.C. Memo. 2007-314.

26 IRC § 911.

27 Treas. Reg. § 1.911-2(h).

28 *Musshafen v. Comm'r*, T.C. Summ. Op. 2009-115.

29 IRC § 61(a)(12).

30 IRC § 108(a).

31 U.S. Tax Court Rules of Practice and Procedure, Rule 142(a).

32 T.C. Memo. 2009-245.

IRC § 108.[33] The court attempted to assess the taxpayer's finances, but was unable to do so due to the taxpayer's inability to provide relevant evidence; consequently, the taxpayer was required to include the discharge of indebtedness income in his gross income.[34]

CONCLUSION

Taxpayers litigate many of the same gross income issues year after year due to the complex nature of what constitutes gross income. This report has highlighted some of the main areas of confusion under IRC § 61, though these issues are not discrete. Many of the Most Litigated Issues touch tangentially or directly on the problem of delineating gross income, for example, Accuracy Related Penalty and Frivolous Issues litigation. Those issues are discussed in their respective sections.

33 *Felt v. Comm'r*, T.C. Memo. 2009-245.

34 *Id.*

MLI #6

Failure to File Penalty Under Internal Revenue Code Section 6651(A)(1) and Estimated Tax Penalty Under Internal Revenue Code Section 6654

SUMMARY

We reviewed 71 decisions issued by the federal courts from June 1, 2009, to May 31, 2010, regarding the addition to tax under Internal Revenue Code (IRC) § 6651(a)(1) for failure to timely file an income tax return, or the addition to tax under IRC § 6654 for failure to pay estimated tax.[1] The phrase "addition to tax" is commonly referred to as a penalty, so we will refer to these two additions to tax as the failure to file penalty and the estimated tax penalty. Thirty-four cases involved imposition of the estimated tax penalty in conjunction with the failure to file penalty, two cases involved only the estimated tax penalty, and the remaining 35 cases involved only the failure to file penalty.

The failure to file penalty is mandatory unless the taxpayer can demonstrate the failure is due to reasonable cause and not willful neglect.[2] Similarly, the estimated tax penalty is mandatory unless the taxpayer can meet one of the statutory exceptions.[3] In the cases analyzed, taxpayers were largely unsuccessful in their attempts to avoid these penalties.

PRESENT LAW

Under IRC § 6651(a)(1), a taxpayer that fails to file a tax return on or before its due date (including extensions) will be subject to a five percent penalty for each month or partial month the return is late, up to a maximum of 25 percent, unless such failure is due to reasonable cause and not willful neglect.[4] The penalty is based on the tax due, minus any credit the taxpayer is entitled to receive or payment made by the due date.[5] The failure to file penalty applies to income, estate, gift, and certain excise tax returns.[6] To establish reasonable cause, the taxpayer must show that he or she exercised ordinary business care and prudence but was still unable to file by the due date.[7]

IRC § 6654 imposes a penalty on any underpayment of a required installment of estimated tax by an individual,[8] and by certain estates and trusts.[9] Four installments are required per taxable year, and each amount is generally 25 percent of the taxpayer's total annual

1 IRC § 6651(a)(2) and (a)(3) also impose additions to tax for failure to pay tax liabilities shown or not shown on a return. However, because only a small number of cases involved these penalties, we did not include them in our analysis.

2 IRC § 6651(a)(1).

3 IRC § 6654(e).

4 IRC § 6651(a)(1). The penalty is increased to 15 percent per month up to a maximum of 75 percent if the failure to file is fraudulent. *See* IRC § 6651(f).

5 IRC § 6651(b)(1).

6 IRC § 6651(a)(1).

7 Treas. Reg. § 301.6651-1(c)(1).

8 IRC § 6654(a) and (b).

9 IRC § 6654(a) and (l).

payment.[10] The required annual payment is the lesser of 90 percent of the tax for the current taxable year or 100 percent of the tax shown on the taxpayer's return for the previous taxable year.[11] The IRS will determine the amount of the penalty by applying the underpayment rate according to IRC § 6621[12] to the amount of the underpayment for the period of the underpayment.[13] To avoid the estimated tax penalty, the taxpayer has the burden of proving one of the following exceptions applies:

- The tax due is less than $1,000;[14]
- The preceding taxable year was a taxable year of 12 months, the taxpayer has no tax liability for the preceding taxable year, and the taxpayer was a citizen or resident of the United States throughout that year;[15]
- The IRS determines that by reason of casualty, disaster, or other unusual circumstances, the imposition of the penalty would be against equity and good conscience;[16] or
- The taxpayer retired after reaching age 62 or became disabled in the taxable year for which estimated payments were required or in the taxable year preceding such year, and the underpayment was due to reasonable cause and not willful neglect.[17]

In any court proceeding, the IRS has the initial burden of production to provide sufficient evidence regarding the appropriateness of the failure to file and the estimated tax penalties.[18] If the IRS meets this burden, the taxpayer may produce evidence to establish any exception to the penalty.[19]

ANALYSIS OF LITIGATED CASES

We analyzed 71 opinions issued between June 1, 2009, and May 31, 2010, where the failure to file penalty or the estimated tax penalty was in dispute. All but ten of these cases were litigated in the United States Tax Court. A detailed list of cases appears in Table 6 in Appendix III. Fifty-three cases involved individual taxpayers and 18 involved businesses (including individuals engaged in self-employment or partnerships). Of the 50 cases in which taxpayers appeared *pro se*, or without counsel, taxpayers prevailed in full in only one case, and eight cases resulted in split decisions. Of the 21 cases in which taxpayers

10 IRC § 6654(c)(1) and (d)(1).

11 IRC § 6654(d)(1)(B).

12 IRC § 6621(a)(2). The interest rate for an underpayment is the sum of the federal short-term rate plus three percentage points.

13 IRC § 6654(a)(1) - (3).

14 IRC § 6654(e)(1).

15 IRC § 6654(e)(2).

16 IRC § 6654(e)(3)(A).

17 IRC § 6654(e)(3)(B).

18 IRC § 7491(c). *See also Higbee v. Comm'r*, 116 T.C. 438, 446 (2001). An exception to this rule alleviates the IRS from this initial burden where the taxpayer's petition fails to state a claim for relief from the penalty, such as where the taxpayer only makes frivolous arguments. *Funk v. Comm'r*, 123 T.C. 213, 217-18 (2004) (citations omitted).

19 *Higbee v. Comm'r*, 116 T.C. 438, 447 (2001). *See also* U.S. Tax Court Rules of Practice and Procedure, Rule 142(a).

appeared with representation, only one was resolved in the taxpayer's favor in full and one resulted in a split decision.

Failure to File Penalty

A common basis for the courts ruling against taxpayers was lack of evidence that the failure to file was due to reasonable cause. In fact, in 41 of the 71 cases, the taxpayers did not present any evidence of reasonable cause. In cases where evidence of reasonable cause was presented, the taxpayers' arguments included:

Medical Illness: Depending on the facts and circumstances, an illness may establish reasonable cause for failure to file.[20] For illness or incapacity to constitute reasonable cause, the taxpayer must show incapacitation to such a degree that he or she could not file a return on time.[21] A court also may allow a taxpayer who is caring for another person to establish reasonable cause if providing the care prevents the taxpayer from filing on time.[22]

While a court may be sympathetic to a taxpayer's medical condition, the court will not find reasonable cause when the condition was not present at the time the return was due. One court determined reasonable cause did not exist where a taxpayer claimed his illness prevented him from filing a return, but he continued his business and other affairs during his period of illness.[23]

Courts have held that illness of a taxpayer's agent is not reasonable cause because it does not discharge the taxpayer's responsibility to timely file a return.[24] For example, in *Benton Workshop, Inc. v. United States*,[25] the president of a corporation experienced physical and mental impairment that required her to give up her duties, one of which was filing the company's employment tax returns. In holding that the president's illness was not reasonable cause, the court noted that the vice president knew the returns needed to be filed and he could have made arrangements to file them, as he arranged to pay the corporation's creditors.

Mistaken Belief as to Filing Obligation: Often, taxpayers mistakenly believe they are not required to file returns. If a taxpayer's mistaken belief about the filing requirement is based on an incomplete or flawed reading of the law, the taxpayer does not have reasonable cause. For example, in *Trask v. Commissioner*,[26] the taxpayer believed he was

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20 *See, e.g., Harbour v. Comm'r*, T.C. Memo. 1991-532 (the taxpayer was in a coma the month before the due date of his tax return and therefore had reasonable cause for failing to timely file).

21 *Williams v. Comm'r*, 16 T.C. 893, 905-06 (1951), *acq.*, 1951-2 C.B. 1.

22 *Tabbi v. Comm'r*, T.C. Memo. 1995-463 (reasonable cause existed for late filing a joint return when taxpayers' son had heart surgery and taxpayers were continuously at hospital for four months surrounding due date of return).

23 *Kelso v. Comm'r*, T.C. Memo. 2009-125.

24 *See, e.g., Donald's Electric & Refrigeration Serv., Inc. v. U.S.*, 95 A.F.T.R.2d (RIA) 1398 (W.D. Va. 2005).

25 104 A.F.T.R.2d (RIA) 6034 (E.D. Ark. 2009).

26 T.C. Memo. 2010-78.

not required to file a timely return because he thought his tax liability was zero due to net operating losses. The court held that the taxpayer's belief was not reasonable cause for failing to file. Similarly, in *Soltan v. Commissioner*,[27] the taxpayers' belief that they were both exempt from paying withholding tax and filing income tax returns because their net operating loss would reduce their tax liability to zero was not reasonable cause.

Reliance on Agent: The Supreme Court, in *United States v. Boyle*, held that taxpayers have a nondelegable duty to file a return on time, and a taxpayer's reliance on an agent does not excuse failure to file.[28] A taxpayer may, however, succeed with a reasonable cause argument where the taxpayer is effectively disabled from fulfilling its obligations because of circumstances beyond its control.[29] Examples of cases where the taxpayers were unsuccessful in claiming reliance on an agent included:

- Consistent with the *Boyle* line of reasoning, where the taxpayer relied on an attorney to request an extension and meet the filing deadline, the court held this was not reliance on tax advice, but a delegation of the taxpayer's duty to file, which is not reliance for reasonable cause.[30]
- Where the taxpayer argued that a bookkeeper who was responsible for filing employment tax returns had suffered a personal crisis, reliance on the bookkeeper was not reasonable cause because it takes no special training to ascertain when returns are due.[31]
- The court found there was no reasonable cause for failing to timely file employment tax returns where the taxpayer stated it had relied on its CPA to file the returns. Although filing the returns was part of the CPA's employee responsibilities, the taxpayer failed to verify that the CPA had actually done so. Additionally, the court noted that the taxpayer had a history of failing to timely file returns and the failure to oversee the CPA's performance was, in light of that history, an indication of a lack of ordinary business care and prudence.[32]

"Zero Return" Filers and Other Frivolous Arguments: Under the longstanding four-part test articulated in *Beard v. Commissioner*, for a document to be a valid return it must: (1) purport to be a return; (2) be signed under penalties of perjury; (3) contain sufficient data to calculate the tax liability; and (4) represent an honest and reasonable attempt to satisfy the requirements of the tax laws.[33] A return subject to the frivolous

27 T.C. Memo. 2010-91.

28 469 U.S. 241, 252 (1985).

29 *United States v. Boyle*, 469 U.S. 241, 248 n.6 (1985).

30 *Estate of Fuertes v. U.S.*, 104 A.F.T.R.2d (RIA) 6527 (N.D. Tex. 2009).

31 *Nicholas Acoustics & Specialty Co. v. U.S.*, 2010 WL 2505472 (S.D. Miss. 2010) (quoting *United States v. Boyle*, 469 U.S. 241, 251 (1985).

32 *McNair Eye Ctr., Inc. v. Comm'r*, T.C. Memo. 2010-81.

33 *Beard v. Comm'r*, 82 T.C. 766, 777 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986).

tax submission penalty under IRC § 6702[34] does not constitute a return for purposes of the failure to file penalty.[35]

Each year, some taxpayers claim they have no obligation to pay taxes by filing returns reporting zero income when they have earned substantial wages accurately reported on a Form W-2, *Wage and Tax Statement*. A "zero return" does not constitute a tax return for purposes of the failure to file penalty of IRC § 6651(a)(1).[36]

In *Hamilton v. Commissioner*,[37] the Tax Court held that a purported return containing only zeros was not valid and the taxpayer failed to show reasonable cause for failing to file a return. In a similar case where the taxpayer had not filed for several years and later filed returns containing all zeros, the court held that the taxpayer did not have reasonable cause.[38] Further, a taxpayer who argued that he had no taxable income, because he did not recognize gain in the sale of his labor, later submitted Forms 1040, *U.S. Individual Income Tax Return*, and 1099 , *U.S. Information Return*, showing only zeros. The court held this was not reasonable cause for failing to file.[39]

A taxpayer attempted to argue that the wages and other income he received was income of a trust and he was therefore exempt from paying withholding taxes.[40] The court found this argument did not constitute reasonable cause for failing to file.

One taxpayer, who had brought multiple separate actions before the Tax Court asserting frivolous arguments, argued that he was not subject to the income tax laws because he did not consent to being a taxpayer.[41] The Tax Court held he failed to show reasonable cause.

Miscellaneous Arguments: One taxpayer argued that she had reasonable cause for failing to file because her husband had advised her that they were not required to file and threatened to leave her if she did, which would have injured her financially.[42] The court, in rejecting the taxpayer's arguments, held that courts have never found threats from a spouse as reasonable cause for failing to file and because there was no evidence the husband had any income or assets, the court could not find how his threat would cause financial injury. In addition, the court stated that the taxpayer's reliance on her husband's advice did not constitute reliance on a tax professional and she had not shown reasonable cause.

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34 IRC § 6702 imposes a penalty of $5,000 for filing a frivolous return.

35 IRM 20.1.2.1.6.2 (Sept. 4, 2009) (citing Rev. Rul. 2007-19, 2007-1 C.B. 843).

36 *See Turner v. Comm'r*, T.C. Memo. 2004-251, and the numerous cases cited therein.

37 T.C. Memo. 2009-271.

38 *Ulloa v. Comm'r*, T.C. Memo. 2010-68.

39 *Hodges v. Comm'r*, T.C. Memo. 2009-179.

40 *Lizalek v. Comm'r*, T.C. Memo. 2009-122.

41 *Florance v. Comm'r*, T.C. Memo. 2009-155. *See also Florance v. Comm'r*, T.C. Memo. 2009-154.

42 *Wolfgram v. Comm'r*, T.C. Memo. 2010-69.

> In *New York Guangdong Finance, Inc. v. Commissioner*,[43] a foreign company failed to file tax returns, arguing that it believed that the company was exempt from paying taxes under a treaty. The court found the company was liable for taxes. Moreover, reliance on a statement of the company's president that the firm was exempt was not reasonable. The court noted that even if the company had been exempt from paying the tax, it was not exempt from filing a return.

> A few taxpayers argued that the assessment of penalties violated the Paperwork Reduction Act. In upholding the failure to file penalty, the court in *Springer v. Commissioner*[44] stated the Act was not applicable to the failure to file penalty because it does not affect a taxpayer's obligation to file federal income tax returns.

A constant theme throughout the cases we reviewed is that the existence of reasonable cause in any given case depends on all the facts and circumstances of the case.[45] In addition, in eight of the 69 cases where the IRS had asserted the failure to file penalty, the courts also imposed a penalty under IRC § 6673 for taking a frivolous position.[46]

Estimated Tax Penalty

Courts routinely found taxpayers liable for the IRC § 6654 estimated tax penalty when the Commissioner proved the taxpayers had a tax liability, had no withholding credits, and did not make any estimated tax payments for that year, and the taxpayers offered no evidence to refute the Commissioner's evidence.[47]

The IRS has the burden of production under IRC § 7491(c) to produce evidence that a taxpayer was required to make four required installments under IRC § 6654(c)(1). In six of the eight cases where taxpayers prevailed on the estimated tax penalty for some or all of the years at issue, their success was a result of the IRS failing to meet its burden of production regarding the appropriateness of the penalty. For example, in *Davenport v. Commissioner*, the Tax Court held that the Commissioner failed to introduce evidence showing whether a taxpayer filed a return for the preceding year and the amount of tax shown on that return. The IRS did not satisfy the burden of production because it was impossible to determine whether the taxpayer had a required annual payment that was payable in four installments.[48]

Most Litigated Issues

43 588 F.3d 889 (5th Cir. 2009), *aff'g* T.C. Memo. 2008-62.

44 508 F.3d 1142 (10th Cir. 2009), *aff'g* 231 Fed. Appx. 793 (10th Cir. 2007), *petition for cert. denied*, 130 S. Ct. 1907 (2010).

45 IRM 20.1.1.3.2 (Dec. 11, 2009).

46 Under IRC § 6673, the Tax Court is authorized to impose a penalty against a taxpayer if the taxpayer takes a frivolous position in a proceeding. The maximum penalty is $25,000. *See* Most Litigated Issue: *Frivolous Issues Penalty and Related Appellate-Level Sanctions Under Internal Revenue Code Section 6673, infra.*

47 *See, e.g., Evans v. Comm'r*, T.C. Memo. 2010-62; *Houston v. Comm'r*, T.C. Memo. 2009-286.

48 T.C. Memo. 2009-248.

CONCLUSION

The U.S. tax system relies on taxpayers voluntarily filing accurate returns and paying their taxes. Penalties attempt to establish fairness in the system by imposing an additional cost on the noncompliant taxpayer. The penalties for failure to file and failure to pay estimated tax were implemented to encourage voluntary compliance.[49]

The IRS should determine whether imposing these penalties positively influences compliance as intended. Congress should again consider the National Taxpayer Advocate's recommendation of a one-time abatement of the failure to file penalty for taxpayers who comply with their filing obligations, but in an untimely manner.[50] This proposal would broaden the definition of reasonable cause by providing the IRS the authority to abate a late filing penalty for inadvertent taxpayer mistakes, while still encouraging the IRS's goal of voluntary compliance.

49 *See* Policy Statement 20-1 (Formerly P-1-18), IRM 1.2.20.1.1 (June 29, 2004). *See also United States v. Boyle*, 469 U.S. 241, 245 (1985) ("Congress' purpose in the prescribed civil penalty was to ensure timely filing of tax returns to the end that tax liability will be ascertained and paid promptly."). For an in-depth discussion of IRS penalty administration, see National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 2 (*A Framework for Reforming the Penalty Regime*).

50 *See* National Taxpayer Advocate 2001 Annual Report to Congress 188. A provision to waive the failure to file penalty for first-time unintentional minor errors was included in the House-passed Taxpayer Protection and IRS Accountability Act of 2003. *See* H.R. 1528, 108th Cong. § 106 (2003). Although the IRS has provided for a one-time administrative waiver of the failure to file penalty in IRM 20.1.1.3.6.1(Dec. 11, 2009), the National Taxpayer Advocate continues to recommend a statutory waiver similar to IRC § 6656(c).

MLI #7 Frivolous Issues Penalty and Related Appellate-Level Sanctions Under Internal Revenue Code Section 6673

SUMMARY

During the 12 months between June 1, 2009, and May 31, 2010, the federal courts issued decisions in at least 39 cases involving the Internal Revenue Code (IRC) § 6673 "frivolous issues" penalty, and at least nine cases involving an analogous penalty at the appellate level.[1] These penalties are imposed against taxpayers for maintaining a case primarily for delay, raising frivolous arguments, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal.[2] The United States Tax Court or a United States District Court raised IRC § 6673 *sua sponte*[3] in a number of cases.[4] In many of these cases, taxpayers escaped liability for the penalty but were warned that they could face sanctions for similar conduct in the future.[5] Similarly, we identified two cases at the appellate level where the court did not impose a sanction under IRC § 7482(c)(4) or any other authority, but did warn the taxpayer that similar future conduct will result in a sanction.[6] Nonetheless, we include these cases in our analysis to illustrate what conduct will and will not be tolerated by the courts.

PRESENT LAW

The U.S. Tax Court is authorized to impose a penalty against a taxpayer if the taxpayer institutes or maintains a proceeding primarily for delay, takes a frivolous position in a proceeding, or unreasonably fails to pursue available administrative remedies.[7] The maximum penalty is $25,000.[8] In some cases, the IRS requests that the Tax Court impose the penalty;[9] in other cases, the Tax Court exercises its discretion, *sua sponte*, to impose the penalty.

1 In two cases, the U.S. Courts of Appeals both affirmed the imposition of the Internal Revenue Code (IRC) § 6673 penalty and addressed the issue of an additional sanction against the taxpayer for filing a frivolous appeal. Thus, the total number of cases we identified as involving frivolous claims is 46.

2 The Tax Court generally imposes the penalty under IRC § 6673(a)(1). Other courts may impose the penalty under IRC § 6673(b)(1). U.S. Courts of Appeals generally impose sanctions under IRC § 7482(c)(4), 28 U.S.C. § 1927, or Rule 38 of the Federal Rules of Appellate Procedure, although some appellate-level penalties may be imposed under other authorities.

3 "*Sua sponte*" means without prompting or suggestion. Black's Law Dictionary 1424 (6th ed. 1990). Thus, for conduct that it finds particularly offensive, the Tax Court can choose to impose a penalty under IRC § 6673 even if the IRS has not requested the penalty.

4 *See, e.g., Hamilton v. Comm'r*, T.C. Memo. 2009-271.

5 *See, e.g., Carney v. Comm'r*, T.C. Memo. 2009-310. Note, however, that in at least one case where the Tax Court *sua sponte* imposed the penalty, the taxpayer was held liable for a $25,000 penalty. *See Davenport v. Comm'r*, T.C. Memo. 2009-248.

6 *Landess v. Comm'r*, 357 Fed. Appx. 167 (10th Cir. 2009); *Landess v. Comm'r*, 357 Fed. Appx. 171 (10th Cir. 2009).

7 IRC § 6673(a)(1)(A), (B), and (C).

8 IRC § 6673(a)(1).

9 The standards for the IRS's decision to seek sanctions under IRC § 6673(a)(1) are found in the Chief Counsel Directives Manual. *See* CCDM 35.10.2 (Aug. 11, 2004). For sanctions of opposing parties, under IRC § 6673(a)(2), all requests for sanctions are reviewed by the designated agency sanctions officer under Executive Order 12988 on Civil Justice Reform. This review ensures uniformity on a national basis. *See, e.g.,* CCDM 35.10.2.2.3 (Aug. 11, 2004).

Taxpayers who institute an action pursuant to IRC § 7433[10] in a U.S. District Court for damages against the United States could be subject to a maximum penalty of $10,000 if the court determines the taxpayer's position in the proceedings is frivolous or groundless.[11] In addition, IRC § 7482(c)(4),[12] § 1927 of Title 28 of the U.S. Code,[13] and Rule 38 of the Federal Rules of Appellate Procedure[14] (among other laws and rules of procedure) authorize federal courts to impose penalties against taxpayers or attorneys for raising frivolous arguments or using litigation tactics primarily to delay the collection process. Because the sources of authority for imposing appellate-level sanctions are numerous and some of these sanctions may be imposed in non-tax cases, this report focuses primarily on the IRC § 6673 penalty. However, the table of cases presented in Table 7 of Appendix III lists nine tax cases in which U.S. Courts of Appeals considered sanctions under other authorities.

ANALYSIS OF LITIGATED CASES

We analyzed 39 opinions issued between June 1, 2009, and May 31, 2010, that addressed the IRC § 6673 penalty. Thirty-four of these opinions were issued by the Tax Court, one by a U.S. District Court, and four were issued by U.S. Courts of Appeals on appeals brought by taxpayers who sought review of the Tax Court's imposition of the penalty. Notably, the Courts of Appeals sustained the Tax Court's position in all four cases. A detailed list of all cases appears in Table 7 of Appendix III.

In 21 cases, the Tax Court imposed penalties under IRC § 6673, with the amounts ranging from $500 to the maximum of $25,000. One taxpayer in the 46 cases we examined was represented by an attorney; all others appeared *pro se.* The taxpayers in these cases presented a wide variety of arguments that the courts have generally rejected on numerous occasions. Upon encountering these arguments, the courts almost invariably cited the language set forth in *Crain v. Commissioner:*

> We perceive no need to refute these arguments with somber reasoning and copious citation of precedent; to do so might suggest that these arguments have some colorable merit. The constitutionality of our income tax system – including the role played within that system by the Internal Revenue Service and the Tax Court – has long been established.[15]

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10 IRC § 7433(a) allows taxpayers a civil cause of action against the United States if an IRS employee intentionally or recklessly disregards any IRC provision or regulation promulgated under the IRC.

11 IRC § 6673(b)(1).

12 IRC § 7482(c)(4) provides that the United States Courts of Appeals and the Supreme Court have the authority to impose a penalty in any case where the Tax Court's decision is affirmed and the appeal was instituted or maintained primarily for delay or the taxpayer's position in the appeal was frivolous or groundless.

13 28 U.S.C. § 1927 authorizes federal courts to sanction an attorney or any other person admitted to practice before any court of the United States or any territory thereof for unreasonably and vexatiously multiplying proceedings.

14 Federal Rule of Appellate Procedure 38 provides that if a United States Court of Appeals determines an appeal is frivolous, the court may award damages and single or double costs to the appellee.

15 *Crain v. Comm'r*, 737 F.2d 1417, 1417-18 (5th Cir. 1984).

In the cases we reviewed, taxpayers raised the following issues that the Tax Court deemed frivolous. Consequently, the taxpayers were subject to a penalty under IRC § 6673(a)(1) (or, in some cases, the court warned that such arguments were frivolous and could lead to a penalty in the future if the taxpayers maintained the same frivolous positions):

- **Citizens of certain states are not subject to income taxes.** At least one taxpayer argued that as a resident of a "sovereign," "compact," or "independent" state, he is not subject to income taxes imposed by the United States government.[16] The Tax Court imposed a penalty in the amount of $10,000.
- **IRS forms and notices violate the Paperwork Reduction Act (PRA) because they do not display a valid Office of Management and Budget (OMB) Control Number.** In at least two cases, taxpayers argued the IRS forms and notices they received violated the PRA.[17] Under the PRA, OMB is given authority to review an agency "collection of information" and to assign a control number to each "collection of information" it approves.[18] If a "collection of information" does not display a current control number or fails to state that the request for information is not subject to the PRA, the PRA provides that a person cannot be subject to a penalty for the failure to maintain or provide information.[19] These taxpayers argued that because certain IRS forms and notices do not contain OMB control numbers, the PRA protects them from any penalties for failure to comply with the IRS's request for information. Interestingly, although the courts have consistently rejected such arguments,[20] in the two cases we reviewed, the Tax Court declined to impose the IRC § 6673 penalty but cautioned the taxpayers that similar arguments in the future would result in a penalty.
- **Only income earned from the United States government is taxable.** Taxpayers in at least three cases presented arguments that only federal government employees, public servants, or those who earn income from the United States government are subject to the income tax.[21]

16 *See Holmes v. Comm'r*, T.C. Memo. 2010-42.

17 *See, e.g., Lizalek v. Comm'r*, T.C. Memo. 2009-122; *Turner v. Comm'r*, T.C. Memo. 2010-44.

18 44 U.S.C. §§ 3502, 3504, 3507(a).

19 44 U.S.C. § 3512.

20 *See U.S. v. Dawes*, 951 F.2d 1189, 1191-93 (10th Cir. 1991) (citations omitted).

21 *See, e.g., Bigley v. Comm'r*, T.C. Memo. 2010-29.

CONCLUSION

Taxpayers in the cases analyzed this year presented the same arguments raised and repeated year after year, which the courts routinely and universally reject.[22] Taxpayers avoided the IRC § 6673 penalty in only eight of the cases where the IRS requested the penalty, demonstrating the willingness of the courts to impose a penalty when the taxpayer makes frivolous arguments or institutes a case merely for delay. Where the IRS has not requested the penalty, the court may nonetheless raise the issue *sua sponte,* and in many cases imposes the penalty or cautions the taxpayer that similar future behavior will result in a penalty.[23] Finally, the U.S. Courts of Appeals have shown their willingness to uphold the penalties imposed by the Tax Court without fail in the cases analyzed for the period between June 1, 2009, and May 31, 2010, and will often impose further appellate-level sanctions on taxpayers who assert frivolous arguments.

22 *See, e.g.,* National Taxpayer Advocate 2009 Annual Report to Congress 461-464.

23 *See, e.g., Hamilton v. Comm'r*, T.C. Memo. 2009-271 (court raised the issue *sua sponte* and found taxpayer liable for $2,000 penalty for "burdening respondent and this court with frivolous arguments.").

MLI #8 Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under Internal Revenue Code Section 7403

SUMMARY

Internal Revenue Code (IRC or "Code") § 7403 authorizes the United States to file a civil action in a United States District Court against a taxpayer who has refused or neglected to pay any tax, to enforce the federal tax lien, or to subject any of the delinquent taxpayer's property to the payment of the tax. We identified 46 opinions issued between June 1, 2009, and May 31, 2010, that involved civil actions to enforce federal tax liens under IRC § 7403. The courts affirmed the position of the United States in the majority of cases. Taxpayers prevailed in only five cases and one case resulted in a split decision. This is the second year that this issue has appeared as a Most Litigated Issue in the National Taxpayer Advocate's Annual Report to Congress.[1]

PRESENT LAW

IRC § 7403 specifically authorizes the United States to enforce a federal tax lien with respect to a taxpayer's delinquent tax liability, or to subject any property, right, title, or interest in the property of the delinquent taxpayer to the payment of tax liability, by initiating a civil action in the appropriate United States District Court against a taxpayer who has refused or neglected to pay any tax.[2] All persons holding liens or claiming any interest in the taxpayer's property should be named as parties to the action.[3] The nature of a taxpayer's legal interest in the property subject to a lien is determined by the law of the state where the property is located.[4] However, once it is determined that a delinquent taxpayer has an interest in the property, federal law controls whether the property is exempt from attachment.[5]

The U.S. District Court may order that the property be sold by an officer of the court and the proceeds applied to the delinquent tax liability.[6] However, the court is not required to authorize a forced sale under all circumstances and may exercise limited equitable discretion.[7] In cases where the forced sale involves the interests of non-delinquent third parties, a U.S. District Court should consider the following four factors when determining whether the property should be sold:

1 *See* 2009 National Taxpayer Advocate Annual Report to Congress 465-470.

2 IRC § 7403(a); Treas. Reg. § 301.7403-1(a). Such action may be initiated regardless of whether levy has been made.

3 IRC § 7403(b).

4 *U.S. v. National Bank of Commerce*, 472 U.S. 713, 722 (1985).

5 *U.S. v. Rodgers*, 461 U.S. 677 (1983). Similarly, federal tax liens can attach to property exempt from the reach of creditors under state law, including property held by a delinquent taxpayer as a tenant by the entirety. *U.S. v. Craft*, 535 U.S. 274 (2002).

6 IRC § 7403(c).

7 *Rodgers*, 461 U.S. at 711.

1) The extent to which the government's financial interests would be prejudiced if they were relegated to a forced sale of the partial interest of the delinquent taxpayer;

2) Whether the innocent third party with a separate interest in the property, in the normal course of events, has a legally recognized expectation that the property would not be subject to a forced sale by the delinquent taxpayer or his or her creditors;

3) The likely prejudice to the third party in personal dislocation costs and inadequate compensation; and

4) The relative character and value of the non-liable and liable interests held in the property.[8]

The IRS may bid at the sale of the property when it holds a first lien.[9] However, the amount of the bid is limited to the amount of the lien, plus selling expenses.[10] If any of the taxpayer's other creditors institute an action to foreclose their lien on the property which is subject to the federal tax lien, and the United States is not a party, the United States may intervene as if it had originally been joined as a proper party[11] and may remove the case to the U.S. District Court if such action was instituted in a state court.[12] However, junior federal tax liens may be effectively extinguished in a foreclosure and sale under state law, even if the United States is not a party to the proceeding.[13] The Code also specifically authorizes the court to appoint a receiver to enforce the lien and, upon the government's certification that it is in the public interest, the court may appoint a receiver with all powers of a receiver in equity to preserve and operate the property prior to sale.[14]

ANALYSIS OF LITIGATED CASES

We reviewed 46 opinions entered between June 1, 2009, and May 31, 2010, in civil actions to enforce federal tax liens. Table 8 in Appendix III contains a detailed list of those cases. In the majority of cases, taxpayers represented themselves (*pro se*).[15] Taxpayers with representation received full relief in three cases and partial relief in one case, while *pro se* taxpayers prevailed in two cases.

8 *Rodgers*, 461 U.S. at 709-11.

9 IRC § 7403(c).

10 *Id*.

11 IRC § 7424; 28 U.S.C. § 2410. If the application of the IRS to intervene is denied, the adjudication in such civil action or suit does not have any effect upon the federal tax lien. IRC § 7424.

12 28 U.S.C. § 1444. However, if the application of the IRS to intervene is denied, the adjudication will have no effect upon the federal tax lien on the property. IRC § 7424.

13 *U.S. v. Brosnan*, 363 U.S. 237 (1960).

14 IRC §§ 7403(d) and 7402(a).

15 Seventeen of 46 taxpayers were represented by counsel. Of those 17 cases, the IRS prevailed in 13, three cases resulted in victories for taxpayers, and one case ended in a split decision.

The issue of whether it was appropriate to foreclose the federal tax lien against the taxpayer's real property was the most prevalent issue. It was considered in 38 cases,[16] with the government prevailing fully in 33 of these cases.[17] A typical case is *United States v. Miller*,[18] in which the government filed an action to foreclose its tax liens and sell the taxpayer's real property to which the liens had attached. First, the court determined the taxpayer had failed to show that tax liabilities assessed against her were incorrect.[19] Second, the court determined that she had not paid the assessed liabilities; consequently, the federal tax liens attached to all of the taxpayer's property.[20] Next, the court established that the assessments were made within the applicable statute of limitations period and after notice and demand.[21] Finally, the court ordered foreclosure of the valid federal tax liens against the taxpayer's real property.

However, in *United States v. Anderson*,[22] the court denied the government's motion for summary judgment, finding that the taxpayer's spouse should be granted time to answer the complaint to address the equities of displacing her from the home by selling the home in its entirety.[23] Similarly, the court in *United States v. Toler*[24] issued a split decision, finding that material issues existed as to ownership of certain parcels of property and whether other parcels had been conveyed fraudulently to avoid foreclosure.

Another common issue litigated by the government was foreclosure of federal tax liens against the taxpayer's property titled in the name of a nominee.[25] For example, in *United States v. DeTar*,[26] the taxpayers, a husband and wife, owed federal taxes. The husband sought to create a trust for the stated purpose of educating his children. However, at the time the trust was created, the husband admitted to the trust creator that he had not paid his federal income tax for several years and that he wanted to transfer certain real property into the trust in order to avoid tax liens that the government might place upon the

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16 *See, e.g., U.S. v. Brown*, 105 A.F.T.R.2d (RIA) 1450 (D.N.J. 2010); *U.S. v. Dix*, 103 A.F.T.R.2d (RIA) 1448 (E.D. Wis. 2009); *U.S. v. Hockensmith*, 104 A.F.T.R.2d (RIA) 5133 (M.D. Pa. 2009); *U.S. v. Morehouse*, 104 A.F.T.R.2d (RIA) 5001 (D. Or. 2009).

17 In four cases, the United States Courts of Appeals affirmed the trial court's decision in favor of the government. *See U.S. v. Evans*, 340 Fed.Appx. 990 (5th Cir. 2009); *U.S. v. Filson*, 347 Fed. Appx. 987 (5th Cir. 2009); *U.S. v. Navolio*, 334 Fed. Appx. 204 (11th Cir. 2009); *U.S. v. Offiler*, 336 Fed. Appx 907 (11th Cir. 2009).

18 *U.S. v. Miller*, 105 A.F.T.R.2d (RIA) 2636 (S.D. Ala. 2010).

19 Once the Government introduces into evidence a certificate of assessments and payments (Form 4340), it establishes a presumption of correctness with respect to the tax assessment and constitutes a *prima facie* case of liability on the part of the taxpayer. The burden then shifts to the taxpayer to show that the assessment was not properly made. *United States v. White*, 466 F.3d 1241, 1248 (11th Cir. 2006). In *Miller*, the Government had introduced the Form 4340, and the taxpayer had offered no evidence to refute the presumption of correctness.

20 If a taxpayer, after notice and demand for a payment, refuses or fails to pay, a "secret" lien that attaches to all the taxpayer's property or rights to property arises upon assessment under IRC §§ 6321 and 6322.

21 *See generally* IRC § 6501.

22 104 A.F.T.R.2d (RIA) 7609 (W.D.N.Y. 2009).

23 *United States v. Anderson*, 104 A.F.T.R.2d (RIA) 7609 (W.D.N.Y. 2009).

24 *U.S. v. Toler,* 666 F. Supp. 2d 872 (S.D. Ohio 2009).

25 *See, e.g., U.S. v. Springer*, 105 A.F.T.R.2d 1192 (N.D. Okla. 2010); *U.S. v. DeTar, et. al.*, 104 A.F.T.R.2d (RIA) 5572 (W.D. Mich. 2009); *U.S. v. Morgan*, 105 A.F.T.R.2d (RIA) 442 (M.D. Fla. 2010).

26 *U.S. v. DeTar*, 104 A.F.T.R.2d (RIA) 5572 (W.D. Mich. 2009).

property. The United States argued the trust was simply the nominee of the taxpayers and that the true beneficial owners of the property were the taxpayers, not the trust. The court determined the trust was the nominee of the taxpayers[27] and the lien properly attached to the property purportedly owned by the trust, and ordered foreclosure of the real property.

CONCLUSION

Enforcement activities by the IRS, including filings of Notices of Federal Tax Lien (NFTLs), continue to increase yearly. In fiscal year (FY) 2002, the IRS filed over 482,000 NFTLs, whereas in FY 2009 the IRS filed over 965,000 NFTLs, an increase of approximately 100 percent in just seven years.[28] Between FY 2008 and FY 2009 alone, NFTL filings increased by nearly 200,000.[29] This rise in NFTL filings has led more taxpayers to contest the foreclosure actions on these liens in the federal court system. As the IRS continues to increase enforcement activities such as filing NFTLs, we expect the number of court cases involving suits to foreclose liens will also continue to increase.

27 The court applied the *Porta-John* factors to determine nominee status: (1) whether the nominee paid no consideration or inadequate consideration; (2) whether the property was placed in the name of the nominee in anticipation of litigation or liabilities; (3) whether there is a close relationship between the transferor and the nominee; (4) whether the parties to the transfer failed to record the conveyance; (5) whether the transferor retained possession; and (6) whether the transferor continues to enjoy the benefits of the transferred property. *Porta-John of Am., Inc. v. United States*, 4 F. Supp. 2d 688, 701 (E.D. Mich. 1998).

28 The IRS filed approximately 492,000 NFTLs in FY 2002 and 965,618 in FY 2009. Statistics of Income Data Books, Table 16b, Delinquent Collection Activities 2002-2009.)

29 The IRS filed 768,168 NFTLs in FY 2008 and 965,618 in FY 2009. Statistics of Income Data Books, Table 16b, Delinquent Collection Activities 2002-2009.

MLI #9 Family Status Issues Under Internal Revenue Code Sections 2, 24, 32, and 151

SUMMARY

Because family status issues center on interrelated exemptions, credits, and filing statuses claimed on federal tax returns, cases litigated in this area often involve multiple issues with similar factual determinations. This report combines the following issues into a single "family status" category:

- Head of household filing status;[1]
- Child tax credit;[2]
- Earned Income Tax Credit (EITC);[3] and
- Dependency exemption.[4]

We reviewed 45 federal court opinions issued between June 1, 2009, and May 31, 2010. Many of these opinions cover multiple family status issues, with the determination of one often affecting others. For example, a denial of the dependency exemption will lead to the summary denial of the child tax credit and may impact eligibility for head of household filing status. In tax year 2009, over 20 million taxpayers filed as head of household, nearly 26 million received the EITC, and more than 55 million sought some form of dependency exemption.[5]

PRESENT LAW

Uniform Definition of Qualifying Child

Before 2005, the Internal Revenue Code (IRC) contained multiple definitions of a "child" for purposes of filing status, deductions, and tax credits associated with dependent children.[6] Effective for tax years after December 31, 2004, the Working Families Tax Relief Act (WFTRA) established a uniform definition of a qualifying child (UDOC) with respect to four family status provisions: head of household filing status, the child tax credit, the EITC, and the dependency deduction.[7] The clear intent of the UDOC legislation was to bring about some uniformity for the vast majority of taxpayers who had to meet multiple tests

1 Internal Revenue Code (IRC) § 2(b).

2 IRC § 24.

3 IRC § 32.

4 IRC § 151.

5 IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File for Tax Year 2009, updated through cycle 39 (Oct. 8, 2010).

6 *E.g.*, IRC § 2(b) (head of household); IRC § 21 (child and dependent care credit); IRC § 24 (child tax credit); IRC § 32 (EITC); IRC § 151 (dependency exemption). IRC § 7703(b) provides an exception to the general determination of whether an individual is married and states that certain married persons who are living apart from their spouses may be treated as unmarried.

7 The Working Families Tax Relief Act, Pub. L. No. 108-311, § 201, 118 Stat. 1166, 1169 (2004). Further, UDOC applies to determining whether a taxpayer qualifies for an income inclusion under IRC § 129.

to determine if they were eligible to claim an exemption, credit, or filing status under the basic family status provisions.[8] Under UDOC eligibility rules, a dependent must be either a "qualifying child" or a "qualifying relative."[9] The other family status provisions incorporate UDOC, but retain rules specific to each IRC section (such as age and income restrictions). These family status provisions impact almost 85 million individual taxpayers, with the benefits potentially reaching 82 million children nationwide.[10]

Qualifying Child

In general, an individual must meet four tests to be claimed as a qualifying child under UDOC.

1. **Relationship Test.** The child must be the taxpayer's child (including an adopted child, stepchild, or eligible foster child), brother, sister, stepbrother, stepsister, or descendant of one of these relatives. An adopted child includes a child lawfully placed with a taxpayer for legal adoption even if the adoption is not final. An eligible foster child is any child placed with a taxpayer by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.[11]
2. **Residency Test.** The child must live with the taxpayer for more than half of the tax year. Exceptions apply for temporary absences for special circumstances: children who were born or died during the year, children of divorced or separated parents, and kidnapped children.[12]
3. **Age Test.** The child must be under a certain age, depending on the tax benefit claimed, to be a qualifying child.[13]
4. **Support Test.** The child cannot provide more than half of his or her own support during the year.[14]

Qualifying Relative

An individual who does not meet the requirements for a qualifying child may still be claimed as a dependent if he or she meets the requirements for a qualifying relative.[15] Again, four tests must be met to claim someone as a qualifying relative.

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8 Nina E. Olson, *Uniform Qualifying Child Definition: Uniformity for Most Taxpayers,* 111 Tax Notes 225 (Apr. 10, 2006). *See also* National Taxpayer Advocate 2006 Annual Report to Congress 463.

9 IRC § 152(a).

10 IRS CDW, Individual Returns Transaction File for Tax Year 2008. These figures are calculated for all taxpayers with at least one qualifying child or dependent, benefiting from at least one of the four "family status" provisions discussed in this Most Litigated Issue.

11 IRC §§ 152(c)(1)(A); 152(c)(2); 152(f)(1).

12 IRC §§ 152(c)(1)(B); 152(f)(6); Treas. Reg. § 1.152-2(a)(2)(ii).

13 IRC § 152(c)(1)(C).

14 IRC § 152(c)(1)(D).

15 IRC § 152(a).

Relationship Test. The individual must be:

- A child or a descendant of a child;
- A brother, sister, stepbrother, or stepsister;
- The father, mother, or an ancestor of either;
- A stepfather or stepmother;
- A son or daughter of a brother or sister of the taxpayer;
- A brother or sister of the father or mother of the taxpayer;
- A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law; or
- An individual (other than the spouse) who, for the taxable year of the taxpayer, has the same principal place of abode as the taxpayer and is a member of the taxpayer's household.[16]

5. **Gross Income Test.** An individual must have gross income below the amount allowed for a personal exemption for the taxable year.[17]
6. **Support Test.** The taxpayer must provide more than one-half of the individual's support for the calendar year in which the taxable year begins.[18]
7. **Not a Qualifying Child.** In general, an individual may not be a qualifying child of the taxpayer or any other taxpayer for the taxable year.[19] IRS Notice 2008-5 clarifies when an individual would be considered "not a qualifying child."[20]

The taxpayer can claim a personal exemption deduction for a dependent who meets the tests of a qualifying relative.[21]

Tie-Breaker Rule

Sometimes a child meets the tests to be a qualifying child for more than one person. However, only one taxpayer can claim that child as a qualifying child. If multiple taxpayers meet the test with respect to the same qualifying child, they may decide among themselves who will claim the child. If they cannot agree, and more than one taxpayer files a return

16 IRC §§ 152(d)(1)(A); 152(d)(2). However, IRC § 152(f)(3) provides that an individual shall not be treated as a member of the taxpayer's household if at any time during the taxable year the relationship between such individual and the taxpayer is in violation of local law.

17 IRC § 152(d)(1)(B).

18 IRC § 152(d)(1)(C).

19 IRC § 152(d)(1)(D).

20 *See* Notice 2008-5, 2008-1 C.B. 256. The purpose of this notice is to provide guidance under IRC § 152(d) for determining whether an individual is a qualifying relative for whom the taxpayer may claim a dependency exemption deduction under IRC § 151(c); specifically, that under IRC § 152(d)(1)(D) an individual is not a qualifying relative of the taxpayer if the individual is a qualifying child of any other taxpayer. This notice clarifies that a taxpayer otherwise eligible to claim a dependency exemption deduction for an unrelated child is not prohibited by IRC § 152(d)(1)(D) from claiming the deduction if the child's parent (or other person with respect to whom the child is defined as a qualifying child) is not required by IRC § 6012 to file an income tax return and (i) does not file a return, or (ii) files only to obtain a refund of withheld income taxes.

21 IRC §§ 152(d); 151(c).

claiming the child, the IRS will use the tie-breaker rules explained in the table below to determine which taxpayer can claim the child.[22] Before 2005, the only family status provision that had a tie-breaker rule was the EITC. With the passage of UDOC, the tie-breaker rules now cover all four family status provisions. Generally, the same taxpayer is entitled to all of the applicable family status benefits with respect to the same qualifying child – or to put it another way, generally taxpayers may not "split the baby" and divide the benefits among themselves.[23] Table 3.9.1 below describes how the tie-breaker rule applies.

TABLE 3.9.1, Tie-Breaker Rule When More Than One Person Files a Return Claiming the Same Qualifying Child

IF . . .	THEN the child will be treated as the qualifying child of the. . .
Only one of the persons is the child's parent,	Parent.
Both persons are the child's parents,	Parent with whom the child lived for the longer period of time during the year. If the child lived with each parent for the same amount of time, then the child will be treated as the qualifying child of the parent with the highest adjusted gross income (AGI).
None of the persons is the child's parent,	Person with the highest AGI.

Special Rule for Divorced or Separated Parents

A child will be treated as the qualifying child or qualifying relative of his or her noncustodial parent if all of the following conditions apply:

- The parents are divorced, legally separated, or lived apart at all times during the last six months of the year;
- The child received over half of his or her support for the year from the parents;
- The child is in custody of one or both parents for more than half the year; and
- The custodial parent releases the claim to the dependency exemption in a written declaration that the noncustodial parent attaches to his or her tax return.[24]

A custodial parent is the parent having custody of the child for the greater part of the calendar year.[25] Accordingly, the other parent is the noncustodial parent.[26] The special rule for divorced or separated parents allows the noncustodial parent to claim the dependency

22 IRC § 152(c)(4).

23 *See* Notice 2006-86, 2006-2 C.B. 680. This notice provides interim guidance to clarify the rule under IRC § 152(c)(4), as amended by WFTRA, for determining which taxpayer may claim a qualifying child when two or more taxpayers claim the same child, and discusses the IRC § 152(e) exception to the prohibition against "splitting the baby," which is only available for divorced or separated parents.

24 IRC § 152(e); Notice 2006-86, 2006-2 C.B. 680. *See also* Form 8332, *Release of Claim to Exemption for Child of Divorced or Separated Parents* (used to release the dependency exemption to the noncustodial parent). The custodial parent may, in lieu of Form 8332, use a similar written statement that meets the requirements of the form. Treas. Reg. § 1.152-4(e)(1) requires that the declaration include an unconditional statement that the custodial parent will not claim the child as a dependent for the years covered by the declaration. As required under Treas. Reg. § 1.152-4(e)(1)(ii), noncustodial parent taxpayers divorced after July 2, 2008, may not attach pages of a divorce decree or separation agreement to substantiate a dependency exemption claim, whereas those divorced on or before that date may continue to do so if the pages constitute a statement substantially similar to the form.

25 IRC § 152(e)(4)(A).

26 IRC § 152(e)(4)(B).

exemption and child tax credit. However, the noncustodial parent may not claim head of household filing status, the credit for child and dependent care expenses, or the EITC; these tax benefits may be claimed only by the custodial parent if all other requirements are met.

The statute does not define "custody." When a child resides with one parent for part of a day and with the other parent for the remainder of that day, it can be difficult to calculate how much time the child spends in the custody of each parent.[27] Under regulations published on July 2, 2008, the custodial parent is the one who resides with the child for the greater number of nights during the calendar year.[28] The regulations also adopt the rule enunciated by the United States Tax Court in *King v. Commissioner*:[29] that the IRC § 152(e) rules for divorced or separated parents also apply to parents who never married.[30]

ANALYSIS OF LITIGATED CASES

As in previous years, most family status cases litigated during our review period were small Tax Court cases.[31] Most of the cases address factual disputes and not novel issues of law.[32]

Pro Se Analysis

Taxpayers were represented by counsel in only six of the 45 cases litigated this year, even though many cases were highly fact-specific and involved a complicated web of statutory provisions. Out of 45 cases, taxpayers with representation received partial relief in one case, while *pro se* taxpayers received full relief in four cases and partial relief in six cases.[33] It appears that many taxpayers did not understand the complex family status provisions or know what evidence to submit; thus, the assistance of counsel (or lack thereof) might have affected the courts' rulings. A detailed list of all family status cases analyzed appears in Table 9 in Appendix III.

Cases Decided Where UDOC Applied

As expected, because UDOC has become operative only recently, the number of cases where UDOC applied has greatly increased since 2008. This year, UDOC applied in nearly 87 percent of family status cases (39 of 45). UDOC appears to have made the decision process easier for the courts by simplifying the "qualifying child" analysis with respect to head of household filing status, the child tax credit, the EITC, and the dependency deduction.

27 *See, e.g., Bjelland v. Comm'r*, T.C. Memo 2009-297(discussing in detail how a child's time in custody is quantified).

28 Treas. Reg. § 1.152-4(d)(1).

29 121 T.C. 245 (2003).

30 Treas. Reg. § 1.152-4(b)(2)(C).

31 In certain tax disputes involving $50,000 or less, taxpayers may elect to have their case conducted under the simplified small tax case procedure. Trials in small tax cases are generally less formal and result in a speedier disposition. However, decisions in these cases cannot be appealed or cited as precedent. *See* IRC § 7463.

32 The cases analyzed in this section often involve multiple family status issues. Therefore a single case might be listed and analyzed in multiple family status categories, though there are only 45 cases discussed.

33 Out of seven cases with split decisions, six taxpayers were *pro se*. Thus, among taxpayers appearing *pro se* during the relevant period, about 26 percent succeeded in at least one of their family status claims.

Moreover, the UDOC reduces the burden on taxpayers who now need only to establish the existence of a "qualifying child" under one standard, rather than several.

Head of Household Filing Status – IRC § 2(b)

We reviewed 18 cases involving head of household status, with six taxpayers prevailing on this issue – although in one case only the mother and not the father prevailed.[34] However, taxpayers succeeded in full in a few circumstances. For example, in *Gaitor v. Commissioner*,[35] the IRS denied the taxpayer's entitlement to head of household filing status in the statutory notice of deficiency. Under Tax Court Rule 142(a), the taxpayer had the burden of proving entitlement to head of household status to the court.[36] The taxpayer was an unmarried father of four, employed by the Florida state courts. Because the child at issue lived with the taxpayer for most of the year, was seven years old at the time of the assessed deficiency (and thus met the age and self-support requirements of IRC § 152(c)), and was not claimed as a dependent by his mother (or released by his father), the Tax Court was easily persuaded that the taxpayer was eligible for head of household status.[37]

In many other cases, taxpayers had difficulty proving entitlement to head of household status, usually due to a lack of tax planning or a misunderstanding of the legal requirements. For example, in *Byles v. Commissioner* the taxpayer claimed head of household status under the theory that his nephews were qualifying children and his sister was a qualifying relative.[38] The court disallowed the filing status, finding the nephews were not qualifying children because the taxpayer's sister (their mother) claimed them as dependents (despite living with the taxpayer and receiving most of their support from him), and the sister was not a qualifying relative because she reported slightly more than $3,300 of income, which was in excess of the personal exemptions amount for that year.[39] Because his sister effectively blocked the taxpayer's ability to claim his nephews as qualifying children and dependents, he was also prevented from claiming the dependency exemption, EITC, and Child Tax Credit, which collectively would have provided the family with greater financial benefit as the taxpayer earned substantially more than his sister. The taxpayer's frustration in this case is typical of the cases reviewed.

34 *Bjelland v. Comm'r*, T.C. Memo. 2009-297. In this case, the petitioners were parents who lived apart during the year in question. Each parent claimed the son as their dependent. Upon analysis of the facts, the court found that the mother was the custodial parent and entered a decision for her and against the father.

35 T.C. Memo 2010-70.

36 *See* Tax Court Rule 142(a) ("The burden of proof shall be upon the petitioner, except as otherwise provided by statute or determined by the Court; and except that, in respect of any new matter, increases in deficiency, and affirmative defenses, pleaded in the answer, it shall be upon the respondent."); *INDOPCO, Inc. v. Comm'r*, 503 U.S. 79 (1992).

37 *Gaitor v. Comm'r*, T.C. Memo. 2010-70.

38 T.C. Summ. Op. 2010-25. This case does not have precedential value and is being used for illustration.

39 *See* IRC § 152(d).

Child Tax Credit

We reviewed 26 cases involving the child tax credit, in which all but one taxpayer appeared *pro se*, and in which taxpayers prevailed in full in four cases (all of which were *pro se*). To receive the child tax credit, the taxpayer must be able to claim the child as a dependent on his or her tax return, and the child must meet the requirements of IRC § 152(c).[40] In *Sheikh v. Commissioner*, the taxpayer was not eligible for the child tax credit because the dependents claimed by the taxpayer did not meet the relationship test under IRC § 152(c)(2) (*i.e.*, they were not the qualifying children or qualifying relatives of the taxpayer).[41]

In *Litton v. Commissioner*, the taxpayer was able to receive the child tax credit for the 2006 tax year.[42] To receive the credit for a child of divorced parents, the taxpayer must show that the dependents meet the special qualifying children requirements, including the custody test under IRC § 152(e)(1), which was the main issue in this case. The taxpayer testified to the total amount of time she had custody of the claimed dependents (her two children), and provided a detailed annotated calendar to support her claims. The court held that though the children spent "slightly more" time in the taxpayer's custody during the school year, what "tipped the custody scales" was the taxpayer's custody of the children over the summer, allowing her to claim them as qualifying children. An interesting aspect of this case was that the taxpayer attempted to exchange summer custody for the husband's signature on a Form 8832, *Release of Claim to Exemption for Child of Divorced or Separated Parents*, which she believed would ensure a "fair" result for both parties in light of a complex custody agreement. The children's primary address was listed as the ex-husband's home, and thus when he did not sign the form and tried to claim the children as his dependents, the IRS sent a notice of deficiency to the taxpayer. The court noted the vagueness of the custody requirement, especially for divorced couples whose children shuttled between them, before agreeing that in this instance the children are the taxpayer's qualifying children. This case highlights a pattern of confusion regarding the use of Form 8832, discussed in more detail with respect to IRC § 151.

Earned Income Tax Credit

We reviewed 19 cases involving the EITC, with two taxpayers (both of whom were *pro se*) prevailing in full on this issue. Taxpayers appeared *pro se* in 17 of the 19 cases. Several themes appear throughout the EITC cases.

- The taxpayer could not prove the child lived at the taxpayer's principal place of abode for at least half of the taxable year;
- The taxpayer was married but did not file a joint return during the tax year he or she claimed the EITC; and
- The taxpayer's income exceeded the adjusted gross income limitation.

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40 *Sheikh v. Comm'r*, T.C. Memo. 2010-33.

41 T.C. Memo. 2010-33.

42 *Litton v. Comm'r*, T.C. Summ. Op. 2010-16. This case does not have precedential value and is being used for illustration.

In *Reyes v. Commissioner*, the government moved to dismiss the taxpayer's refund claim for EITC because: (1) his claim was not made timely; and (2) his girlfriend's children were not qualifying children as defined in IRC § 32(c)(3)(A).[43] The court granted the IRS's motion to dismiss the taxpayer's claim for 2002, but denied the IRS's motion to dismiss the suit for other tax years. The court noted that the taxpayer was granted EITC in 2000 based on one of his girlfriend's children, leading to a "plausible inference" that the taxpayer may qualify, at least partially, for EITC.[44]

In *Scott v. Commissioner*, the taxpayer claimed one of his nieces and one of his nephews as dependents and qualifying children in 2004 and 2006.[45] The court allowed his EITC claim for 2004, but disallowed it for 2006. The taxpayer could not convince the court he held the same principal place of abode as the children in the latter year, as required under IRC § 152(c)(1)(B), because of inconsistent testimony and evidence relating to an apartment he allegedly rented for a girlfriend.

Dependency Exemption – IRC §151

We reviewed 38 cases involving the dependency exemption, with three taxpayers (all of whom were *pro se*) prevailing in full. Taxpayers appeared *pro se* in all but three of the 38 cases.

Taxpayers continue to experience particular trouble with the requirements for releasing or securing dependency exemption claims through Form 8332, or an equivalent document.[46] In *Thomas v. Commissioner*, the court denied the exemption because a Form 8832 was not attached to the return and because the taxpayer's divorce decree was not a substantial equivalent of the form and conditioned entitlement to the exemption on payment of child support.[47] Further, in *Himes v. Commissioner*, the court held that the noncustodial parent could not claim dependency exemptions for his sons without a signed release from their custodial parent, despite the taxpayer's payment of child support and his ex-wife's failure to comply with both the divorce decree and state law.[48]

In *Adler v. Commissioner*, the taxpayer claimed a dependency deduction for his adult daughter for tax years 2001 through 2004 and for his son-in-law for 2002 through 2004.[49] During those years, the daughter and son-in-law attended college together. The taxpayer

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43 *Reyes v. Comm'r*, 105 A.F.T.R.2d (RIA) 830 (E.D. Cal. 2010).

44 *Id.*

45 *Scott v. Comm'r*, T.C. Memo. 2009-211.

46 The final regulations under IRC § 152(e), made effective July 2, 2008, require the release of a claim to the dependency exemption must be on Form 8332 or must be a "document executed for the sole purpose of serving as a written declaration" that the custodial parent is not claiming the dependency exception for a child in a given tax year. *See* IRC § 152(e)(2).

47 *Thomas v. Comm'r*, T.C. Memo. 2010-11.

48 *Himes v. Comm'r*, T.C. 2010-97. *See Gessic v. Comm'r*, T.C. Memo. 2010-88 (co-signed page from a separation agreement did not constitute a declaration releasing claim to dependency exemptions because the signatures were undated, the page did not identify the minor children, and the exemptions were conditioned on the taxpayer remaining current on child support payment, and the ex-wife's employment status).

49 *Adler v. Comm'r*, T.C. Memo. 2010-47.

testified that he paid for his daughter's expenses, including tuition, textbooks, room and board, and clothes; and later paid for his son-in-law's car and auto insurance, groceries, and other bills. While the court was convinced that the taxpayer paid some of his daughter's expenses, and found it plausible that he paid some of his son-in-law's expenses as well, none of the taxpayer's claims were supported by adequate records or other credible evidence. Because the taxpayer could not meet the support test, the court denied the dependency exemption deductions.

CONCLUSION

Family status provisions still seem to be a confusing area for taxpayers, even though the number of cases we have identified declined significantly in recent years. We reviewed 34 cases in the 2008 Annual Report to Congress,[50] down from 41 in the 2007 report[51] and 46 in 2006.[52] However, the number of family status cases rose to 48 in 2009 and is only slightly lower at 45 in 2010.[53]

The increase in family status cases supports the National Taxpayer Advocate's position that these provisions of the tax code still contain complicated and sometimes conflicting eligibility standards. Because of this complexity, tax return filing can be a difficult and confusing exercise for low and middle income families. Taxpayers who wish to claim the family status credits and deductions often do not understand the qualification requirements or how to properly satisfy them. Further, such taxpayers often lack legal representation when they go before the courts, which may adversely affect the outcomes of their cases. In an effort to build on the improvements made by UDOC and reduce the complexity of these provisions even more, the National Taxpayer Advocate proposed a legislative recommendation in her 2005 Annual Report to Congress on how to restructure the requirements governing these provisions to make them easier for taxpayers to understand, thereby reducing complexity.[54] The National Taxpayer Advocate updated her 2005 recommendation in the 2008 Annual

50 National Taxpayer Advocate 2008 Annual Report to Congress 537.

51 National Taxpayer Advocate 2007 Annual Report to Congress 634.

52 National Taxpayer Advocate 2006 Annual Report to Congress 555.

53 National Taxpayer Advocate 2009 Annual Report to Congress 478. It is not clear what caused the recent increase in family status cases, although one possible explanation could be IRS correspondence examination procedures. *See* National Taxpayer Advocate 2009 Annual Report to Congress 158; National Taxpayer Advocate 2008 Annual Report to Congress 243. The way the IRS conducts these examinations has affected results. For several years, the IRS has had high levels of "unassociated" correspondence (*i.e.*, taxpayers send in documentation but the IRS does not align it with the case, and sends a statutory notice of deficiency, so the taxpayers must go to court). *See* National Taxpayer Advocate 2008 Annual Report to Congress 243; National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 94 (IRS Earned Income Credit Audits – A Challenge to Taxpayers).

54 National Taxpayer Advocate 2005 Annual Report to Congress 397. This proposal included the following recommendations: (1) combine the exemptions, child tax credit, and part of the EITC into a refundable family credit comprising two components – one for the taxpayer (and his or her spouse) and one for whomever is the "main caregiver" of a child or children based on a per-child amount; (2) separate the child and dependent care credits into two credits; (3) eliminate head-of-household filing status; (4) modify the EITC so that it provides a refundable credit to low income workers based solely on the taxpayer's earned income and is available to workers age 18 and over, regardless of the existence of children in the household; (5) permit married taxpayers who have a legal and binding separation agreement and who live separate and apart as of the last day of the calendar year to be considered "not married" for purposes of filing status; and (6) provide a separate credit for noncustodial parents.

Report to Congress, once again highlighting the importance of creating a less complex tax system.[55]

Since her 2001 Annual Report to Congress, the National Taxpayer Advocate has recommended several times that Congress create an additional credit for noncustodial parents who pay substantially all of a child's support.[56] The National Taxpayer Advocate believes this credit would reduce litigation and give recognition to the noncustodial parent's ability to pay taxes.

55 National Taxpayer Advocate 2008 Annual Report to Congress 363.

56 *See* National Taxpayer Advocate 2008 Annual Report to Congress 368; National Taxpayer Advocate 2005 Annual Report to Congress 397-398; National Taxpayer Advocate 2001 Annual Report to Congress 122.

MLI #10

Relief From Joint and Several Liability Under Internal Revenue Code Section 6015

SUMMARY

Married couples may elect to file their federal income tax returns jointly or separately. Spouses filing joint returns are jointly and severally liable for any deficiency or tax due.[1] Joint and several liability permits the IRS to collect the entire amount due from either taxpayer.[2]

IRC § 6015 provides three avenues for relief from joint and several liability. Section 6015(b) provides "traditional" relief for deficiencies. Section 6015(c) also provides relief for deficiencies for certain spouses who are divorced, separated, widowed, or not living together, by allocating the liability between the spouses. Section 6015(f) provides "equitable" relief from both deficiencies and underpayments, but only applies if a taxpayer is not eligible for relief under IRC § 6015(b) or (c).

We reviewed 35 federal court opinions involving relief under IRC § 6015 that were issued between June 1, 2009, and May 31, 2010, as well as one decision, *Lantz v. Commissioner*,[3] issued on June 8, 2010. The most significant issue the courts addressed this year is the period of time within which a taxpayer may request relief under IRC § 6015(f). The Tax Court also explored the doctrine of *res judicata* and its exception under IRC § 6015(g)(2),[4] and the effect of a family court order that first required a taxpayer to file amended returns electing joint filing status, then allocated liability for the resulting tax.[5] Finally, one district court decision demonstrates that the issue persists as to whether IRC § 6015 can be raised as a defense in a collection suit.[6]

PRESENT LAW

Traditional Innocent Spouse Relief Under IRC § 6015(b)

IRC § 6015(b) provides that a requesting spouse shall be partially or fully relieved from joint and several liability, pursuant to procedures established by the Secretary, if the requesting spouse can demonstrate that:

1. A joint return was filed;

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1 Internal Revenue Code (IRC) § 6013(d)(3). We use the terms "deficiency" and "understatement" interchangeably for purposes of this discussion and the case table in Appendix III, even though IRC § 6015(b)(1)(D) and IRC § 6015(f) expressly use the term "deficiency" and IRC § 6015(b)(1)(B) refers to an "understatement of tax."

2 The National Taxpayer Advocate, in her 2005 Annual Report to Congress, proposed legislation that would eliminate joint and several liability for joint filers. See National Taxpayer Advocate 2005 Annual Report to Congress 407.

3 607 F.3d 479 (7th Cir. 2010), *rev'g and remanding* 132 T. C. 131 (2009).

4 *Diehl v. Comm'r*, 134 T.C. No. 7 (2010). Under the doctrine of *res judicata*, a judgment on the merits in a prior suit bars a second suit involving the same tax year.

5 *Bruen v. Comm'r*, T.C. Memo 2000-249.

6 105 A.F.T.R.2d 2827 (S.D. Ohio 2010), *adopted by* 105 A.F.T.R.2d (RIA) 2831 (S.D. Ohio 2010).

2. There was an understatement of tax attributable to erroneous items of the nonrequesting spouse;[7]
3. Upon signing the return, the requesting spouse did not know or have reason to know of the understatement;
4. Taking into account all the facts and circumstances, it is inequitable to hold the requesting spouse liable; and
5. The requesting spouse elected relief within two years after the IRS began collection activities against him or her.[8]

Allocation of Liability Under IRC § 6015(c)

IRC § 6015(c) provides that the requesting spouse shall be relieved from liability for deficiencies allocable to the nonrequesting spouse, pursuant to procedures established by the Secretary. To obtain relief under this section, the requesting spouse must demonstrate that:

1. A joint return was filed;
2. At the time relief was elected, the joint filers were unmarried, legally separated, widowed, or had not lived in the same household for the 12 months immediately preceding the election; and
3. The election was made within two years after the IRS began collection activities with respect to the requesting spouse.

This election allocates to each joint filer the portion of the deficiency attributable to each filer as calculated under the allocation provisions of IRC § 6015(d). A taxpayer is ineligible to make an election under IRC § 6015(c) if the IRS demonstrates that, at the time he or she signed the return, the requesting taxpayer had "actual knowledge" of any item giving rise to the deficiency.[9] Relief is not available for amounts attributable to fraud, fraudulent schemes, or certain transfers of disqualified assets.[10] Finally, no credit or refund is allowed as a result of relief granted under IRC § 6015(c).[11]

7 An erroneous item is any income, deduction, credit, or basis that is omitted from or incorrectly reported on the joint return. *See* Treas. Reg. § 1.6015-1(h)(4).

8 Not all actions that involve collection will trigger the two-year limitations period. Under the regulations, only the following four events constitute "collection activity" that will start the two-year period: (1) an IRC § 6330 notice; (2) an offset of an overpayment of the requesting spouse against the joint income tax liability under IRC § 6402; (3) the filing of a suit by the United States against the requesting spouse for the collection of the joint tax liability; and (4) the filing of a claim by the United States to collect the joint tax liability in a court proceeding in which the requesting spouse is a party or which involves property of the requesting spouse. Treas. Reg. § 1.6015-5(b)(2).

9 IRC § 6015(c)(3)(C).

10 IRC § 6015(c)(4),(d)(3)(C).

11 IRC § 6015(g)(3).

Equitable Relief Under IRC § 6015(f)

IRC § 6015(f) provides that the Secretary may relieve a taxpayer from liability for both deficiencies and underpayments[12] where the taxpayer demonstrates that:

1. Relief under IRC § 6015(b) or (c) is unavailable; and
2. Taking into account all the facts and circumstances, it would be inequitable to hold the taxpayer liable for the underpayment or deficiency.

One of the regulations under IRC § 6015(f) requires the taxpayer to request relief under IRC § 6015(f) within two years after the IRS initiates collection activity with respect to the taxpayer.[13] As discussed in last year's report, the U.S. Tax Court, in *Lantz v. Commissioner*, held that this regulation is invalid.[14] This year, the United States Court of Appeals for the Seventh Circuit reversed the Tax Court and held that the two-year rule is a valid interpretation of IRC § 6015(f).[15]

Revenue Procedure 2003-61 lists some of the factors the IRS considers in determining whether equitable relief is appropriate.[16] These factors include marital status, economic hardship, knowledge or reason to know, legal obligations of the nonrequesting spouse, significant benefit to the requesting spouse, compliance with income tax laws, and abuse.

Rights of Nonrequesting Spouse

The individual with whom the requesting spouse filed the joint return is generally referred to as a "nonrequesting spouse," and is granted certain rights by IRC § 6015. The nonrequesting spouse must be notified and given an opportunity to participate in any administrative proceedings concerning a claim under IRC § 6015.[17] Further, if during the administrative process full or partial relief is granted to the requesting spouse, the nonrequesting spouse can file a protest and receive an administrative conference in the IRS Appeals function.[18] However, the nonrequesting spouse does not have the right to petition the Tax Court in response to the IRS's administrative determination regarding IRC § 6015 relief.[19] If the requesting spouse files a Tax Court petition, the nonrequesting spouse must receive notice of the Tax Court proceeding and has an unconditional right to intervene in

12 An underpayment of tax occurs when the tax is properly shown on the return but is not paid. *Washington v. Comm'r*, 120 T.C. 137, 158-159 (2003).

13 Treas. Reg. §1.6015-5(b)(1).

14 132 T.C. 131 (2009).

15 *Lantz v. Comm'r*, 607 F.3d 479 (7th Cir. 2010), *rev'g and remanding* 132 T. C. 131 (2009). In *Hall v. Comm'r*, 135 T.C. No. 19 (Sept. 22, 2010), decided after the Seventh Circuit's reversal in *Lantz*, the Tax Court continued to disagree with the Seventh Circuit and held the taxpayer was entitled to relief even though the request was not made within the two-year period.

16 Rev. Proc. 2003-61, 2003-2 C.B. 296.

17 IRC § 6015(h)(2).

18 Rev. Proc. 2003-19, 2003-5 C.B. 371.

19 IRC § 7442; *Maier v. Comm'r*, 119 T.C. 267 (2002), *aff'd*, 360 F.3d 361 (2d Cir. 2004) (holding that there are no provisions in IRC § 6015 that allow the nonrequesting spouse to petition the Tax Court from a notice of determination).

the proceeding to dispute or support the requesting spouse's claim for relief.[20] However, an intervening spouse has no standing to appeal the Tax Court's decision to the United States Court of Appeals.[21]

Judicial Review

Taxpayers seeking relief under IRC § 6015 generally file Form 8857, *Request for Innocent Spouse Relief*.[22] After reviewing the request, the IRS issues a final notice of determination granting or denying relief in whole or in part. The taxpayer has 90 days from the date the IRS mails the notice to file a petition with the Tax Court.[23] The Tax Relief and Health Care Act of 2006 (TRHCA) amended IRC § 6015(e) to expressly provide that the Tax Court has jurisdiction in stand-alone cases to review IRC § 6015(f) determinations, even where no deficiency has been asserted.[24]

ANALYSIS OF LITIGATED CASES

We analyzed 35 opinions issued between June 1, 2009, and May 31, 2010, including 32 cases in the Tax Court, one each in the United States Courts of Appeals for the Sixth and Ninth Circuits, and one in a U.S. District Court. In addition, we analyzed one opinion issued on June 8, 2010, by the United States Court of Appeals for the Seventh Circuit. Sixty-one percent of the cases (22 of 36) were decided in favor of the IRS, 28 percent (ten of 36) in favor of the taxpayer (including two cases in which only the intervenor opposed granting relief), and 11 percent (four of 36) ended in split decisions. In 56 percent (20 of 36) of the cases, the taxpayers were *pro se* (*i.e.*, they represented themselves). Taxpayers prevailed in 25 percent (five of 20) of the cases in which they proceeded *pro se*; one other *pro se* taxpayer obtained a split decision. The nonrequesting spouse intervened in 28 percent of the cases (ten of 36).

Seventy-two percent of the cases (26 of 36) involved an analysis of whether to grant relief. Thirty-one percent of the cases (11 of 36) involved procedural issues,[25] with 55 percent (six of 11) of these cases decided in favor of the IRS, 36 percent (four of 11) in favor of the taxpayer, and one case a split decision.

Of the 26 cases decided on the merits, 62 percent (16 of 26) were decided in favor of the IRS, 27 percent (seven of 26) in favor of the taxpayer, and in 12 percent (three cases) the

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20 *Van Arsdalen v. Comm'r*, 123 T.C. 135 (2004).

21 *Baranowicz v. Comm'r*, 432 F.3d 972 (9th Cir. 2005).

22 *See* IRS Form 8857, *Request for Innocent Spouse Relief, Instructions* (Sept. 2010).

23 IRC § 6015(e)(1)(A)(ii).

24 Pub. L. No. 109-432, Div. C, § 408(a), (c), 120 Stat. 2922, 3061-62 (2006). The filing of a Tax Court petition in response to the final notice of determination or after the § 6015 claim is pending for six months is often referred to as a "stand-alone" proceeding, because jurisdiction is predicated on IRC § 6015(e) and not deficiency jurisdiction under IRC § 6213.

25 The percentages add up to more than 100 and the number of cases adds up to more than 36 because one case that addressed procedural issues also contained an analysis of whether to grant relief.

court split its decision.[26] See Table 10 in Appendix III for a detailed breakdown of the cases.

Procedural Issues

The most significant procedural issue courts addressed is the validity of a Treasury regulation that requires a taxpayer to request relief under IRC § 6015(f) within two years after the IRS commences collection activity. Additionally, the Tax Court discussed the doctrine of *res judicata* and its exception under IRC § 6015(g)(2), and one district court continued the disturbing trend of holding that a taxpayer was not entitled to raise innocent spouse relief as a defense in a collection suit.

Lantz v. Commissioner

As reported last year, in *Lantz v. Commissioner*[27] the Tax Court considered the validity of Treasury Regulation §1.6015-5(b)(1), which requires the requesting spouse to make an election for relief under IRC § 6015(f) within two years after the IRS initiates collection activity against the requesting spouse. The court held that the regulation was not entitled to judicial deference because it failed the test articulated by the Supreme Court in *Chevron*,[28] noting:

> [T]he Supreme Court created a two prong test: (1) If Congress has directly spoken to the precise question at issue, the court is to give effect to the unambiguously expressed intent of Congress. If the statute is ambiguous, then the court is to continue to the second prong: (2) If the statute is ambiguous with respect to the specific issue, the court is to determine whether the regulation is a permissible construction of the statute.[29]

The Tax Court, applying the first prong, found IRC § 6015 is not ambiguous because while IRC § 6015 (b) and (c) both contain the two-year limitation at issue, IRC § 6015(f) does not; Congress had "spoken" by its "audible silence" in not including the two-year limitation in IRC § 6015(f). Congress' intent in enacting IRC § 6015(f) was to address inequitable situations not addressed by subsections (b) and (c); adopting the timing rule that Congress had imposed on subsections (b) and (c) but had specifically omitted from subsection (f) ran directly contrary to the nature of the relief provided by Congress, and for that reason was invalid. For argument's sake, the Tax Court also considered the second prong of the *Chevron* analysis and found the regulation's one-size-fits-all approach for both traditional and equitable relief was an invalid interpretation of IRC § 6015(f).[30] The IRS appealed the

26 These percentages add up to more than 100 due to rounding.

27 *Lantz v. Comm'r*, 132 T.C. 131 (2009) *reversed and remanded by* 607 F.3d 479 (7th Cir. 2010).

28 *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

29 *Lantz v. Comm'r*, 132 T.C. 131, 137-138 (2009), *reversed and remanded by*, 607 F.3d 479 (7th Cir. 2010).

30 *Lantz v. Comm'r*, 132 T.C. 131 (2009), *reversed and remanded by* 607 F.3d 479 (7th Cir. 2010).

Tax Court's decision to the United States Court of Appeals for the Seventh Circuit, which reversed and remanded the case to the Tax Court.[31]

The Seventh Circuit rejected the Tax Court's use of "audible silence" as a reliable guide to interpreting the statute. The court noted that where a statute does not impose a time limit for bringing a claim, it does not necessarily follow that there is no deadline. As Congress is aware, courts may "borrow" a deadline from other statutes as a means of preventing stale claims. Administrative agencies also impose deadlines when none is provided by statute; the Treasury was doing nothing unusual in imposing a two-year deadline for claims under IRC § 6015(f).

The Seventh Circuit rejected the argument that IRC § 6015(f) in fact contains a deadline due to the operation of IRC § 6502, which imposes a ten-year statute of limitations on collection.[32] Moreover, according to the Seventh Circuit, any deadline (or substitute for a deadline such as the equitable doctrine of laches) for bringing claims under IRC § 6015(f) other than two years would undermine the provisions of IRC § 6015(b) and (c), both of which contain a two-year deadline.[33] This is because a taxpayer who meets the criteria for relief under IRC § 6015(b) also qualifies for relief under IRC § 6015(f). Many taxpayers who qualify for relief under IRC § 6015(f) would be eligible for relief under subsection (c) as well. Without the two-year rule imposed by the regulations under § 6015(f), taxpayers who do not qualify for relief under IRC § 6015(b) or (c) because of the two-year rule would be eligible for relief under IRC § 6015 (f). The two-year deadline in IRC § 6015 (b) and (c) would simply be substituted with the time limit, if any, contained in § 6015(f). Ultimately, keeping in mind that Treasury regulations are entitled to judicial deference, especially when issued pursuant to a specific grant of authority like IRC § 6015(f), the court held that the regulation was a valid interpretation of the statute.[34]

In addition to appealing the Tax Court's decision in *Lantz*, the IRS has filed an appeal in five other United States Courts of Appeals. The IRS has appealed this issue to the Third Circuit in *Mannella v. Commissioner*,[35] the Second Circuit in *Coulter v. Commissioner*,[36] the Sixth Circuit in *Buckner v. Commissioner*,[37] the Ninth Circuit in *Carlile v. Commissioner*,[38] and the Fourth Circuit in *Jones v. Commissioner*.[39] Due to the significance of this developing

31 *Lantz v. Comm'r*, 607 F.3d 479 (7th Cir. 2010), *rev'g and remanding* 132 T.C. 131 (2009).

32 The court noted that IRC § 6502 is not a constraint on taxpayer action. As long as the IRS attempts to collect the tax within the ten-year period, nothing in IRC § 6502 limits the time within which the taxpayer must make a claim for relief under IRC § 6015(f).

33 The doctrine of laches operates to bar relief for claims that are brought after unreasonable delay prejudicial to the defendant. *See Lantz v. Comm'r*, 607 F.3d 479, 483 (7th Cir. 2010), *rev'g and remanding* 132 T.C. 131 (2009).

34 IRC § 6015(f) commences with "under procedures prescribed by the Secretary," and IRC § 6015(h) provides that "the Secretary shall prescribe such regulations as are necessary to carry out the provisions of this section [IRC § 6015]."

35 132 T.C. 196 (2009), *appeal docketed*, No. 07-175310 (3rd Cir. Jan. 25, 2010).

36 Tax Court Docket No. 1003-09, *appeal docketed*, No. 10-680 (2nd Cir. Feb. 24, 2010).

37 Tax Court Docket No. 12153-09, *appeal docketed*, No.10-2056 (6th Cir. Aug. 18, 2010).

38 Tax Court Docket No. 011567-09, *appeal docketed*, No. 10-72578 (9th Cir. Aug. 23, 2010).

39 Tax Court Docket No. 017359-08, *appeal docketed*, No. 10-1985 (4th Cir. Aug. 30, 2010).

issue, the National Taxpayer Advocate this year reiterates her 2006 legislative recommendation that Congress amend IRC § 6015(f) to clarify that taxpayers may seek relief under IRC § 6015(f) for as long as the period of limitations on collection under IRC § 6502 remains open.[40] Moreover, in Volume 2 of this year's Annual Report, the National Taxpayer Advocate analyzes the legislative history of IRC § 6015 and its antecedents, concluding that Congress did not intend to impose the two-year time limit on equitable claims for relief.[41] Additionally, a bill introduced in the U.S. House of Representatives on August 10, 2010 would eliminate any time limit for granting relief under IRC § 6015(f).[42]

At the administrative level, during a nine-month period following the Tax Court's decision in *Lantz*, the IRS referred both docketed and nondocketed cases to the Cincinnati Centralized Innocent Spouse Unit for an evaluation of the merits of the claims.[43] However, on March 12, 2010, the IRS Office of Chief Counsel "designated for litigation" the two-year issue, meaning that the IRS will not settle this issue, and no administrative appeal would be available.[44]

On April 5, 2010, the IRS began issuing letters that gave two options to requesting spouses who filed IRC § 6015(f) claims after the two-year period had expired: suspend their claims pending the outcome of litigation "in the courts"; or receive a final notice of determination denying relief.[45] The notice of determination would not include an evaluation of the merits of the claim. Taxpayers who did not affirmatively choose either of these options within 30 days were issued final notices of determination. Thus, taxpayers continue to receive notices of determination in *Lantz*-type cases and petition the Tax Court on this issue.[46]

Deihl v. Commissioner

In *Deihl v. Commissioner*,[47] the Tax Court applied the doctrine of *res judicata* and an exception to it under IRC § 6015(g)(2). The doctrine of *res judicata* generally bars subsequent proceedings involving a tax year for which the Tax Court has entered a decision.

40 *See* National Taxpayer Advocate 2006 Annual Report to Congress 540-541; Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015(f) or 66(c) at Any Time Before Expiration of the Period of Limitations on Collection and to Raise Innocent Spouse Relief as a Defense in Collection Actions, supra.*

41 *See Unlimit Innocent Spouse Equitable Relief*, vol. 2, *infra*.

42 H.R. 6089, 111 Cong. (2010).

43 *See* IRS Appeals, Exam Programs - Innocent Spouse, *Actions to Be Taken on Cases Involving the 2-Year Rule in IRC 6015(f) Cases*, issued June 10, 2009, *available at* http://appeals.web.irs.gov/tech_services/innocentspouse/Documents/Lantz%20guidance%20_06102009.pdf.

44 Notice CC-2010-005 (Mar. 12, 2010); IRS Appeals, Exam Programs - Innocent Spouse, *Designation for Litigation: Validity of Two-year Deadline for Section 6015(f) Requests for Relief*, issued Mar. 19, 2010, *available at* http://appeals.web.irs.gov/tech_services/innocentspouse/default.htm. *See also* CCDM 33.3.6.1, Designating a Case for Litigation (Aug. 11, 2004). The IRS designates cases for litigation when it believes there is a critical need for enforcement activity with respect to recurring, significant legal issues affecting large numbers of taxpayers. The IRS takes the position that designation for litigation is in the interest of sound tax administration to establish judicial precedent, conserve resources, or reduce litigation costs for the IRS and taxpayers.

45 *See* Letter 4581-C *available at* http://serp.enterprise.irs.gov/databases/forms-ltrs-pubs.dr/crxltrs.dr/c.dr/4581c.htm.

46 As of Aug. 28, 2010, of the 2,693 taxpayers to whom the IRS's Cincinnati Centralized Innocent Spouse Operation sent Letters 4581-C describing these options,1,383 requested suspension of their claims, 135 opted for a final notice of determination, and 1,175 were issued a final notice of determination because they did not respond to the letter. E-mail from Wage and Investment division (W&I) Compliance (Sept. 1, 2010).

47 134 T.C. No. 7 (2010).

IRC § 6015(g)(2) provides, however, that a final court decision in a prior proceeding will not be conclusive with respect to the qualification of a taxpayer as an innocent spouse, if that was not at issue in the prior proceeding and if the court determines that the taxpayer did not meaningfully participate in the prior proceeding. In a prior proceeding, the taxpayer in *Deihl* and her spouse litigated their tax liabilities for 1996, 1997, and 1998, and the taxpayer raised the issue of relief under IRC § 6015 with respect to 1996. The taxpayer did not predicate her claim for relief on any specific subsection of IRC § 6015, and was ineligible to make an election under IRC § 6015(c) because she was married and not separated from her husband when she made her claim. The Tax Court, in addressing this issue of first impression, held that the taxpayer had not meaningfully participated in the prior proceeding. Therefore, the doctrine of *res judicata* barred the taxpayer from raising relief from liability under IRC § 6015 with respect to 1996 only under subsections (b) and (f), and not under subsection (c). Because the taxpayer's husband died after the opinion in the prior proceeding had been filed but before final decisions were entered, the taxpayer was entitled to make an election for relief under IRC § 6015(c) for 1996. In addition, the court held that the taxpayer could claim relief under IRC § 6015 (b), (c), and (f) with respect to 1997 and 1998.

United States v. Wallace

In *United States v. Wallace*, the taxpayer raised IRC § 6015 as a defense in an action to reduce joint federal tax assessments to judgment.[48] Before taking this action, the taxpayer-husband had requested relief from joint and several liability with the IRS with respect to tax years 1995 through 1998. The IRS denied the request as untimely because the husband had submitted it more than two years after the first collection activity. The court noted that because the claim was untimely, "no relief could have been granted under 26 U.S.C. § 6015(b)(1)(E)," and did not consider whether relief under IRC § 6015(f) might be available. Consequently, the court did not explore the Tax Court's opinions in *Lantz* or *Mannella.*

The *Wallace* case also continued the trend, identified by the National Taxpayer Advocate in past Annual Reports to Congress, of restricting a taxpayer's ability to raise IRC § 6015 as a defense in collection suits in district court.[49] IRC § 6015 (e)(1)(A) provides that an individual who seeks relief from joint liability may, "*in addition to* any other remedy provided by law," petition the Tax Court to determine the appropriate relief available (emphasis added). In recent years, however, the district courts have not been willing to consider the validity of innocent spouse claims in the context of a suit to reduce the assessment to judgment,

48 105 A.F.T.R.2d 2827 (S.D. Ohio), *adopted by* 105 A.F.T.R.2d (RIA) 2831 (S.D. Ohio).

49 *See* National Taxpayer Advocate 2009 Annual Report to Congress 487; National Taxpayer Advocate 2008 Annual Report to Congress 524; National Taxpayer Advocate 2007 Annual Report to Congress 631. Moreover, the National Taxpayer Advocate twice recommended that legislation clarify that taxpayers may raise relief under IRC §§ 6015 and 66 as a defense in collection actions. *See* National Taxpayer Advocate 2009 Annual Report to Congress 378; National Taxpayer Advocate 2007 Annual Report to Congress 549.

such as in *Wallace*, or in a foreclosure suit.[50] In *Wallace*, the court relied on *United States v. Boyton*[51] and held that a district court only has jurisdiction to consider an IRC § 6015 claim in the context of a refund suit and exclusive jurisdiction lies with the Tax Court in all other circumstances. According to the court in *Wallace*, the only way the taxpayer will be permitted to raise his IRC § 6015 claim is to pay the tax and seek a refund in a separate proceeding.[52] Because taxpayers continue to be harmed by this trend in the district courts, the National Taxpayer Advocate reiterates her recommendation that legislation clarify that taxpayers may raise innocent spouse relief as a defense in collection actions.[53]

Relief on the Merits

While the courts considered many factors in determining the appropriateness of relief on the merits under IRC § 6015, the most significant factor was whether the requesting taxpayer had actual or constructive knowledge of the tax deficiency. All three avenues for relief contain a knowledge element or factor, making it the linchpin in most of the courts' analyses.[54] Actual or constructive knowledge was a factor in 22 of the 26 decisions on the merits. These cases suggest that determining what a taxpayer knew or should have known will continue to generate a significant amount of controversy as long as joint filers are taxed on their combined incomes and remain jointly and severally liable for the tax required to be shown on the return. One case decided this year illustrates how the Tax Court evaluated a taxpayer's knowledge of an underpayment where the joint return arose as a consequence of divorce proceedings.

In *Bruen v. Commissioner*,[55] the taxpayer and her spouse filed separate returns for 2002 and 2003. The taxpayer paid the tax shown on her separate returns, but her spouse did not pay the tax shown on his returns. The taxpayer divorced her husband in 2004. In dividing the couple's assets, the family court ordered the couple to file amended returns for 2002 and 2003, using the filing status of married filing jointly. The court's judgment provided that each ex-spouse would be liable for one half of the 2003 tax liability, but was silent as to responsibility for the 2002 liability because it mistakenly assumed the liability had already been paid. The taxpayer and her ex-spouse filed the joint returns as ordered; the returns for both years showed liabilities attributable entirely to the former husband's earnings. Neither the taxpayer nor her ex-husband paid the tax shown on the joint returns, and the

50 *See U.S. v. Boyton*, 99 A.F.T.R.2d (RIA) 920 (S.D. Cal. 2007); *U.S. v. Bucy*, 100 A.F.T.R.2d (RIA) 6666 (S.D. W. Va. 2007); *U.S. v. Feda*, 97 A.F.T.R.2d (RIA) 1985, 1989 (N.D. Ill. 2006) (taxpayer could not raise IRC § 6015 as a defense in a suit to reduce assessment to judgment); *U.S. v. Cawog*, 97 A.F.T.R.2d (RIA) 3069 (W.D. Pa. 2006), *appeal dismissed* (3d Cir. July 5, 2007) (taxpayer could not raise IRC § 6015 as a defense in a suit to foreclose tax liens).

51 99 A.F.T.R.2d (RIA) 920 (S.D. Cal. 2007).

52 The court in *Wallace* erroneously asserted that the refund action based on IRC § 6015 must proceed *simultaneously* with the Tax Court case. If a court were to apply this interpretation, then the taxpayer would have no prepayment forum in which to assert his IRC § 6015 claim. The taxpayer would petition the Tax Court and at the same time have to pay the tax and file a refund claim. IRC § 6015(e)(3) provides that if a suit for refund is commenced, the Tax Court loses jurisdiction over the IRC § 6015 claim to the extent jurisdiction is acquired by the district court.

53 *See* Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015(f) or 66(c) at Any Time Before Expiration of the Period of Limitations on Collection and to Raise Innocent Spouse Relief as a Defense in Collection Actions, supra.*

54 *See* IRC § 6015(b)(1)(C); § 6015(c)(3)(C); Rev. Proc. 2003-61, 2003-2 C.B. 296 §§ 4.02(1)(b) and 4.03(2)(a)(iii).

55 T.C. Memo. 2009-249.

taxpayer claimed that she should be relieved of liability for the underpayments under IRC § 6015(f). The IRS denied her claim, finding that because the taxpayer knew her former husband would not pay the portion of the liability assigned to her by the family court, she was not entitled to any relief for 2003. The Tax Court agreed that the taxpayer knew that her former husband would not pay the portion of the liability that had been assigned to her, and was therefore not entitled to relief for those amounts. However, the Tax Court found that the taxpayer did not know or have reason to know that her ex-husband would not pay the portion of the liability that had been assigned to him. Noting that "section 6015(f) allows relief 'for any unpaid tax or any deficiency (*or any portion* of either)' (emphasis added)," the court held that the taxpayer was entitled to relief from liability for those amounts. The Tax Court applied the same analysis to the 2002 liability, holding that the taxpayer was entitled to relief from liability for the portion the family court had assigned to her former husband, but not from liability for the portion the family court had assigned to her. Finally, the Tax Court analyzed the taxpayer's claim for relief in the light of all the facts and circumstances, applying the factors found in Revenue Procedure 2003-61.[56] The court found that while several of the factors weighed in the taxpayer's favor, her knowledge that her former husband would not pay the portion of the liability that the family court had assigned to her, as well as the family court's allocation of liability in the context of an overall allocation of the couple's debts, led to the conclusion that equitable relief beyond half of the tax liability was not appropriate.

The National Taxpayer Advocate has proposed legislation that would eliminate joint and several liability for joint filers and would tax each spouse only on his or her own income.[57] Adoption of such a proposal would eliminate the need for innocent spouse relief in most instances, as well as the attendant inquiry into a spouse's knowledge.

CONCLUSION

This year, the courts continued to address the procedural issue of whether the Treasury regulation that imposes a two-year time period within which a requesting spouse must elect relief under IRC § 6015(f) was invalid. The United States Court of Appeals for the Seventh Circuit, reversing the Tax Court, held that the regulation is valid. The issue is before five other United States Courts of Appeals. In addition, the Tax Court clarified that a nonspecific claim for relief under IRC § 6015 does not necessarily mean that all subsections of IRC § 6015 are at issue for purposes of applying the doctrine of *res judicata* and its exception under IRC § 6015(g)(2). With respect to determinations on the merits, issues concerning the requesting spouse's knowledge continued to predominate. Finally, the issue of whether IRC § 6015 can be raised as a defense in a collection suit continues to create difficulty for taxpayers.

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56 2003-2 C.B. 296.

57 National Taxpayer Advocate 2005 Annual Report to Congress 407.

Case Advocacy

Activities of the Office of the Taxpayer Advocate

Under Internal Revenue Code (IRC) § 7803(c), the Office of the Taxpayer Advocate has four principal functions:

- Assist taxpayers in resolving problems with the IRS;
- Identify areas in which taxpayers are experiencing problems with the IRS;
- Propose changes in the administrative practices of the IRS to mitigate problems taxpayers are experiencing with the IRS; and
- Identify potential legislative changes which may be appropriate to mitigate such problems.

Taxpayer Advocate Service (TAS) employees assist taxpayers whose tax problems are causing financial difficulty, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe an IRS system or procedure is not working as it should. TAS employees share with all IRS personnel the responsibility to consider and protect taxpayer rights.

In addition to helping taxpayers with specific cases and individual problems, TAS employees advocate for taxpayers by identifying IRS procedures that adversely impact taxpayer rights or create taxpayer burden, recommending solutions to taxpayer problems, and working with the IRS to improve tax administration. TAS serves as the voice of the taxpayer within the IRS by providing the taxpayer's viewpoint when the IRS is considering new policies, procedures, or programs. Additionally, TAS administers the Low Income Taxpayer Clinic (LITC) grant program and oversees the Taxpayer Advocacy Panel (TAP).[1]

TAS Assists Taxpayers in Resolving Problems

Taxpayers come to TAS with specific cases when:

- They have experienced a tax problem that causes financial difficulty;
- They have encountered problems trying to resolve their issues directly with the IRS; or
- An IRS action or inaction has caused or will cause them to suffer a long-term adverse impact, including a violation of taxpayer rights.

TAS accomplishes this part of its statutory mission through a combination of case advocacy and outreach. TAS's philosophy calls for each employee who works on a case to advocate, communicate, and reach the right answer, not only for the taxpayer who sought help, but also for others by elevating issues for a more broad-based form of advocacy. This process enables TAS to resolve individual issues, address systemic issues that surface in our casework, and identify areas where taxpayer education is needed. TAS's education and outreach campaigns are designed to make TAS a known advocacy organization, help taxpayers

1 TAP issue committees work to identify and resolve systemic IRS problems.

resolve current problems, educate them to avoid future ones, protect taxpayer rights, and reduce taxpayer burden.

TAS provides a vital service to individual and business taxpayers who come to or are referred to TAS for help with a specific tax issue by:

- Researching IRS systems to determine what is occurring on the taxpayer's account (TAS looks at all the taxpayer's issues, not just the one that brought the taxpayer to TAS);
- Researching appropriate statutes, regulations, and IRS guidance;
- Determining the correct resolution for each issue;
- Helping the taxpayer obtain any supporting documentation needed to resolve the issue;
- Advocating for the taxpayer with the appropriate function in the IRS to resolve each issue, including expediting actions where appropriate; and
- Helping the taxpayer understand all the issues involved and the resolution(s) achieved.

Because Congress did not intend TAS to be a substitute for regular IRS channels for resolving issues, TAS accepts cases in four categories:

- Economic Burden – Cases in which a taxpayer is experiencing financial difficulty;
- Systemic Burden – Cases in which an IRS process, system, or procedure has failed to operate as intended, and as a result, the IRS has failed to timely respond to or resolve a taxpayer's issue;
- Equitable Treatment or Taxpayer Rights – Cases accepted to ensure taxpayers receive fair and equitable treatment and taxpayers' rights are protected; and
- Public Policy – Cases accepted when the National Taxpayer Advocate determines compelling public policy warrants assistance to an individual or group of taxpayers.

TAS received 298,933 cases in fiscal year (FY) 2010, a 9.7 percent increase from FY 2009, and provided relief to taxpayers in 73.7 percent of cases closed in FY 2010.[2] Figure 4.1 shows TAS FY 2010 receipts and closures by case category.

FIGURE 4.1, TAS Case Receipts, Closures, and Relief Rates[3]

	FY 2010 Receipts	FY 2010 Closures	Relief Rate
Economic Burden	119,807	114,320	70.4%
Systemic Burden	178,784	171,720	75.8%
Equitable Treatment or Taxpayer Rights Issues	290	211	63.5%
Public Policy	52	47	72.3%
Total Cases	**298,933**	**286,298**	**73.7%**

TAS Analyzes Economic Burden and Systemic Burden Case Receipts to Improve IRS Processes

TAS cases rose by 23.4 percent from FY 2006 to FY 2010.[4] Figure 4.2 below breaks down receipts by case acceptance category.

FIGURE 4.2, TAS Case Receipts by Case Acceptance Category, FY 2006 – FY 2010[5]

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	% Change FY 2006 to FY 2010
Economic Burden	72,463	86,261	92,410	101,624	119,807	65.3%
Systemic Burden	169,198	161,235	181,120	170,524	178,784	5.7%
Equitable Treatment or Taxpayer Rights Issues	273	257	484	228	290	6.2%
Public Policy	239	86	37	28	52	-78.2%
Total TAS Receipts	**242,173**	**247,839**	**274,051**	**272,404**	**298,933**	**23.4%**

As reflected in Figure 4.2, the composition of TAS receipts has changed in recent years. In FY 2006, economic burden cases represented roughly 30 percent of all receipts and systemic burden cases receipts made up nearly 70 percent. In FY 2010, economic burden cases represented 40 percent of total receipts and systemic burden cases accounted for 60 percent. While TAS strives to expeditiously resolve all cases meeting TAS criteria, it establishes special timeliness requirements in cases involving taxpayers who are experiencing financial difficulty. In these instances, TAS requires case advocates to take specific actions to expedite

2 TAS determines relief based upon whether TAS is able to provide full or partial relief or assistance on the issue initially identified by the taxpayer. Thus, this relief rate is understated because TAS frequently provides relief on issues that differ from the ones the taxpayer initially identified. Data obtained from the Taxpayer Advocate Management Information System (TAMIS). TAS uses TAMIS to record, control, and process taxpayer cases, as well as to analyze the issues that bring taxpayers to TAS.

3 Data obtained from TAMIS. TAS tracks resolution of taxpayer issues through codes entered at the time of closing on TAMIS and requires case advocates indicate the type of relief or assistance they provide to the taxpayer. *See* Internal Revenue Manual (IRM) 13.1.7.10.2.1 (Apr. 1, 2003). The codes reflect full relief, partial relief, or assistance provided. The relief rate is determined by dividing the total number of cases closed with full relief, partial relief, or assistance by the total number of closures.

4 Data obtained from TAMIS.

5 *Id*.

initial case processing, and contact the taxpayer to communicate these actions and request additional information (if needed) within three workdays of the date TAS received the case.[6]

TAS experienced a 65.3 percent growth in economic burden receipts over the past five years, compared with a 5.7 percent growth in systemic burden receipts.[7] TAS expects both the number and percentage of economic burden cases to continue to grow because of the weak U. S. economy and the IRS's increased enforcement actions designed to close the tax gap. New tax credit programs, such as the First-Time Homebuyer Credit (FTHBC)[8] or the adoption credit,[9] can cause IRS processing delays because they require taxpayers to file paper returns and attach supporting documentation. These delays in turn increase the likelihood of taxpayers experiencing economic burden by not receiving their refunds on time.

By categorizing the issues involved in individual casework, TAS identifies trends that also affect larger groups of taxpayers and uses that information to work with the IRS to resolve the broader issues.[10] Figure 4.3 shows the increases and decreases in different types of TAS cases since FY 2006.

FIGURE 4.3, TAS Case Receipts by Issue, FY 2006 – FY 2010[11]

Description of Issue	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	% Chg FY 2006 to FY 2010
Document Processing Issues	52,775	44,552	58,888	53,528	86,485	63.9%
Audit Issues	47,703	59,601	60,051	55,542	67,949	42.4%
Refund Issues	27,781	31,521	46,680	47,785	43,687	57.3%
Collection Issues	43,552	43,706	42,418	43,799	41,142	-5.5%
Entity Issues	11,495	15,334	17,313	22,920	23,526	104.7%
Penalty Issues	12,328	15,716	13,705	13,921	13,399	8.7%
Technical, Procedural, or Statute Issues	12,585	12,121	11,103	10,248	9,428	-25.1%
Payment or Credit Issues	8,173	9,047	9,046	7,891	6,251	-23.5%
Appeals Issues	2,618	2,498	2,841	3,084	3,443	31.5%
Criminal Investigation Issues	21,395	11,846	10,152	11,954	2,150	-90.0%
Interest Issues	1,029	1,249	1,235	1,135	907	-11.9%
Other Issues	739	648	619	597	566	-23.4%
Total TAS Receipts	**242,173**	**247,839**	**274,051**	**272,404**	**298,933**	**23.4%**

6 *See* IRM 13.1.7.5.2 (Oct. 31, 2004); TAS Interim Guidance Memorandum, *Re-issuance of Memorandum to Implement Arbitration Decision re: 2007 Revisions to IRM 13.1*, TAS-13.1-0810-006 (Sept. 1, 2010). For all other types of cases, TAS employees have seven calendar days from the date TAS receives the case to complete the same activities. IRM 13.1.7.6.3 (Oct. 31, 2004); TAS Interim Guidance Memorandum, *Re-issuance of Memorandum to Implement Arbitration Decision re: 2007 Revisions to IRM 13.1*, TAS-13.1-0810-006 (Sept. 1, 2010).

7 Data obtained from TAMIS.

8 IRC § 36.

9 IRC § 36C.

10 TAS also asks its employees to submit systemic issues they find in TAS cases to the Systemic Advocacy Management System (SAMS). SAMS allows TAS to record and manage advocacy activities that benefit groups of taxpayers. To assist with systemic issue identification, TAS asks case advocates to answer questions about systemic problems on each individual case when closing the case on TAMIS.

11 Data obtained from TAMIS.

In addition to grouping receipts by categories, TAS also analyzes the underlying issues. Figure 4.4 lists the top 15 issues facing taxpayers who came to TAS in FY 2010.

FIGURE 4.4, Top 15 Issues Received In TAS, FY 2010[12]

Rank	Description of Issue	FY 2009	FY 2010	% Change
1	Processing Amended Return	19,939	30,891	54.9%
2	Open Audit (Not Earned Income Tax Credit)	10,630	26,182	146.3%
3	Unpostable and Reject Returns[13]	3,786	22,341	490.1%
4	Levies (including Federal Payment Levy Program)[14]	18,153	18,015	-0.8%
5	Stolen Identity	14,023	17,291	23.3%
6	Reconsideration of Substitute for Return under IRC § 6020(b)[15] and Audits[16]	11,488	12,843	11.8%
7	Processing Original Return	9,170	11,997	30.8%
8	Expedite Refund Request	10,959	11,755	7.3%
9	Earned Income Tax Credit	13,475	11,198	-16.9%
10	Injured Spouse Claim	10,130	7,777	-23.2%
11	IRS Offset	6,176	6,865	11.2%
12	Other Refund Inquiries and Issues	11,578	6,707	-42.1%
13	Automated Underreporter Completed[17]	7,481	6,137	-18.0%
14	Returned and Stopped Refunds	5,517	6,115	10.8%
15	Installment Agreements	6,318	6,039	-4.4%
Total TAS Receipts Cumulative		**272,404**	**298,933**	**9.7%**

The following discussion addresses trends in TAS cases as well as individual issues affecting receipts.

Downstream Impact on TAS of IRS Administration of Social Benefit Programs

The objectives of the Office of the Taxpayer Advocate are firmly linked to the IRS's goals, initiatives, and challenges. TAS's case inventory reflects, in part, the downstream impact of changes to IRS policies and procedures. In her FY 2011 Objectives Report to Congress, the

12 Data obtained from TAMIS. Data reflect only the top 15 issues and will not total to all TAS receipts received for the fiscal year.

13 Each account transaction, including tax return processing, is subjected to a series of validity checks before posting to the IRS Master File. A transaction is termed unpostable when it fails to pass any of the checks and is returned to the campus (Rejects Function) for follow-up action(s). IRM 21.5.5.2 (Oct. 1, 2007).

14 The Federal Payment Levy Program (FPLP) is a systemic collection enforcement tool authorized by IRC § 6331(h). It allows the IRS to levy on federal payments disbursed by Treasury's Financial Management Service (FMS) to delinquent taxpayers. Each week, the IRS creates a file of certain balance due accounts and transmits the file to FMS's Treasury Offset Program. FMS transmits a weekly file back to the IRS listing those that matched. FPLP will subsequently transmit levies on matching accounts.

15 IRC § 6020(b) allows the IRS to prepare a return on behalf of the taxpayer based on its own knowledge and other data, and assess the tax after providing a statutory notice of deficiency to the taxpayer.

16 Audit reconsideration is the process the IRS uses to reevaluate the results of a prior audit where additional tax was assessed and remains unpaid, or a tax credit was reversed. IRM 21.5.10.4.3 (Oct. 1, 2010).

17 The Automated Underreporter program matches information returns reporting income and deductions submitted by third parties (*e.g.*, Forms 1098, *Mortgage Interest Statement*, and 1099-MISC, *Miscellaneous Income*) against amounts reported on the taxpayer's return.

National Taxpayer Advocate discussed the challenges posed to the IRS by the economy and the need to close the tax gap. Further, she noted the IRS is increasingly viewed not only as a tax collection agency, but also as a vehicle for administering social benefit programs, and suggested the IRS's mission statement should acknowledge this dual mission.[18]

The Earned Income Tax Credit (EITC) was one of the first social benefit programs administered by the IRS.[19] In recent years, the IRS faced the task of distributing billions of dollars to millions of taxpayers through other programs, including Economic Stimulus Payments (ESP),[20] Making Work Pay (MWP) Credits (including their interaction with Economic Recovery Payments),[21] the FTHBC,[22] and the Hybrid Car Credit,[23] to name just a few. In FY 2011, the IRS will begin to administer provisions of the Affordable Care Act, the Adoption Credit, and other social programs. The IRS's administration of these programs can result in:

- High volumes of telephone contacts and taxpayer correspondence;
- Processing delays and programming problems; and
- Opportunities for refund fraud schemes.

18 National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress v-vii. *See also* Most Serious Problem: *The IRS Mission Statement Does Not Reflect the Agency's Increasing Responsibilities for Administering Social Benefits Programs, supra.*

19 IRC § 32. In 1975, Congress enacted legislation creating the EITC. The EITC program is administered by the IRS and provides support to low to moderate income working individuals and families. The EITC is a refundable credit which means eligible taxpayers may get a refund of the credit even if they had no tax liability and paid no withholding or estimated tax. Tax Reduction Act of 1975, Pub. L. No. 94-12, § 204, 89 Stat. 26 (1975).

20 IRC § 6428.

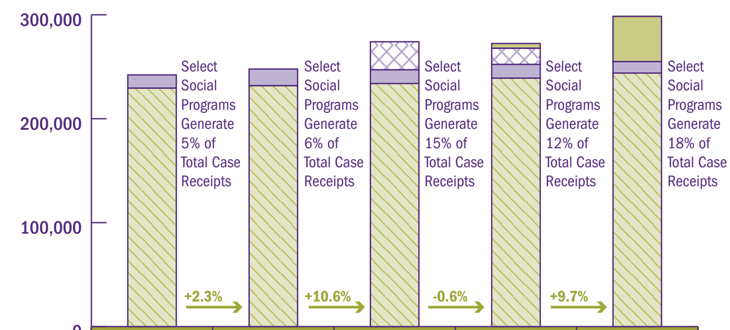
21 IRC § 36A.

22 IRC § 36.

23 IRC § 30B.

As demonstrated in Figure 4.5, the expansion of social benefit programs in the tax code increases TAS's case receipts. The percentage of TAS total case receipts attributable to social benefit programs rose from five percent to 18 percent over the past five years (from 12,769 in FY 2006 to 54,997 in FY 2010).

FIGURE 4.5, TAS Case Receipts, FY 2006 – FY 2010[24]



	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Total Cases	242,173	247,839	274,051	272,404	298,933

TAS Assists the IRS with the Administration of the First-Time Homebuyer Credit[25]

The FTHBC was designed to bolster the residential real estate market during the recession and continuing economic downturn.[26] However, it requires taxpayers to navigate a complex set of rules. To claim the credit, taxpayers must attach a Form 5405, *First-Time Homebuyer Credit and Repayment of the Credit,* to an original or amended 2008, 2009, or 2010 tax return along with supporting documentation that cannot be submitted

24 Data obtained from TAMIS. The level of growth for TAS receipts without social programs is 6.3 percent from FY 2006 to FY 2010. TAS employees use primary issue codes to identify the most significant issue, policy, or process causing the taxpayer's problem. IRM 13.4.5-1 (Jan. 15, 2005). EITC data obtained from TAMIS using the EITC primary issue code. In addition to the primary issue code, TAS uses special case codes to track issues which may have significant impact, but are short term in nature (*e.g.*, ESP or MWP), or be categorized and worked under more than one IRS process (*e.g.*, TAS FTHBC cases may involve return processing, audit, or collection issues). IRM 13.4.5.2.1.5(2)(t) (Jan. 15, 2005). Cases having special case codes will also have a primary issue code. To avoid counting a case more than once for purposes of this chart, TAS removed cases coded as FTHBC, MWP, and ESP and having a primary issue of EITC from the number of EITC cases. The statistics gathered for ESP, MWP, and FY 2009 FTHBC were compiled on Oct. 7, 2010, and FY 2010 FTHBC data was compiled on Oct. 4, 2010. TAMIS is a dynamic system, therefore the ESP, FTHBC, and MWP statistics may not match statistics gathered on another date. TAS began capturing statistics for the ESP on Feb. 15, 2008, FTHBC on Oct. 20, 2009, and MWP on Apr. 20, 2010. MWP cases fall into the Social Benefit Program category, but the number of MWP cases received in FY 2010 (483) was so small that the category did not show up in the graph.

25 The laws, in order of enactment, are the Housing and Economic Recovery Act of 2008 (HERA), Pub. L. No. 110-289, 122 Stat. 2654; the American Recovery and Reinvestment Act of 2009 (ARRA), Pub. L. No. 111-5, 123 Stat. 115; the Worker, Homeownership, and Business Assistance Act of 2009 (WHBAA), Pub. L. No. 111-92, 123 Stat. 2984; the Homebuyer Assistance and Improvement Act of 2010 (HAIA), Pub. L. No. 111-198, 124 Stat. 1356.

26 Associated Press, *Northeast Home Sales Post 13 Pct. Annual Increase*, The New York Times, *available at* http://www.nytimes.com/aponline/2010/03/23/business/AP-US-Home-Sales-Northeastern-Cities.html (Mar. 23, 2010).

electronically. Thus, FTHBC claims can only be filed with paper (not e-filed) returns.[27] The inability of taxpayers to obtain the credit electronically created administrative problems for the IRS during FY 2010:

- Taxpayers filed more than 2.3 million original and amended returns that include FTHBC claims;[28]
- The IRS has selected more than 415,500 of these returns for examination; and
- Nearly 132,000 of these audits remain open.[29]

As of September 30, 2010, the IRS had completed more than 1.3 million individual audits for FY 2010.[30] Of these, more than 295,000 (over 22 percent) involved the FTHBC. At the same point in FY 2009, only 1.1 percent of more than 1.1 million completed audits involved the FTHBC.[31] Thus, FTHBC-related audits displaced a significant number of regular discretionary audits in FY 2010.

To the IRS's credit, the FTHBC audit selection process appears to have improved somewhat, as reflected by a decrease in FTHBC no-change rates over the last year.[32] In September 2009, the Small Business/Self-Employed Division's (SB/SE's) and the Wage & Investment Division's (W&I's) no-change rates involving original returns claiming FTHBC were nearly 82 percent and over 83 percent, respectively, compared to September 2010, where SB/SE and W&I no-change rates involving original returns claiming FTHBC were over 68 percent and 38 percent. In September 2009, the no-change rates for SB/SE and W&I audits involving FTHBC amended returns were nearly 41 percent and 60 percent, respectively, compared to September 2010 where the rates had fallen to 34 percent and 51 percent.[33] Although the FY 2010 no-change rates have improved, they are still unacceptably high.

The FTHBC also impacts TAS's inventory. In FY 2010, TAS received 43,520 FTHBC-related cases, of which approximately 91 percent concerned an audit or document processing issue. This number may seem like a small fraction of all the FTHBC-related returns processed by

27 *See* IRM 21.6.3.4.2.11.6(8) (Mar. 5, 2010); IRS Instructions to Form 5405, *First-Time Homebuyer Credit and Repayment of the Credit* (July 2010). The year in which the FTHBC is claimed depends in part on the home purchase date. Taxpayers can elect to treat a residence purchased after December 31, 2008, and before December 1, 2009, as purchased on December 31, 2008, so that the FTHBC may be claimed on a 2008 amended return. IRC § 36(g). The FTHBC may also be claimed on 2009 or 2010 original or amended returns, but cannot be claimed before the closing date. IRS, *First-Time Homebuyer Credit, available at* http://www.irs.gov/newsroom/article/0,,id=204671,00.html (last visited Apr. 5, 2010).

28 IRS, *FTHBC Compliance Activities Report* (Sept. 2010).

29 *Id*.

30 Regular discretionary audit work involves non-EITC and non-Questionable Refund Program (QRP) cases. IRS, W&I Insider, *W&I Compliance Examination Program Responsibilities*. Examples of such discretionary work include innocent spouse, non-filers, alimony, charitable contributions, employee business expenses, and alternative minimum tax issues. IRS, Audit Information Management System (AIMS) (data extracted on July 23, 2010).

31 IRS, AIMS (data extracted on Sept. 30, 2010).

32 The term "change rate" represents the percent of cases in which the examiner took corrective action. By extension, the "no-change" rate refers to the percentage of examinations that did not result in any change to the amounts reported by the taxpayer. A lower no-change rate indicates that the IRS is doing a better job of selecting returns that actually need to be audited and not selecting returns that were correct as they were filed, thereby allowing timely refunds for the correctly filed returns.

33 IRS, AIMS (data extracted on Sept. 30, 2010). In 2009, SB/SE started 27 percent of the FTHBC audits and W&I started 73 percent. In 2010, SB/SE started 25 percent of the FTHBC audits and W&I started 75 percent.

the IRS and selected for audit. However, Figure 4.6 below shows that if not for the FTHBC, TAS would have received fewer cases in FY 2010 than 2009 in three of the seven top case categories affected by the credit. TAS provided relief to taxpayers in 79.6 percent of the FTHBC cases closed in FY 2010. This is eight percent higher than the relief rate provided to taxpayers for all TAS cases closed during the same period.[34]

FIGURE 4.6, Analysis of TAS Top Seven FTHBC Case Issues Impacted by the FTHBC, FY 2009 – FY 2010[35]

Issue Description	FY 2009	FY 2010	% Change	FY 2009 without FTHBC	FY 2010 without FTHBC	% Change without FTHBC
Open Audit (Not EITC)	10,630	26,182	146.3%	9,394	10,539	12.2%
Processing Amended Return	19,939	30,891	54.9%	17,812	18,217	2.3%
Unpostable or Reject Returns[36]	3,786	22,341	490.1%	3,762	17,594	367.7%
Math Error	2,741	4,597	67.7%	2,713	2,568	-5.3%
Reconsideration of Substitute for Return under IRC § 6020(b) and Audits	11,488	12,843	11.8%	11,467	11,313	-1.3%
Expedite Refund Request	10,959	11,755	7.3%	10,761	10,343	-3.9%
Processing Original Return	9,170	11,997	30.8%	9,117	10,598	16.2%

In addition to advocating for individual taxpayers on FTHBC cases, TAS is addressing the broader, systemic issues by:

- Recommending that the FTHBC be administered by the Federal Housing Administration or another agency that would have direct access to information to verify eligibility, a step which would also address concerns about the delay in providing this credit;[37]
- Participating on the IRS's FTHBC executive steering committee;
- Maintaining an internal TAS team that meets regularly to identify and discuss FTHBC issues impacting taxpayers;
- Establishing an internal (intranet) web page for TAS employees to use when working FTHBC issues, including the latest procedures, guidance, and frequently asked questions; and
- Joining with the IRS to present a FTHBC session for tax practitioners at the 2010 Nationwide Tax Forums.

34 TAS provided relief to taxpayers in 73.7 percent of the cases closed in FY 2010. Data obtained from TAMIS. TAS determines relief based upon whether TAS is able to provide full or partial relief or assistance on the issue initially identified by the taxpayer.

35 Data obtained from TAMIS.

36 *See TAS Assists with Document Processing Issues, infra*, for a discussion of other factors impacting TAS Unpostable or Reject Return cases.

37 *See* National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 102-103; Tax Filing Season Update: Current IRS Issues, Hearing Before the Sen. Comm. on Finance, 111th Cong. 5-12 (Apr. 15, 2010) (statement of Nina E. Olson, National Taxpayer Advocate).

TAS Assists with Audit Issues

As previously noted in the FTHBC discussion and reflected in Figure 4.7, TAS experienced a dramatic increase (nearly 278 percent) in open audit cases from FY 2006 to FY 2010.

FIGURE 4.7, TAS Audit Receipts, FY 2006 – FY 2010[38]

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	% Chg FY 2006 to FY 2010
Open Audit (Not EITC)	6,934	8,729	9,232	10,630	26,182	277.6%
Reconsideration of Substitute for Return under IRC § 6020(b) and Audits	10,005	12,331	12,419	11,488	12,843	28.4%
EITC - Revenue Protection Strategy Claims	12,769	16,081	13,489	13,475	11,198	-12.3%
Automated Underreporter - Closed Cases[39]	7,706	9,125	9,594	7,481	6,137	-20.4%
Combined Annual Federal Wage Reporting (CAWR) and Federal Unemployment Tax Act (FUTA)[40]	4,223	7,123	8,928	6,755	5,495	30.1%
Automated Underreporter - Open Cases	4,718	4,645	4,575	3,874	3,726	-21.0%
Other Audit	1,348	1,567	1,814	1,839	2,368	75.7%
Audit Issues	47,703	59,601	60,051	55,542	67,949	42.4%

While the FTHBC accounts for the 2010 increase, the National Taxpayer Advocate has advocated extensively on audit issues by identifying them as Most Serious Problems (MSPs) in her Annual Reports to Congress over the past decade.[41] Additionally, TAS conducted two research studies and has participated on several IRS teams that dealt with audit issues.[42] Moreover, in an effort to strengthen TAS's advocacy efforts through education, the National Taxpayer Advocate recorded four video segments to educate taxpayers about the audit process: an examination (audit) overview, information about the Automated Underreporter (AUR) program, correspondence audits, and appealing audit results. These videos are available to the public on YouTube, Facebook, and TAS's Tax Toolkit.[43]

38 Data obtained from TAMIS.

39 The Automated Underreporter program matches information returns reporting income and deductions submitted by third parties (*e.g.*, Forms 1098, *Mortgage Interest Statement*, and 1099-MISC, *Miscellaneous Income*) against amounts reported on the taxpayer's return.

40 While TAS CAWR/FUTA receipts showed a 30 percent increase from FY 2006 to FY 2010, these cases actually peaked in FY 2008 and significantly decreased in FYs 2009 and 2010. The IRS and the Social Security Administration (SSA) jointly administer the CAWR document matching program, which is designed to ensure that employers report the correct amount of wages, pay the proper amount of taxes, and properly credit the individual employee's Social Security account. The FUTA provides for cooperation between state and federal governments in the establishment and administration of unemployment insurance. For additional information on CAWR/FUTA, see Most Serious Problem: *The Combined Annual Wage Reporting Program Continues to Impose a Substantial Burden on Employers, supra*.

41 National Taxpayer Advocate 2009 Annual Report to Congress 158-179, 185-195; National Taxpayer Advocate 2008 Annual Report to Congress 176-192, 227-259; National Taxpayer Advocate 2007 Annual Report to Congress 222-241, 259-274, 287-323; National Taxpayer Advocate 2006 Annual Report to Congress 289-310, 355-375; National Taxpayer Advocate 2005 Annual Report to Congress 94-122; National Taxpayer Advocate 2004 Annual Report to Congress 211-225; National Taxpayer Advocate 2003 Annual Report to Congress 26-37, 87-98, 135-144; National Taxpayer Advocate 2002 Annual Report to Congress 55-68, 75-80; National Taxpayer Advocate 2001 Annual Report to Congress 26-29, 59-60.

42 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 94-116 (*Taxpayer Advocate Service Research Studies and Reports*); National Taxpayer Advocate 2004 Annual Report to Congress vol. 2 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

43 *See* http://www.youtube.com/user/TASNTA; http://www.facebook.com/YourVoiceAtIRS; http://www.taxtoolkit.irs.gov.

In addition to assisting taxpayers with the overall audit process, the National Taxpayer Advocate has long been concerned about the success of taxpayers who qualify for the EITC but for one reason or another are unable to navigate IRS processes to obtain the credit.[44] In 2004, TAS and the IRS conducted a study of the factors that made a difference in whether taxpayers in the IRS audit process were ultimately successful in obtaining the EITC.[45] Concerned that relief rates in EITC cases were lower than other types of cases worked by TAS, the National Taxpayer Advocate asked that a sample of TAS cases be tested to determine if changes to TAS processes could better assist these taxpayers.[46]

The National Taxpayer Advocate commissioned a team to review TAS EITC cases in which no relief was provided. Working with the TAS Research office, a statistically valid sample of 400 EITC cases closed in TAS during fiscal year 2009 was selected for review and analysis. TAS is reviewing this sample to determine why EITC cases have such a low relief rate, and specifically whether TAS can put procedures into place to facilitate communication with the taxpayer and decrease the amount of TAS cases closed because the taxpayer failed to respond.[47] TAS anticipates completing this study by March 2011.

TAS Assists with Document Processing Issues

Historically, document processing issues have been among the largest sources of TAS systemic burden receipts.[48] These issues include problems or delays related to IRS processing of original returns, amended returns, and claims for refund.

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44 IRC § 32. In 1975, Congress enacted legislation creating the EITC. The EITC program is administered by the IRS and provides support to low to moderate income working individuals and families. The EITC is a refundable credit which means eligible taxpayers may get a refund of the credit even if they had no tax liability and paid no withholding or estimated tax. Tax Reduction Act of 1975, Pub. L. No. 94-12, § 204, 89 Stat. 26 (1975). National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 12 (*EITC Audit Reconsideration Study*).

45 The study found that 43 percent of the taxpayers who sought reconsideration of their audits that disallowed the EITC in whole or in part received additional EITC as a result of the reconsideration. Additionally, the study found that where TAS employees initiated contact with taxpayers by phone instead of relying solely on correspondence, the likelihood of additional EITC increased with the number of phone calls made by the TAS employees. National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, i (*EITC Audit Reconsideration Study*).

46 TAS classifies completed cases as "full relief," "partial relief," or "no relief," depending on the outcome of the case. Whether relief is provided to a taxpayer is dependent on numerous factors, including: whether the taxpayer is legally entitled to the relief and can substantiate the claim. While TAS has provided some relief in an average of 73 percent of all cases over the last three years, the average relief in EITC cases over that time has been 47 percent.

47 In addition to tracking whether relief is granted in its cases, TAS also classifies its cases based on the reason that no relief was provided. For example, codes are assigned to cases where the taxpayer was not legally entitled to relief or did not respond to TAS's attempts at contact. Of the average 53 percent of no relief EITC cases in TAS in FY 2008, 2009, and 2010, 38 percent were closed by TAS because the taxpayer did not respond.

48 Data obtained from TAMIS.

Figure 4.8 depicts the various TAS case-related issues associated with document processing:

FIGURE 4.8, TAS Document Processing Cases, FY 2006 – FY 2010

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	% Chg FY 2006 to FY 2010
Processing Amended Return	17,140	16,267	21,963	19,939	30,891	80.2%
Unpostable or Reject Returns	2,484	1,969	2,948	3,786	22,341	799.4%
Processing Original Return	10,398	9,290	10,021	9,170	11,997	15.4%
Other Document Processing Issues	8,248	6,252	6,941	7,762	8,882	7.7%
Injured Spouse Claim	11,599	8,295	14,238	10,130	7,777	-33.0%
Math Error	2,906	2,479	2,777	2,741	4,597	58.2%
Total Document Processing Issues	**52,775**	**44,552**	**58,888**	**53,528**	**86,485**	**63.9%**

As with audit cases, the IRS's administration of the FTHBC had a significant impact on TAS's document processing caseload, specifically in processing original and amended returns and math errors.[49]

Procedural and Legislative Changes Impact IRS's Ability to Expeditiously Process Tax Returns

As shown in Figure 4.8 above, unpostable or "reject" returns were the most common issue in TAS document processing cases in FY 2010,[50] with *receipts increasing by nearly 800 percent over FY 2006*. The IRS experienced higher inventories of reject returns because of a significant procedural change resulting from an IRS Office of Chief Counsel opinion,[51] tax law changes, and programming errors. On May 21, 2010, IRS reject inventory included over 1.1 million returns compared to fewer than 400,000 for the same period in 2009, an increase of over 190 percent.[52] Several factors caused the growth, including:

- A new procedure for processing unsigned refund returns;
- Returns claiming the Making Work Pay Credit where taxpayers claimed an incorrect amount, failed to claim the credit, used an invalid Social Security number, or failed to provide the number;[53] and

49 *See* IRC § 6213(g)(2), for the definition of "mathematical or clerical error." See also *TAS Assists the IRS with the Administration of the First-Time Homebuyer Credit* for a discussion of the impact the FTHBC had on TAS's case receipts.

50 Each account transaction is subjected to a series of validity checks prior to posting to the Master File. A transaction is termed unpostable when it fails to pass any of the validity checks (*e.g.*, the taxpayer failed to sign the return prior to filing it with the IRS) and is then returned to the campus (Rejects function) for follow-up action(s). IRM 21.5.5.2 (Oct. 1, 2007).

51 IRS, *National Office Program Manager Technical Advice*, PMTA 2008-1947 (Sept. 2, 2008).

52 IRS, Miscellaneous Monitoring Report (Aug. 20, 2010).

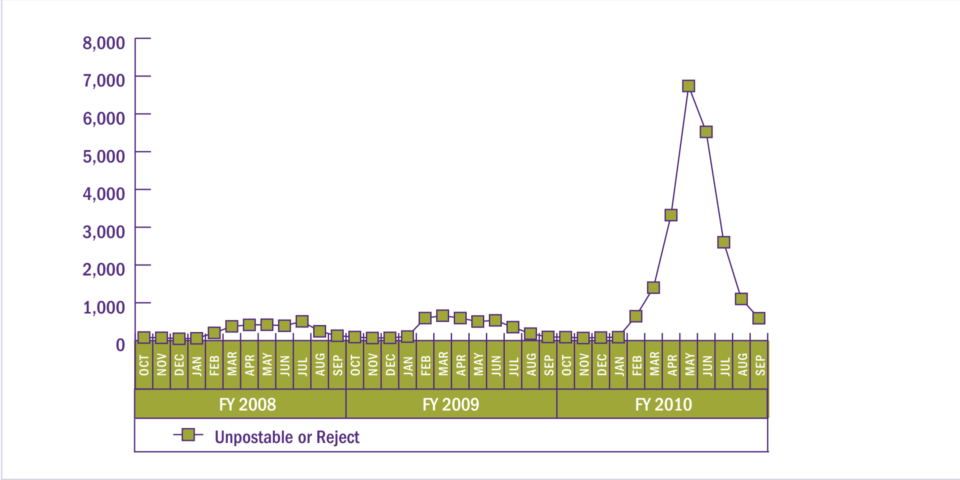
53 The ARRA of 2009 provided for the MWP credit – a refundable credit of up to $400 for working individuals and up to $800 for working married taxpayers who file joint returns. *See* IRC § 36A.

- The IRS's decision to manually verify returns claiming the FTHBC.[54]

The new procedure for processing refund returns had the most significant impact on TAS document processing receipts. On September 2, 2008, the IRS Office of Chief Counsel issued a memorandum addressing "*Correspondence to the Taxpayer for Missing Information and Supporting Schedules.*[55]" This memo stated that an unsigned refund return does not constitute a valid return,[56] but should be retained to determine whether it can be processed as an informal claim for refund. Additionally, in instances where a taxpayer files a signed return without a required entry, form, schedule, or other missing information or documentation, the return is still valid if it provides sufficient data to allow the IRS to calculate the tax liability.

Based on this opinion, on October 1, 2009, the IRS changed its return processing procedures.[57] For the 2010 filing season, refund returns missing a signature or schedule were no longer sent back to taxpayers, but were retained while the IRS suspended processing and sent letters requesting the missing information from the taxpayers. This change created large inventories of returns waiting for replies from taxpayers and a backlog of work for the Rejects function.[58]

FIGURE 4.9, TAS Case Receipts Related Unpostable or Reject Returns by Month, FY 2008 – FY 2010[59]



54 In addition to requiring manual verification, the IRS initially required that taxpayers claiming the FTHBC submit a copy of Form HUD-1, *Settlement Statement*, or another settlement statement, bearing the signature of both the buyer and seller. The IRS subsequently learned that the law in some jurisdictions does not require signatures on settlement statements. This misunderstanding caused additional delays until the IRS updated its procedures to accept statements that are complete and valid according to local law. *See* National Taxpayer Advocate 2011 Objectives Report to Congress 3; *TAS Assists the IRS with the Administration of the First-Time Homebuyer Credit, infra*.

55 IRS, *National Office Program Manager Technical Advice*, PMTA 2008-1947 (Sept. 2, 2008).

56 IRC § 6061; *Beard v. Comm'r*, 82 T.C. 766, 777 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986).

57 IRM 3.11.249, Nature of Changes (9) (Jan. 1, 2010). "IRM 3.11.249.4.4(2)(b) - In compliance with a Chief Counsel opinion issued September 2, 2008, tax examiners will no longer send returns back to the taxpayer when corresponding for missing signature, missing information and supporting schedules and documentation on refund or zero balance returns (with some exceptions). These changes are effective October 5, 2009."

58 On May 21, 2010, IRS reject inventory numbered 1,168,229 compared to 399,434 for the same period in 2009, an increase of 192.5 percent. IRS, *Miscellaneous Monitoring Report* (Aug. 20, 2010).

59 Data obtained from TAMIS.

Once the IRS recognized the implications of the processing change, it shifted resources from other unpostable or reject work. Thus, while the change may have caused much of the increase in TAS receipts, the cases TAS received encompassed a variety of unpostable or reject issues. As shown in Figure 4.9, TAS's monthly reject case receipts began to increase significantly in the second quarter of FY 2010 and peaked in May. In FY 2009, TAS received about 120 reject cases a week in the month of May. In May 2010, TAS received approximately 1,500 such cases each week, a 1,150 percent increase.[60]

TAS secured additional overtime funding to address the increase in receipts. Additionally, in June 2010, the IRS temporarily detailed 41 campus employees who were familiar with document processing procedures into TAS to help with these cases.[61] TAS and the IRS also developed procedures for quick communications on unpostable or reject cases, eliminating the need for an Operations Assistance Request (OAR).[62] This action allowed TAS to resolve these cases more expeditiously. In FY 2010, TAS closed 20,377 unpostable or reject cases, with a relief rate of 77.9 percent.[63]

The National Taxpayer Advocate, the Deputy National Taxpayer Advocate, and the Executive Director of Systemic Advocacy are in discussions with the Office of Chief Counsel and W&I to revise the procedures for the upcoming filing season. The goal is to minimize harm to taxpayers and get correct return information.

TAS Assists with Collection Issues

Issues involving IRS collection actions are most likely to affect taxpayers who are facing financial difficulties. TAS's overall collection cases decreased nearly six percent from 43,552 in FY 2006 to 41,142 in FY 2010; yet as shown in Figure 4.10, economic burden collection receipts increased by nearly six percent.[64] Cases involving levies, installment agreements (IAs), liens, currently not collectible (CNC) determinations, and offers in compromise (OICs) represented nearly 89 percent of TAS economic burden collection receipts in FY 2010.

60 Data obtained from TAMIS.

61 TAS trained the detailed employees to advocate for taxpayers on a number of unpostable or reject issues, while assigning other cases to TAS employees when the taxpayers would be better served by the expertise of TAS employees. The temporary assignments ended in September 2010. This was the first time TAS used IRS employees in this manner and found it to be an effective way to address a large influx of unanticipated single-issue cases quickly and in the best interest of the taxpayer.

62 TAS issues an OAR when TAS lacks the statutory or delegated authority to directly resolve a taxpayer's problem.

63 Data obtained from TAMIS. TAS tracks resolution of taxpayer issues through codes entered at the time of closing on TAMIS and requires case advocates to indicate the type of relief or assistance they provide to the taxpayer. *See* IRM 13.1.7.10.2.1 (Apr. 1, 2003). The codes reflect full relief, partial relief, or assistance provided. The relief rate is determined by dividing the total number of cases closed with full relief, partial relief, or assistance provided by the total number of closures.

64 Data obtained from TAMIS.

FIGURE 4.10, Analysis of TAS Economic Burden Collection Receipts, FY 2006 – FY 2010

Economic Burden Receipts						
	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	% Chg FY 2006 to FY 2010
Levies	15,119	15,481	14,274	15,167	15,263	1.0%
Liens	3,287	3,246	2,972	2,961	3,438	4.6%
IAs	1,191	1,660	1,916	2,536	2,435	104.5%
CNC Determinations	972	1,218	198	1,746	1,791	84.3%
OICs	483	433	411	418	420	-13.0%
Other Collection Issues	3,843	3,760	4,558	3,574	2,975	-22.6%
Total Economic Burden Collection Receipts	**24,895**	**25,798**	**24,329**	**26,402**	**26,322**	**5.7%**

A TAS economic burden case generally involves a taxpayer who is experiencing a financial difficulty. It is not surprising that, when the national unemployment rate is hovering around ten percent,[65] many taxpayers who met their tax obligations in the past have hit a rough patch (*e.g.*, a job loss, foreclosure, serious illness, or other personal setback) and have fallen behind on their tax payments. What is surprising is that, despite the IRS's announced initiatives to help taxpayers who are experiencing economic difficulties in 2008, 2009, and 2010, TAS economic burden collection cases continue to rise.[66]

Levy issues are among the top 15 TAS case issues.[67] A taxpayer coming to TAS because of an economic burden resulting from a levy is often facing the immediate threat of an adverse action, but may be unaware that the IRS has also filed a Notice of Federal Tax Lien (NFTL) that could impede his or her future financial viability and ability to pay past,

65 Bureau of Labor Statistics (BLS), *Labor Force Statistics for the Current Population Survey*, (data extracted on Oct. 14, 2010). In August 2009, the federal unemployment rate was 9.7 percent and peaked at 10.1 percent in October 2009. As of September 2010, the unemployment rate stood at 9.6 percent.

66 In December 2008, the IRS announced an expedited process to assist financially distressed homeowners whose refinancing or sale of their homes was hampered by the IRS's filing of a notice of federal tax lien (NFTL). *See* IRS News Release, *Prepared Remarks of Douglas H. Shulman, Commissioner of Internal Revenue, Before the American Payroll Association & the American Accounts Payable Association 28th Annual Congress*, IR-2010-68 (May 27, 2010); IRC § 6050W; Prop. Treas. Reg. § 1.6041-1(a)(1)(iv), 74 Fed. Reg. 61,294 (Nov. 24, 2009). In 2009, the IRS kicked off the tax filing season by announcing assistance to financially distressed taxpayers, including the postponement of collection actions, added flexibility for missed payments, an additional review of home values for offers in compromise, prevention of OIC defaults, and expedited levy releases. *See* IRS News Release, *IRS Begins Tax Season 2009 with Steps to Help Financially Distressed Taxpayers; Promotes Credits, e-File Options*, IR-2009-2 (Jan. 6, 2009). In March 2010, the IRS outlined additional steps to assist unemployed taxpayers such as adding "new" flexibility for OIC considerations and accelerated lien relief for taxpayers who cannot refinance or sell a home because of the tax lien. *See* IRS News Release, *IRS Outlines Additional Steps to Assist Unemployed Taxpayers and Others*, IR-2010-29 (Mar. 9, 2010).

67 Data obtained from TAMIS.

current, and future taxes.[68] Levy and lien issues account for 71 percent of TAS's economic burden collection receipts.[69]

As shown in Figure 4.10, TAS's FY 2010 currently not collectible economic burden cases rose 84 percent over FY 2006. A CNC (hardship) designation means that the IRS has determined collection of a liability would create a hardship on a taxpayer by leaving him or her unable to meet necessary living expenses.[70] While a CNC determination may benefit a financially struggling taxpayer because the account will be removed from active collection inventory, that same taxpayer may not realize that the IRS routinely files an NFTL in CNC hardship cases if the liability exceeds $5,000.[71] Taxpayers also may not understand the impact of the NFTL on future financial viability.

TAS's OIC cases continue to decrease, falling by 13 percent from FY 2006 to FY 2010.[72] It may be that declining TAS OIC receipts reflect taxpayers and practitioners giving up on the offer process, or that the IRS is placing more taxpayers into CNC status instead of accepting their offers.[73]

Since 2001, the National Taxpayer Advocate has raised concerns about how the IRS interacts with and treats taxpayers in the collection arena.[74] In FY 2010, the National Taxpayer Advocate:

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68 National Taxpayer Advocate 2011 Objectives Report to Congress 14-16 *(TAS Is Zealously Advocating for the IRS to Change Its Lien Filing Policies and Practices, Which Unnecessarily Harm Taxpayers and May Undermine Future Tax Compliance)*; National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS's Use of Notices of Federal Tax Lien*); National Taxpayer Advocate 2009 Annual Report to Congress 357-364 (Legislative Recommendation: *Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens*); Tax Filing Season Update: Current IRS Issues, Hearing Before the Sen. Comm. on Finance, 111th Cong. 26-35 (Apr. 15, 2010) (statement of Nina E. Olson, National Taxpayer Advocate); The *National Taxpayer Advocate's 2009 Annual Report to Congress, Hearing Before the H. Subcomm. on Oversight and H. Comm. on Ways and Means*, 111th Cong. 5-14 (Mar. 16, 2010) (statement of Nina E. Olson, National Taxpayer Advocate).

69 Data obtained from TAMIS.

70 IRM 5.16.1.2.9 (June 29, 2010). CNC status generally suspends certain enforced collection actions, but the liability is still due and owing; thus, penalties and interest continue to accrue until the statutory period of limitations on collection expires. IRM 5.16.1.2.9(11) (June 29, 2010); *see also* IRM 1.2.14.1.14, IRS Policy Statement P-5-71 (Nov. 19, 1980).

71 IRM 5.19.4.5.2 (Aug. 4, 2009).

72 Data obtained from TAMIS.

73 *See* Status Update: *The IRS Offer in Compromise Program Continues to Be Underutilized, supra*; National Taxpayer Advocate 2011 Objectives Report to Congress 20-22 (*IRS Initiatives to Improve the Offer in Compromise Program Have Not Yet Achieved Tangible Results*); National Taxpayer Advocate 2009 Annual Report to Congress 196-216.

74 National Taxpayer Advocate 2009 Annual Report to Congress 17-40, 196-216, 217-227, 228-244, 318-319; National Taxpayer Advocate 2008 Annual Report to Congress 15-38, 193-212, 328-336; National Taxpayer Advocate 2007 Annual Report to Congress 324-336, 337-354, 355-373, 374-387, 388-394, 395-410, 411-431, 432-447; National Taxpayer Advocate 2006 Annual Report to Congress 34-61, 62-82, 83-109, 110-129, 130-140, 141-156, 157-171; National Taxpayer Advocate 2005 Annual Report to Congress 76-93, 123-135, 192-208, 209-222, 270-291, 345-356; National Taxpayer Advocate 2004 Annual Report to Congress 180-192, 226-245, 246-263, 311-343, 342-355; National Taxpayer Advocate 2003 Annual Report to Congress 99-112, 206-212; National Taxpayer Advocate 2002 Annual Report to Congress 15-24, 104-109, 110-115, 116-121; National Taxpayer Advocate 2001 Annual Report to Congress 41-42, 52-55). *See also* Status Update: *The IRS Has Been Slow to Address the Adverse Impact of its Lien Filing Policies on Taxpayers and Future Tax Compliance, supra*; Status Update: *The IRS Offer in Compromise Program Continues to Be Underutilized, supra*; Status Update: *The IRS's Handling of Collection Statute Expiration Dates Continues to Adversely Affect Taxpayers, supra*.

- Issued three Taxpayer Advocate Directives (TADs) to the senior leaders of the IRS, directing them to revise certain collection practices;[75]
- Issued guidance to TAS Case Advocacy employees on advocating for the non-filing of NFTLs in certain situations and handling cases where economic hardship is present but the taxpayer has not filed all required tax returns;[76]
- Developed training for TAS employees on taxpayer rights in the collection context;[77]
- Supported Local Taxpayer Advocates who issued 48 Taxpayer Assistance Orders (TAOs) in cases involving collection;[78] and
- Participated in a servicewide "Collection Process Study" established in response to the 2009 Annual Report to Congress.[79]

TAS will continue to advocate vigorously for taxpayers in the collection arena.

TAS Assists with Entity Issues

Entity issues involve taxpayers' identities, including their names and taxpayer identifying numbers (TINs).[80] Nearly 74 percent of TAS entity cases stem from identity theft.[81]

The IRS and TAS Continue to Work Together to Address Return Processing Issues Impacting Victims of Identity Theft

The National Taxpayer Advocate initially recognized identity theft as an emerging trend in tax administration in her 2004 Annual Report to Congress.[82] Since that time, the IRS has significantly improved its processes for identifying and helping taxpayers who are victims of identity theft.[83] Identity theft may occur in tax administration when an individual uses the Social Security number (SSN) of another person to file a false tax return or fraudulently gain employment. When these types of identity theft occur, the victim often begins a journey through IRS processes and procedures that may take years to complete. When those processes and procedures fail to resolve the taxpayers' issues timely, those taxpayers often seek TAS assistance.

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75 TADs 2010-1, 2010-2, and 2010-3 (Jan. 20, 2010). *See* National Taxpayer Advocate 2011 Objectives Report to Congress Appendix VIII.

76 TAS, Interim Guidance Memorandum, *Nonfiling of Notices of Federal Tax Liens in Certain Situations*, TAS Control No. 13.1-0310-003 (Mar. 31, 2010), *available at* http://www.irs.gov/pub/foia/ig/tas/tas-13.1-0310-003.pdf; TAS, Interim Guidance Memorandum, *Interim Guidance on Handling Collection Cases Where Economic Hardship Is Present but the Taxpayer Has Not Filed All Required Returns*, TAS Control No.13.1-0110-001 (Mar. 23, 2010), *available at* http://www.irs.gov/pub/foia/ig/tas/tas-13_1-0110-01.pdf.

77 TAS, Collection Alternatives Overview; TAS, Collection Alternatives Levies I; TAS, Collection Alternatives Liens I; TAS, Collection Alternatives Installment Agreements; TAS, Collections Alternatives Offers in Compromise.

78 *See* TAS Uses Taxpayer Assistance Orders to Advocate for Taxpayers, *infra*.

79 *See* IRS, *The Collection Process Study* (Sept. 30, 2010). *See also* National Taxpayer Advocate 2010 Report to Congress vol. 2 (*The IRS Collection Strategy is Failing to Meet Key Objectives of the IRS Mission*), *infra*.

80 See IRM 21.6.2.1 (Jan. 19, 2010) for details about the types of problems relating to TINs.

81 Of the 23,526 entity cases TAS received in FY 2010, 17,291 involved identity theft. Data obtained from TAMIS.

82 *See* National Taxpayer Advocate 2004 Annual Report to Congress 133-136.

83 *See* National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress 51-53; National Taxpayer Advocate 2009 Annual Report to Congress 307-317.

In January 2008, the IRS began marking the accounts of identity theft victims to protect them from tax-related identity theft actions. The IRS places a marker on an account when the taxpayer identifies himself or herself as a victim of identity theft or when the IRS identifies and confirms that a taxpayer is a victim.[84] This marker puts IRS employees on notice and allows the IRS to track the number of affected taxpayer accounts, protect federal revenue threatened by identity theft, and reduce taxpayer burden.[85]

In January 2009, the IRS began to apply a series of filters or "business rules" to any return filed with an SSN associated with a marked account.[86] Business rules give the IRS an automated means of distinguishing valid returns from fraudulent ones, and blocking potentially fraudulent returns from processing. Returns that do not pass the "business rules" will not post to the taxpayer's account until the IRS reviews the account and determines that the return belongs to the true owner of the SSN. In calendar year 2009, the IRS placed the identity theft tracking marker on 254,079 taxpayer accounts and has marked an additional 234,966 accounts in calendar year 2010 through September 2010.[87]

The IRS appropriately subjected all accounts with identity theft markers to the business rules in an effort to protect taxpayers from identity theft. Unfortunately, the rules can also delay refunds for the very taxpayers the process is designed to safeguard. To address these concerns, the IRS enlisted employees in the Identity Protection Specialized Unit (IPSU), Accounts Management Taxpayer Assurance Program (AM TAP), and the Criminal Investigation Division, who have unique skills in resolving identity theft issues, to assist Submission Processing employees with account resolution. In addition, the AM TAP and TAS finalized procedures that will allow the IRS to process the return filed by the actual owner of the SSN expeditiously.[88]

Despite the IRS's process improvements, TAS's identity theft receipts continued to increase in FY 2010, as reflected in Figure 4.11 below. While TAS's identity theft cases continue to rise, TAS received nearly 3,400 fewer cases in FY 2010 than it would have, because the IPSU worked these cases under the Memorandum of Understanding between TAS and W&I discussed below.[89]

84 IRM 10.5.3.2.3 (May 15, 2009).

85 IRM 10.5.3.2(1) (May 15, 2009).

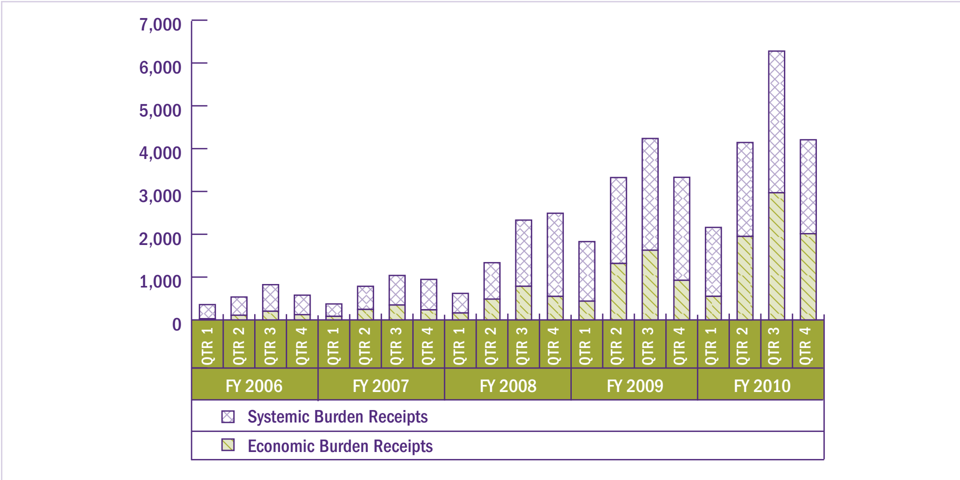
86 IRM 3.12.179.43.1 (Jan. 1, 2010).

87 IRS, *Identity Protection Incident Tracking Statistics Report 2009*; IRS, *Identity Protection Incident Tracking Statistics Report* (Sept. 30, 2010).

88 IRM 21.9.1.8 (Oct. 1, 2010).

89 IRS, *IPSU Identity Theft Report* (Oct. 2, 2010). The IPSU began working TAS's systemic burden identity theft cases on June 14, 2010. *See* Memorandum of Understanding Between the National Taxpayer Advocate and the Commissioner, Wage & Investment to Transition TAS Criteria 5-7 Identity Theft Cases to Wage & Investment Identity Protection Specialized Unit (IPSU) (Mar. 31, 2010).

FIGURE 4.11, Identity Theft Receipts by Burden, FY 2006 – FY 2010[90]



TAS identity theft receipts have increased over 23 percent, from 14,023 cases in FY 2009 to 17,291 in FY 2010.[91] Some of the growth stems from the business rules implemented in FY 2010 as receipts involving the tracking indicator nearly tripled from 969 in FY 2009 to 2,710 in FY 2010.[92]

As with any new process, unanticipated issues will occur. However, the National Taxpayer Advocate is pleased that the IRS continues to work through these issues to improve this process, which benefits victims of identity theft and strengthens overall tax administration. The IRS estimates it held on to $245 million in fraudulent refunds by not processing more than 48,000 "bad" returns during calendar year 2010 (through September 30, 2010).[93]

On March 31, 2010, the National Taxpayer Advocate and W&I Commissioner signed a Memorandum of Understanding (MOU) granting the IPSU the authority to work certain identity theft systemic burden cases.[94] The IRS has agreed to provide taxpayers whose cases move to the unit a service level similar to that provided by TAS and to contact the taxpayer within TAS timeframes so the transition of cases to the IPSU will not harm the taxpayers. The IPSU will operate in a manner similar to TAS, maintaining contact with the taxpayer and communicating estimated timeframes for resolving all issues. The IRS will

90 Data obtained from TAMIS.

91 *Id.*

92 *Id.* Data reflect receipts with a primary issue code 425 (identity theft) and a secondary issue code 315 (unpostable/reject) (Oct. 1, 2010). TAMIS is a dynamic system, therefore a report run on one date may not exactly match a report run on another date.

93 IRS, Generalized Unpostable Framework (GUF) 5740 Closed Inventory Summary (Sept. 30, 2010).

94 The MOU called for the IPSU to start taking certain systemic burden identity theft cases on June 14, 2010. A systemic burden case is a case in which an IRS process, system, or procedure has failed to operate as intended, and as a result, the IRS has failed to timely respond to or resolve a taxpayer's issue.

continue to direct taxpayers facing economic burden to TAS for immediate assistance.[95] TAS employees will continue to handle cases involving identity theft when taxpayers:

- Are facing financial difficulties;
- Are dissatisfied with prior attempts to resolve the issue with the IRS; or
- Have unusual circumstances that require TAS's unique advocacy role.

TAS and the IRS are tracking these cases to ensure that taxpayers receive the proper assistance and are not harmed by this agreement. Through FY 2010, identity theft referrals that would previously have come to TAS, but went to IPSU, totaled 3,376 cases.[96] TAS expects fewer systemic burden identity theft cases to come to TAS in FY 2011. However, TAS continues to receive identity theft cases because some government agencies are still listing TAS as the IRS point of contact for taxpayers with this problem.[97] As agencies are identified, TAS works with them to update their listings. Additionally, Local Taxpayer Advocates educate taxpayers about the IPSU as the first point of contact for identity theft issues during outreach events.

TAS Uses Taxpayer Assistance Orders to Advocate Effectively in Taxpayer Cases

IRC § 7811 authorizes the National Taxpayer Advocate to issue a TAO when a taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered if relief is not granted.[98] In certain circumstances, the National Taxpayer Advocate may issue a TAO to order the IRS to take an action, cease an action, or refrain from taking an action in a case.[99] The National Taxpayer Advocate may also issue a TAO to order the IRS to expedite consideration of a taxpayer's case, reconsider its determination in a case, or review the case at a higher level of the organization.[100] Upon receipt of a TAO, the responsible IRS official can either agree to take the action or appeal the order.[101] Only the National Taxpayer Advocate, the Commissioner, or the Deputy Commissioner can modify or rescind a TAO.[102]

In FY 2010, TAS issued 95 TAOs. The IRS complied with 68, TAS rescinded three, and the remaining 24 are under consideration by the IRS. Of the 13 TAOs the IRS appealed, it

95 *See* Memorandum of Understanding Between the National Taxpayer Advocate and the Commissioner, Wage & Investment to Transition TAS Criteria 5-7 Identity Theft Cases to Wage & Investment Identity Protection Specialized Unit (IPSU) (Mar. 31, 2010).

96 IRS, *IPSU Identity Theft Report* (Oct. 2, 2010).

97 For example, in 2006, the Federal Trade Commission (FTC), the lead federal agency responsible for combating identity theft, published a brochure advising identity theft victims with unresolved tax issues to contact TAS. This brochure is still available on the FTC website. *See* FTC, *Take Charge: Fighting Back Against Identity Theft* 24 (Feb. 2006), *available at* http://www.ftc.gov/bcp/edu/pubs/consumer/idtheft/idt04.pdf (last viewed Oct. 24, 2010). Until the FTC updates its brochure, some identity theft victims may continue to contact TAS, rather than the IPSU, when they have an unresolved tax issue.

98 *See* IRC § 7811(a)(1); IRM 13.1.20.1 (Dec. 15, 2007).

99 *See* IRC § 7811(b); IRM 13.1.20.3 (Dec. 15, 2007).

100 IRM 13.1.20.3 (Dec. 15, 2007).

101 IRM 13.1.20.5(2) (Dec. 15, 2007).

102 IRC § 7811(c).

subsequently complied with four, TAS modified one, and eight are awaiting resolution.[103] The figure below depicts the TAOs issued annually from FY 2006 through FY 2010.

FIGURE 4.12, Taxpayer Assistance Orders Issued to IRS, FY 2006 – FY 2010[104]

Fiscal Year	TAOs Issued
2006	46
2007	28
2008	68
2009	45
2010	95

The TAO can be an effective tool to advocate for taxpayers. In situations where the IRS does not agree with TAS's recommendation, TAS can issue a TAO to advocate for the taxpayer based on the law and the facts of the taxpayer's case. TAS also uses the TAO to secure taxpayer relief in situations where the IRS has not taken the actions requested on an OAR,[105] or in circumstances where time constraints require bypassing the OAR procedure.[106]

In FY 2010, TAS issued 14 TAOs to advocate for taxpayers where the IRS had served a levy to collect a delinquent tax liability. The IRS may generally levy if it assessed the tax and sent notice and demand for payment, the taxpayer did not pay, and the IRS sent the taxpayer a *Notice of Intent to Levy and Notice of Your Right to a Hearing* at least 30 days before the levy.[107] However, the IRS will release the levy if certain conditions are met.[108] TAS used TAOs to successfully advocate for ten taxpayers by demonstrating to the IRS that these taxpayers met at least one of the conditions for release of the levy. TAS rescinded one TAO and the IRS is still considering the remaining three.[109]

103 TAOs can be appealed to three levels in TAS – the Local Taxpayer Advocate, the Area Director, and the National Taxpayer Advocate.

104 Data obtained from TAMIS.

105 TAS issues an OAR when TAS lacks the statutory or delegated authority to directly resolve a taxpayer's problem.

106 IRM 13.1.20.2(5) (Dec. 15, 2007).

107 *See* IRC §§ 6331(d) and 6330(a). For examples of exceptions to these general rules, *see* IRC §§ 6331(d)(3) and 6330(f).

108 IRC § 6343(a). The IRS will release the levy if:
- The tax, penalty, and interest owed are paid in full;
- The time for collection (the statute of limitations) ended before the levy was served;
- Documentation proves that releasing the levy will facilitate collection of the tax;
- The taxpayer has an installment agreement, or enters into one, unless the agreement says the levy does not have to be released;
- The levy is creating an economic hardship as defined in Treas. Reg. § 301.6343-1(b)(4); or
- The fair market value of the property exceeds the liability, and the levy could be released on a part of the property without hindering collection of the liability.

109 Data obtained from TAMIS. *See* Most Serious Problem: *IRS Collection Policies and Procedures Fail to Adequately Protect Taxpayers Suffering an Economic Hardship, supra. See also* TAS Interim Guidance Memorandum, *Interim Guidance on Handling Collection Cases Where Economic Hardship Is Present but the Taxpayer Has Not Filed All Required Returns* (Mar. 23, 2010), *available at* http://www.irs.gov/pub/foia/ig/tas/tas-13_1-0110-01.pdf.

TAS also used the TAO process in FY 2010 to advocate for 22 taxpayers seeking the withdrawal of a lien. Thus far, TAS has resolved 12 of these cases and the remaining ten are still under consideration. When a taxpayer cannot fully pay a balance due, the IRS can file an NFTL to protect the government's interest in any assets held by the taxpayer and establish its priority against certain third party creditors and purchasers.[110] The lien reaches all the taxpayer's interest in present and future property, appears on the taxpayer's credit report, and can severely hamper his or her ability to obtain credit. IRC § 6323(j)(1) provides for withdrawal of an NFTL under certain conditions.[111] The National Taxpayer Advocate has repeatedly urged the IRS to exercise its discretion to withdraw liens when it is in the best interest of the United States and the taxpayer.[112]

TAS also used a TAO to advocate for 12 taxpayers facing IRS audits or requesting audit reconsideration. The IRS complied with 11 TAOs, including three issued when the IRS audit function failed to respond to OARs. One TAO remains under consideration. TAS issued another four TAOs to advocate for taxpayers under audit who filed returns using their own Individual Taxpayer Identification Numbers (ITIN) but who had also used other individuals' SSNs to obtain work.[113] This created a situation where the IRS accepted the income reported on the Form W-2, but would not allow the withholding taxes reported on the same form.[114]

110 IRC § 6323.

111 The IRS will withdraw a lien when:
- The NFTL was filed prematurely or not in accordance with administrative procedures;
- Issuance of a withdrawal will facilitate collection of the tax;
- The taxpayer entered into an installment agreement to pay the tax, unless the agreement provides for the NFTL; or
- With the consent of the taxpayer or National Taxpayer Advocate, the withdrawal of the NFTL is in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States (as determined by the Commissioner of the IRS). *See* IRC § 6323(j)(1); Treas. Reg. § 301.6323(j)-1.

112 *See* TAS Interim Guidance Memorandum, *Interim Guidance on Handling Collection Cases Where Economic Hardship Is Present but the Taxpayer Has Not Filed All Required Returns*, (Mar. 23, 2010), *available at* http://www.irs.gov/pub/foia/ig/tas/tas-13_1-0110-01.pdf; TADs 2010-1 and 2010-2 (Jan. 20, 2010); Status Update: *The IRS Has Been Slow to Address the Adverse Impact of its Lien Filing Policies on Taxpayers and Future Tax Compliance, supra*; National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*).

113 Any individual who has a tax return filing obligation but is not eligible to obtain an SSN must apply to the IRS for an ITIN. IRC § 6109; Treas. Reg. § 301.6109-1(d)(3).

114 Data obtained from TAMIS. *See also* Status Update: *Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers, supra*.

TAOs serve to focus the IRS's attention on procedures and policies that are not working as intended. Figure 4.13 lists the tax issues and reason(s) for which TAOs were issued in FY 2010.

FIGURE 4.13, TAOs Issued, FY 2010[115]

Issue Description	Number of TAOs Issued	Why TAO was Issued
Collection Issues	48	The IRS refused to withdraw a lien. The IRS refused to release a levy. The IRS refused to return levied funds. The IRS refused to place an account in CNC status. The IRS refused to process an OIC. The IRS refused to establish an IA.
Audit Issues	12	The IRS refused to consider additional information provided to support claim. The IRS refused to expedite the taxpayer's claim after proof of economic burden was provided.
Penalty Issues	10	The IRS refused to consider penalty abatement.
Refund Issues	7	The IRS refused to process a refund claim.
Document Processing Issues	6	The IRS refused to process an injured spouse claim.
Technical, Procedural, or Statute Issues	6	The manner in which the IRS administered the tax account caused additional penalty and interest charges to accrue. The IRS refused to correct the statute expiration date.
Other Issues	6	The IRS refused to follow its policy on cash bond payments. The IRS delayed processing a request for exempt status. The IRS refused to reconsider its decision to deny an OIC. The IRS refused to reconsider an innocent spouse claim.
Total	**95**	

115 Data obtained from TAMIS.

Congressional Case Trends

TAS is responsible for responding to certain tax account inquiries sent to the IRS by members of Congress. As shown in Figure 4.14, document processing, audit, and collection-related issues made up the top three categories of congressional inquiries in 2010.

FIGURE 4.14, Issues In Congressional Cases, FY 2009 – FY 2010[116]

	FY 2009	FY 2010	Percentage Change
Document Processing Issues	1,888	3,451	82.8%
Audit Issues	2,165	3,244	49.8%
Collection Issues	3,359	3,009	-10.4%
Refund Issues	5,273	1,778	-66.3%
Technical, Procedural, or Statute Issues	1,500	1,367	-8.9%
Penalty Issues	1,459	1,258	-13.8%
Entity Issues	905	830	-8.3%
Payment or Credit Issues	475	335	-29.5%
Appeals Issues	282	278	-1.4%
Interest Issues	124	88	-29.0%
Other Issues	64	49	-23.4%
Criminal Investigation Issues	68	24	-64.7%
Total Congressional Issues	**17,603**	**15,711**	**-10.7%**

TAS congressional inquiries peaked in FY 2008, with 47 percent of the inquiries relating to Economic Stimulus Payments. As shown in Figure 4.15, congressional inquiries declined in FY 2009 and FY 2010, but the ESP and FTHBC contributed significantly to TAS congressional receipts in both years.

FIGURE 4.15, TAS Congressional Receipts, FY 2006 – FY 2010[117]

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Congressional Receipts	10,873	9,779	22,097	17,603	15,711
Total Case Receipts	242,173	247,839	274,051	272,404	298,933
% of Total Receipts	4.5%	3.9%	8.1%	6.5%	5.3%
Congressional Receipts Related to ESP			10,320	4,264	127
Congressional Receipts Related to FTHBC					3,243

116 Data obtained from TAMIS. TAMIS is a dynamic system, and the statistics gathered for issue categories for this table were not compiled from the same data as the total congressional receipts and therefore will not match. The congressional receipt data by issue were retrieved on November 2, 2009, for FY 2009 and October 8, 2010, for FY 2010.

117 Data obtained from TAMIS.

Top 25 Case Advocacy Issues for FY 2010 by TAMIS* Receipts

Issue Code	Description	FY 2010 Cases
330	Processing Amended Return	30,891
610	Open Audit (Non-Revenue Protection Strategy RPS)/Earned Income Tax Credit (EITC) Claim	26,182
315	Unpostable/Reject	22,341
425	Stolen Identity	17,291
710	Levy	14,766
620	Reconsideration of Substitute for Return under IRC § 6020(b) and Audits	12,843
310	Processing Original Return	11,997
20	Expedite Refund Request	11,755
340	Injured Spouse Claim	7,777
60	IRS Offset	6,865
630	RPS (EITC Claim)	6,769
90	Other Refund Inquiries/Issues	6,707
670	Closed Underreporter	6,137
40	Returned/Stopped Refunds	6,115
540	Civil Penalties other than Trust Fund Recovery Penalty	5,544
390	Other Document Processing Issues	5,172
675	Combined Annual Wage Reporting/Federal Unemployment Tax	4,951
320	Math Error	4,597
790	Other Collection Issues	4,433
759	Installment Agreement - Other	3,938
660	Open Underreporter	3,726
520	Failure to File (FTF)/Failure to Pay (FTP) Penalty	3,646
10	Lost or Stolen Refunds	3,464
210	Missing/Incorrect Payments	3,181
45	Pre-Refund Wage Verification Hold	3,171
Total Top 25 Receipts		**234,259**
Total TAS Receipts		**298,933**

* Taxpayer Advocate Management Information System.

Appendix One

Portfolio Advisor Assignments

Portfolio Assignment	Portfolio Owner	Location	Phone Number
Military Issues	Douts, K	AK	907-271-6297
Forms 2848 Powers of Attorney (POA)	Hawkins, D	AL	205-912-5634
Levy [Hardship determination linked to release of levy]	Wilde, B	AR	501-396-5820
Mixed and Scrambled Taxpayer Identification Numbers	Murphy, M	AZ	602-636-9503
Tax Forums - Case Resolution Program	Sawyer, M	CA-FSC	559-442-6418
Designated Federal Official (DFO) - Taxpayer Advocacy Panel (TAP)	Curran, D	CA-LA	213-576-3016
Tax Forums - Case Resolution Program	Adams, C	CA-LAG	949-389-4790
E- Services	Todaro, T	CA-OAK	510-637-3068
Audit Reconsiderations	Martin, T	CA-SAC	916-974-5191
Collection Statute Expiration Dates (CSED)	Sherwood, T	CO	303-603-4601
Federal Tax Liens including Lien Release, Lien Withdrawal, Lien Subordination, Lien Discharge	Sherwood, T	CO	303-603-4601
Interest Computations: Abatement of Interest	Romano, F	CT	860-756-4550
Employment Tax Policy	Garvin, W	DE	302-286-1545
Seizure and Sale -Foreclosures on Equity	Crook, T	FL-FTL	954-423-7676
Examination Strategy	Revel-Addis, B	FL-JAX	904-665-0523
Designated Federal Official (DFO) - Taxpayer Advocacy Panel (TAP)	Browne, R	GA-ATL	404-338-8085
U.S. Territories and Possessions	James, G	HI	808-539-2855
Health Care I	DeTimmerman, P	IA	515-564-6880
Innocent Spouse Relief: IRC § 6015	Knowles, J	ID	208-387-2827 ex 272
Health Care II	Taylor, S	IL-CHI	312-566-3801
Penalties	Bates, P	IL-SPR	217-862-6348
Correspondence Exam	Blinn, F	IN-IND	317-685-7799
Designated Federal Official (DFO) - Taxpayer Advocacy Panel (TAP)	Adams, M	KS	316-352-7505
Centralized Lien Filing and Releases	Diehl, J	KY-CSC	859-669-4013
Earned Income Tax Credit (EITC): Outreach, Education, Financial Literacy, Low Income	Campbell, D	KY-LOU	502-572-2201
Low Income Taxpayer Clinics (LITC)	Lewis, C	LA	504-558-3468
Identity Theft - Identity Protection Specialized Unit (IPSU)	Benoit, F	MA-ANC	978-474-9560
Appeals: Nondocketed Inventory, Alternative Dispute Resolutions, Collection Due Process	Leith, J	MD	410-962-8120
Automated Underreporter (AUR)	Boucher, D	ME	207-622-8577
Individual Taxpayer Identification Number (ITIN) Outreach	Blount, P	MI	313-628-3664
Nonfiler Strategy [Substitute for Returns]	Warren, J	MN	651-312-7874
Accessing Taxpayer File	Todd, G	MO-KCC	816-291-9001
Exempt Organization (EO) Education and Outreach	Guinn, P	MO-STL	314-612-4371
Disaster Response and Recovery	Washington, J	MS	601-292-4810
Designated Federal Official (DFO) - Taxpayer Advocacy Panel (TAP)	Thompson, T	MT	406-441-1044
Designated Federal Official (DFO) - Taxpayer Advocacy Panel (TAP)	Juncewicz, T	NC	336-378-2141
Amended Returns/Claims/Carryback/Carryforward Claims	Reeve, D	ND-FAR	701-237-8342
IRS Training on Taxpayers' Rights	Hickey, M	NE	402-221-7240
Federal Payment Levy Program (FPLP)/FPLP Communications	Simmons, M	NH	603-433-0753
Earned Income Tax Credit (EITC) Compliance	Harrison, Marcie	NJ	973-921-4376

Portfolio Assignment	Portfolio Owner	Location	Phone Number
Tip Reporting	Grant, D	NV	702-868-5180
Preparer Penalties	Greene, S	NY-ALB	518-427-5412
Offer In Compromise	Tehrani, B	NY-BLY	718-488-3501
Identify Theft	Fuentes, B	NY-BSC	631-654-6687
Indian Tribal Government Issues	Wirth, B	NY-BUF	716-686-4820
Allowable Living Expenses	Spisak, J	NY-MAN	212-436-1010
Processing: Payments	Davis, S	OH CLE	216-522-8241
Tax Exempt Entities: EO Applications & Determinations	Esrig, B	OH-CIN	513-263-3249
IRS Policies Affecting Financially Distressed Taxpayers	Hensley, D	OK	405-297-4139
Customer Account Data Engine (CADE)	Logan, A	OR	307-633-0881
Automated Collection System (ACS)	Lombardo, L	PA-PHIL	215-861-1237
Bankruptcy Processing Issues	Mettlen, A	PA-PITT	412-395-6423
Office of Professional Responsibility	Juarez, V	PA-PSC	215-516-2525
International Taxpayers	Vargas, C	PR	787-622-8950
Math Errors	Sonier, G	SC	803-765-5300
Abusive Schemes	Gilchrist, L	SD	605-377-1606
Criminal Investigation Freezes and Tax Assurance Program	Wess, D	TN-MSC	901-395-1700
Designated Federal Official (DFO) - Taxpayer Advocacy Panel (TAP)	Wess, D	TN-MSC	901-395-1700
Electronic Tax Administration (ETA)	Martin, B	TN-NVL	615-250-6015
Individual Taxpayer Identification Number (ITIN) Processing	Caballero, A	TX-AUC	512-460-4652
Multilingual Initiative (MLI)	Rolon, J	TX-AUS	512-499-5970
First Time Home Buyers Credit	Lucas, D	TX-HOU	713-209-4781
Combined Annual Wage Reporting (CAWR)/Federal Unemployment Tax Act (FUTA)	Polson, R	UT-OSC	801-620-3000
TAS Confidentiality/IRC 6103	Cooper-Aquilar, S	UT-SLC	801-799-6962
Trust Fund Recovery Penalty (TFRP)	Campbell, M	VA	804-916-3500
Communication Liaison Group (CLG)	Campbell, Hickey, James, Martin, Simmons, Hensley, Crook,Tehrani, Thompson	VA, IA, HI, SC, TN, NH,OK,FL,MT	
Taxpayer Assistance Centers (TACs)	Fett, B	VT	802-859-1056
Designated Federal Official (DFO) - Taxpayer Advocacy Panel (TAP)	Fett, B	VT	802-859-1056
Returned/Stopped Refunds	Johnson, B.	WI	414-231-2391
Injured Spouse	Post, T	WV	304-420-8695
Installment Agreements: Processing	Hough, C	WY	307-633-0881
Tax Forums - Case Resolution Program	Sawyer, M	CA-FSC	559-442-6418
Tax Forums - Case Resolution Program	Adams, C	CA-LAG	949-389-4790

Table 1 Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers			
Alarcon, U.S. v., 105 A.F.T.R.2d (RIA) 1466 (N.D. Cal. 2010)	Court enforced summons because TP failed to respond to petition to enforce summons	Yes	IRS
Allen, U.S. v., 105 A.F.T.R.2d 1032 (S.D. Ohio 2010), *adopted by* 105 A.F.T.R.2d (RIA) 1391 (S.D. Ohio 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Allen, U.S. v., 105 A.F.T.R.2d (RIA) 887 (S.D. Ohio 2009)	Court found jurisdiction and non-taxpayer arguments frivolous; court rejected 1st and 4th Amendment claims, as well as claim of improper service of summons	Yes	IRS
Andrikopoulis v. U.S., 105 A.F.T.R.2d (RIA) 1085 (D. Colo. 2010), *adopted by* 105 A.F.T.R.2d (RIA) 1087 (D. Colo. 2010)	Court adopted magistrate's recommendation to dismiss for lack of jurisdiction; TP failed to timely file petition to quash summons	Yes	IRS
Armijo v. U.S., 105 A.F.T.R.2d (RIA) 2822 (S.D. Fla. 2010), *adopted by, motion granted by, motion denied by* 105 A.F.T.R.2d (RIA) 2825 (S.D. Fla. 2010)	Court adopted magistrate's recommendation, granted government's motion to dismiss, and dismissed TP's motion to quash for lack of jurisdiction	No	IRS
Beeman, U.S. v., 105 A.F.T.R.2d (RIA) 1137 (W.D. Pa. 2010)	Powell requirements satisfied; court enforced summons	Yes	IRS
Berkowitz v. U.S., 104 A.F.T.R.2d (RIA) 6920 (D.S.C. 2009), *adopted in part by* 104 A.F.T.R.2d (RIA) 6923 (D.S.C. 2009)	Court partially adopted magistrate's recommendation to grant U.S. motion to dismiss for lack of jurisdiction; court lacking jurisdiction over all but one of 21 respondents	Yes	Split
Bernhoft, U.S. v., 104 A.F.T.R.2d (RIA) 7059 (E.D. Wis. 2009)	Powell requirements satisfied; court rejected blanket attorney-client privilege claim	No	IRS
Bishop (Jan), U.S. v., 105 A.F.T.R.2d (RIA) 624 (N.D. Cal. 2010), *show cause order entered* 2010 U.S. Dist. LEXIS 35901 (N.D. Cal. 2010) *enforced by* 2010 U.S. Dist. LEXIS 13834 (N.D. Cal. 2010)	Powell requirements satisfied; court enforced summons	Yes	IRS
Bishop (Richard), U.S. v., 2009 U.S. Dist. LEXIS 125018 (N.D. Cal. 2009), *show cause order entered* 2010 U.S. Dist. LEXIS 46977 (N.D. Cal. 2010), *enforced by* 2010 U.S. Dist. LEXIS 13834 (N.D. Cal. 2010)	Powell requirements satisfied; court enforced summons	Yes	IRS
Bohall v. U.S., 339 Fed. App'x. 661 (8th Cir. 2009)	Powell requirements satisfied; dismissal of motion to quash third-party summonses upheld; due process argument rejected	Yes	IRS
Breaux v. U.S., 105 A.F.T.R.2d (RIA) 988 (W.D. La. 2010), *adopted by* 2010 U.S. Dist. LEXIS 8595 (W.D. La. 2010)	Court adopted magistrate's recommendation and granted government's motion to dismiss	Yes	IRS
Bright, U.S. v., 596 F.3d 683 (9th Cir. 2010), *aff'g in part* 102 A.F.T.R.2d (RIA) 6183 (D. Haw. 2008)	Court rejected 5th Amendment privilege claims as to all documents except for ones related to two offshore credit card accounts where government failed to show knowledge, at time summonses were issued, that TP controlled accounts	No	Split
Brumbaugh, U.S. v., 2010 U.S. Dist. LEXIS 24947 (W.D. Wash. 2010) *adopted by* 2010 U.S. Dist. LEXIS 33207 (W.D. Wash. 2010)	Court upheld magistrate's finding that TP in contempt and set a hearing for TP to show why he should not be held in contempt	Yes	IRS
Brumbaugh, U.S. v., 2010 U.S. Dist. LEXIS 24961 (W.D. Wash. 2010)	Magistrate found TP in contempt	Yes	IRS
Burch, U.S. v., 104 A.F.T.R.2d (RIA) 6204 (E.D. Cal. 2009)	Powell requirements satisfied; court adopted magistrate's recommendation and enforced summons	Yes	IRS
Cannady, U.S. v., 103 A.F.T.R.2d (RIA) 2821 (D. Kan. 2009), *adopted by* 104 A.F.T.R.2d (RIA) 5014 (D. Kan. 2009)	Powell requirements satisfied; court adopted magistrate's recommendation and enforced summons	No	IRS
Catlett v. U.S., 326 Fed. App'x. 681 (4th Cir. 2009), *petition for cert. denied by* 130 S. Ct. 810 (2009)	Fourth Circuit affirmed District Court's order enforcing summonses	Yes	IRS
Chavez v. U.S., 104 A.F.T.R.2d (RIA) 7502 (D. Utah 2009)	Court dismissed TP's motion to quash for improper service and lack of jurisdiction	Yes	IRS
Cobb, U.S. v., 103 A.F.T.R.2d 2674 (S.D. Cal. 2009)	Court rejected TP's assertion of 5th Amendment privilege and held TP in contempt for non-compliance	Yes	IRS
Colby, U.S. v., 105 A.F.T.R.2d (RIA) 1459 (D.N.H. 2010), *adopted by* 105 A.F.T.R.2d (RIA) 1477 (D. N.H. 2010)	Court adopted magistrate's recommendation to enforce summons and award the government its costs	Yes	IRS

Table 1: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	*Pro Se*	Decision
Collins v. Provost (Andre), 104 A.F.T.R.2d (RIA) 7382 (E.D. Cal. 2009), *adopted by* 104 A.F.T.R.2d (RIA) 7778 (E.D. Cal. 2009)	Court adopted magistrate's recommendation and enforced summons; 5th Amendment claims rejected	Yes	IRS
Colby v. Provost (Sheri), 104 A.F.T.R.2d (RIA) 7386 (E.D. Cal. 2009), *adopted by* 2009 U.S. Dist. LEXIS 118428 (E.D. Cal. 2009)	Court adopted magistrate's recommendation and enforced summons; 5th Amendment claims rejected	Yes	IRS
Cook v. U.S., 104 A.F.T.R.2d (RIA) 5303 (D. Idaho 2009), *adopted by* 104 A.F.T.R.2d (RIA) 5306 (D. Idaho 2009)	Court denied TP motion to quash third-party summons; court adopted magistrate's recommendation and enforces summons	Yes	IRS
Corriveau, U.S. v., 104 A.F.T.R.2d (RIA) 6051 (D. Me. 2009), *aff'd by* 2009 U.S. Dist. LEXIS 80460 (D. Me. 2009)	Powell requirements satisfied; court adopted magistrate's recommendation and enforced summons	Yes	IRS
Cortese, U.S. v., 104 A.F.T.R.2d (RIA) 6298 (N.D.N.Y. 2009)	Powell requirements satisfied; court enforced summons	Yes	IRS
Cromar, U.S. v., 105 A.F.T.R.2d (RIA) 1994, *adopted by* 105 A.F.T.R.2d (RIA) 1995 (D. Utah 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Crowe (Maria), U.S. v., 2010 U.S. Dist. LEXIS 26408 (D.N.H. 2010), *adopted by* 2010 U.S. Dist. LEXIS 26410 (D.N.H. 2010)	Court adopted magistrate's recommendation, enforced summons, and awarded government its costs	Yes	IRS
Crowe (Richard), U.S. v., 2010 U.S. Dist. LEXIS 26407 (D.N.H. 2010), *adopted by* 2010 U.S. Dist. LEXIS 26411 (D.N.H. 2010)	Court adopted magistrate's recommendation, enforced summons, and awarded government its costs	Yes	IRS
Cryer, U.S. v., 105 A.F.T.R.2d (RIA) 2946 (W.D. La. 2010), *adopted by* 105 A.F.T.R.2d 2949 (W.D. La. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Dalgleish , U.S. v., 104 A.F.T.R.2d (RIA) 6012 (C.D. Utah 2009), *adopted by* 104 A.F.T.R.2d (RIA) 6013 (C.D. Utah 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Delgado, U.S. v., 105 A.F.T.R.2d (RIA) 1062 (S.D. Cal. 2010)	Powell requirements satisfied; court adopted magistrate's recommendation, enforced summons, and cautioned TP of possible conditional confinement	Yes	IRS
DePolo, U.S. v., 2010 U.S. Dist. LEXIS 42451 (N.D. Tex. 2010)	Powell requirements satisfied; court enforced summons	Yes	IRS
Dew v. U.S., 105 A.F.T.R.2d 1012 (D.S.C. 2010), *adopted by* 105 A.F.T.R.2d 1013 (D.S.C. 2010)	Court dismissed petition to quash summons because IRS had withdrawn summons, and so TP's motion was moot	Yes	No decision
Dye, U.S. v., 104 A.F.T.R.2d (RIA) 5983 (W.D. Tenn. 2009)	Court held TP in contempt for non-compliance with summons order; court ordered TP to comply with summons order, assessed fines, and issued arrest warrant for conditional confinement	Yes	IRS
Edomwande v. I.R.S., 2009 U.S. Dist. LEXIS 122530 (N.D. Tex. 2009), *accepted by* 2010 U.S. Dist. LEXIS 1508 (N.D. Tex. 2010)	Court adopted magistrate's recommendation to grant government's motion to dismiss and to dismiss motion to quash for lack of jurisdiction	Yes	IRS
Elsberg, U.S. v., 104 A.F.T.R.2d (RIA) 5456 (D. Colo. 2009), *motion granted in part by* 105 A.F.T.R.2d (RIA) 2333 (D. Colo. 2009)	Court granted government's motion to re-serve by publication and to serve by substituted service	Yes	IRS
Elmes, U.S. v., 104 A.F.T.R.2d (RIA) 7676 (S.D. Fla. 2009), *reconsideration denied by* 105 A.F.T.R.2d (RIA) 322 (S.D. Fla. 2009, *sanctions denied by* 105 A.F.T.R.2d (RIA) 666 (S.D. Fla. 2010), *petition dismissed by* 2010 U.S. Dist. LEXIS 10234 (S.D. Fla. 2010)	Court granted summons enforcement; after granting motion to dismiss, court dismissed petition for summons enforcement; civil sanctions disallowed; 1st and 5th Amendment claims dismissed	Yes	IRS
Ennis, U.S. v., 2010-1 U.S.T.C. (CCH) ¶ 50,202 (D. Colo. 2010)	Court ordered TPs to comply with summons and cautioned of possible finding of contempt if TPs failed to comply	Yes	IRS
Eulich v. U.S., 104 A.F.T.R.2d (RIA) 6332 (N.D. Tex. 2009), *motion granted by* 104 A.F.T.R.2d (RIA) 6337 (N.D. Tex. 2009)	Court rejected motion to hold TP in contempt of court and granted TP's motion to dismiss; TP asserted work-product and attorney-client privileges; court granted government's motion to determine TP's claim of privilege and to turn over documents determined not privileged	No	TP
Fabian v. Comm'r, 105 A.F.T.R.2d (RIA) 1848 (D. Md. 2010)	Powell requirements satisfied	Yes	IRS
Fisher v. U.S., 103 A.F.T.R.2d (RIA) 2696 (W.D. Wash. 2009)	Court declined to transfer case to another venue and dismissed motion to quash summons	Yes	IRS

Appendix Three

Table 1: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	*Pro Se*	Decision
Fisher v. U.S., 676 F. Supp. 2d 1165 (W.D. Wash. 2009)	Court rejected argument that summonses were illegal subterfuge to gather documents related to third-party entities and not TP; 4th Amendment claims rejected	Yes	IRS
Flores, U.S. v., 104 A.F.T.R.2d (RIA) 7782 (E.D. Cal. 2009), *adopted by* 105 A.F.T.R.2d (RIA) 370 (E.D. Cal. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Ganem, U.S. v., 104 A.F.T.R.2d (RIA) 6297 (D.N.H. 2009), *approved by* 104 A.F.T.R.2d (RIA) 6298 (D.N.H. 2009)	Court adopted magistrate's recommendation, enforced summons, and awarded government its costs	Yes	IRS
Glavin v. U.S., 2010 U.S. Dist. LEXIS 36137 (W.D. Wis. 2010)	Powell requirements satisfied; court enforces summons	Yes	IRS
Good, U.S. v., 104 A.F.T.R.2d (RIA) 6307 (S.D. Ala. 2009), *magistrate's recommendation* 104 A.F.T.R.2d (RIA) 5954 (S.D. Ala. 2009), *adopted by* 104 A.F.T.R. 2d (RIA) 6140 (S.D. Ala. 2009), and 104 A.F.T.R.2d (RIA) 6302 (S.D. Ala. 2009)	Court adopted magistrate's recommendation to enforce summons	Yes	IRS
Griggs, U.S. v., 103 A.F.T.R.2d (RIA) 922 (D. Ariz. 2009), *magistrate's recommendation* 2009-2 T.C. (CCH) ¶50768 (D. Ariz. 2009), *accepted by* 104 A.F.T.R.2d (RIA) 7695 (D. Ariz. 2009), *reconsideration denied by* 105 A.F.T.R.2d (RIA) 744 (D. Ariz. 2009), *stay denied by* 105 A.F.T.R.2d (RIA) 859 (D. Ariz. 2009), *motion granted by* 105 A.F.T.R.2d (RIA) 1525 (D. Ariz. 2010)	Court denied TP's motion to dismiss and motion for reconsideration where magistrate's recommendation was adopted and summons enforced; 5th Amendment claims rejected	Yes	IRS
Hassell, U.S. v., 2010 U.S. Dist. LEXIS 35163 (D.N.H. 2010), *adopted by* 2010 U.S. Dist. LEXIS 35159 (D.N.H. 2010)	Court adopted magistrate's recommendation, enforced summons, and awarded government its costs	Yes	IRS
Hendrickson, U.S. v., 104 A.F.T.R.2d (RIA) 6836 (E.D. Mich. 2009), *motion denied by* 664 F. Supp. 2d 793 (E.D. Mich. 2009)	Court denied TP's motion for judgment of acquittal or new trial finding that jury instructions were proper and TP's evidentiary challenges lacked merit	No	IRS
Hibben v. U.S., 104 A.F.T.R.2d (RIA) 5378 (E.D. Tenn. 2009), *aff'd by* 104 A.F.T.R.2d (RIA) 5516 (E.D. Tenn. 2009)	Court adopted magistrate's recommendation, denied motion to quash, and granted government's motion to dismiss	Yes	IRS
Hibben v. U.S., 104 A.F.T.R.2d (RIA) 6621 (S.D. Ohio 2009), *adopted by* 104 A.F.T.R.2d (RIA) 6623 (S.D. Ohio 2009)	Court adopted magistrate's recommendation and dismissed petition to quash summons; 4th Amendment claims rejected	Yes	IRS
Horne, U.S. v., 343 Fed. App'x. 192 (9th Cir. 2009), *aff'g* 101 A.F.T.R.2d (RIA) (D. Nev. 2008)	Ninth Circuit affirmed District Court's decision to enforce summons	Yes	IRS
Johansen, U.S. v., 105 A.F.T.R.2d (RIA) 321 (D.N.H. 2009), *approved by* 105 A.F.T.R.2d (RIA) 322 (D.N.H. 2009)	Court adopted magistrate's recommendation and enforced summons and awarded government its costs	Yes	IRS
Jones, U.S. v., 105 A.F.T.R.2d (RIA) 1876 (W.D. Wash 2010)	Court denied award of attorney's fees to TP where government's motion to withdraw summons had been granted	No	IRS
Kern v. U.S., 105 A.F.T.R.2d (RIA) 1520 (E.D. Mich. 2010), *adopted by* 105 A.F.T.R.2d (RIA) 1525 (E.D. Mich. 2010), *and* 105 A.F.T.R.2d (RIA) 1526 (E.D. Mich. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Kliethermes, U.S. v., 2009-2 T.C. (CCH) ¶50563 (W.D. Mo. 2009), *adopted by* 104 A.F.T.R.2d (RIA) 5366 (W.D. Mo. 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Lalonde, U.S. v·, 105 A.F.T.R.2d (RIA) 1824 (W.D. Pa. 2010)	Powell requirements satisfied; court enforced summons	Yes	IRS
Lanoie, U.S. v., 105 A.F.T.R.2d (RIA) 844 (10th Cir. 2010)	Tenth Circuit found jurisdictional defect on appeal because District Court did not enter summons enforcement order	Yes	TP
Le, U.S. v., 105 A.F.T.R.2d (RIA) 1827 (N.D. Cal. 2010)	Powell requirements satisfied; court enforced summons	Yes	IRS
Levy, U.S. v., 104 A.F.T.R.2d (RIA) 6049 (D. Utah 2009), *adopted by* 104 A.F.T.R.2d 6050 (D. Utah 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Little, U.S. v., 104 A.F.T.R.2d (RIA) 7473 (E.D. Ky. 2009)	Powell requirements satisfied; court enforced summons; 5th Amendment claims rejected	No	IRS
Lopez, U.S. v., 102 A.F.T.R.2d (RIA) 6777 (E.D. Cal. 2008), *adopted by* 103 A.F.T.R.2d (RIA) 1293 (E.D. Cal. 2009), *magistrate's recommendation at* 105 A.F.T.R.2d 1148 (E.D. Cal. 2010)	Magistrate certified further consideration of contempt and set matter for hearing where TP did not comply with summons order	Yes	IRS

Table 1: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	*Pro Se*	Decision
Luong, U.S. v., 102 A.F.T.R.2d (RIA) 6499 (E.D. Cal. 2009), *petition granted by* 2009 U.S. Dist. LEXIS 116921 (E.D. Cal. 2009)	Court enforced summons, held TP in contempt, and ordered confinement for failure to comply with court order enforcing summons	Yes	IRS
Maehr v. U.S., 103 A.F.T.R.2d (RIA) 405 (D. Neb. 2009), *motion granted by, in part, motion denied by* 104 A.F.T.R.2d (RIA) 5927 (D. Neb. 2009)	Powell requirements satisfied; court also found frivolous arguments	Yes	IRS
Manuia, U.S. v., 2009-2 T.C. (CCH) ¶50778 (D. Haw. 2009), *adopted by* 104 A.F.T.R.2d (RIA) 5631 (D. Haw. 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Marino, U.S. v., 2010 U.S. Dist. LEXIS 35863 (D.N.H. 2010), *adopted by* 2010 U.S. Dist. LEXIS 35981 (D.N.H. 2010)	Court adopted magistrate's recommendation and enforced summons, and awarded government its costs	Yes	IRS
Maxwell v. I.R.S, 104 A.F.T.R.2d (RIA) 5064 (M.D. Tenn. 2009), *sanctions allowed by* 2009 U.S. Dist. LEXIS 118275 (M.D. Tenn. 2009)	Court found frivolous TP's filings before hearing and ordered TP not to make further filings or institute further actions until TP satisfied previous sanction	Yes	IRS
Mengedoht, U.S. v., 99 A.F.T.R.2d 1137 (D. Neb. 2007), *adopted by 100 A.F.T.R.2d 6480 (D. Neb. 2007), appeal dismissed by* 343 Fed. App'x. 158 (8th Cir. 2009)	Court adopted magistrate judge's recommendation and enforced summons; appeal dismissed because notice of appeal filing was untimely	Yes	IRS
Mensh v. U.S., 104 A.F.T.R.2d (RIA) 5658 (E.D.N.Y. 2009)	Court granted motion to dismiss petition to quash third-party summons because jurisdiction over third-party entity was lacking; TP failed to state a claim for which relief may be granted	Yes	IRS
Menz, U.S. v., 2010 U.S. Dist. LEXIS 39719 (D.N.H. 2010), *approved by* 2010 U.S. Dist. LEXIS 39801 (D.N.H. 2010)	Powell requirements satisfied	Yes	IRS
Metz v. U.S., 104 A.F.T.R.2d (RIA) 7228 (M.D. Fla. 2009)	Court rejected privacy arguments and dismisses motion to seek injunctive relief	Yes	IRS
Mollison v. U.S., 2007 U.S. Dist. LEXIS 43407 (D. Nev. 2007), *rev'd and remanded by* 568 F.3d 1073 (9th Cir. 2009)	Ninth Circuit found District Court had proper jurisdiction to consider motion to quash third-party summons because TP's service was proper	No	TP
Morgan, U.S. v., 105 A.F.T.R.2d (RIA) 1979 (M.D. Fla. 2010), *adopted by* 105 A.F.T.R.2d (RIA) 1980 (M.D. Fla. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Navarro v. I.R.S., 105 A.F.T.R.2d (RIA) 2587 (2nd Cir. 2010)	Court affirmed magistrate's finding of lack of jurisdiction	Yes	IRS
Neilson v. U.S., 104 A.F.T.R.2d (RIA) 7778 (D.D.C. 2009)	Court dismissed TP's claims for injunctive relief from third-party summons for lack of jurisdiction; court dismissed TP's remaining claims for failure to state a claim; government's motion to dismiss granted	Yes	IRS
Ohendalski, U.S. v., 2009 U.S. Dist. LEXIS 88416 (S.D. Tex. 2009)	Powell requirements satisfied	Yes	IRS
O'Shea, U.S. v., 662 F. Supp. 2d 535 (S.D. W. Va. 2009), *related opinion* 105 A.F.T.R.2d (RIA) 877 (S.D. W. Va. 2009), *judgment entered by* 105 A.F.T.R.2d (RIA) 660 (S.D. W. Va. 2009)	Powell requirements satisfied; court found summons not enforceable as to oral testimony and enforced summons partially; court found TPs (H&W) waived privilege by failing to submit privilege log	Yes	Split
Panzo, U.S. v., 105 A.F.T.R.2d (RIA) 1648 (N.D. Cal. 2010)	Powell requirements satisfied; court enforced summons	Yes	IRS
Parker, U.S. v., 2010 U.S. Dist. LEXIS 34000 (D. Minn. 2010), *accepted by* 2010 U.S. Dist. LEXIS 33981 (D. Minn. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Parker, U.S. v., 2010 U.S. Dist. LEXIS 46185 (D. Minn. 2010), *adopted by* 2010 U.S. Dist. LEXIS 46324 (D. Minn. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Paulsen, U.S. v., 104 A.F.T.R.2d (RIA) 7201 (W.D. Wash. 2009)	Court denied TP's motion to dismiss and motion for preliminary injunction; court granted government's motion to withdraw and dismiss petition for enforcement of summons	Yes	IRS
Pennington v. U.S., 105 A.F.T.R.2d (RIA) 784 (W.D. Tex. 2010)	Court dismissed petition to quash third-party summons because no jurisdiction existed and limited waiver of sovereign immunity did not apply	Yes	IRS
Perry v. U.S., 104 A.F.T.R.2d (RIA) 6597 (E.D. Mich. 2009), *petition dismissed, judgment entered by* 2009 U.S. Dist. LEXIS 90013 (E.D. Mich. 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS

Appendix Three

Table 1: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	*Pro Se*	Decision
Personett v. I.R.S., 104 A.F.T.R.2d (RIA) 6580 (D. Colo. 2009), *accepted by* 104 A.F.T.R.2d (RIA) 6586 (D. Colo. 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Pragovich v. I.R.S., 104 A.F.T.R.2d (RIA) 7625 (E.D. Mich. 2009), *accepted by* 676 F. Supp. 2d 557 (E.D. Mich. 2009)	Powell requirements satisfied; court adopted magistrate's recommendation and enforced summons	Yes	IRS
Pragovich, U.S. v., 105 A.F.T.R.2d (RIA) 597 (6th Cir. 2009)	Court adopted magistrate's recommendation and enforced third-party summons; 1st Amendment claims rejected	Yes	IRS
Provost, U.S. v., 104 A.F.T.R.2d (RIA) 7386 (E.D. Cal. 2009), *adopted by* 2009 U.S. Dist. LEXIS 118428 (E.D. Cal. 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Putnam v. U.S., 104 A.F.T.R.3.2d (RIA) 5820 (D. Md. 2009), *motion granted by* 2009 U.S. Dist. LEXIS 78312 (D. Md. 2009)	Powell requirements satisfied; third-party summons enforced; Right to Privacy Act claim rejected	Yes	IRS
Rader v. U.S., 2009 U.S. Dist. LEXIS 92570 (D. Colo. 2009), *adopted by* 104 A.F.T.R.2d (RIA) 6132 (D. Colo. 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Ratcliff, U.S. v., 103 A.F.T.R.2d (RIA) 2677 (E.D. Cal. 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Redeker-Barry v. U.S., 103 A.F.T.R.2d (RIA) 2076 (M.D. Fla. 2008), *aff'd by* 333 Fed. App'x. 482 (11th Cir. 2009)	Powell requirements satisfied; third-party summons upheld	Yes	IRS
Reed, U.S. v., 105 A.F.T.R.2d (RIA) 862 (N.D. Cal. 2009)	Powell requirements satisfied; court enforced summons	Yes	IRS
Rodriguez, U.S. v., 105 A.F.T.R.2d (RIA) 1177 (D. Colo. 2010)	Court held TP in contempt for failure to comply and assessed conditional fine	Yes	IRS
Rodriguez, U.S. v., 105 A.F.T.R.2d (RIA) 1246 (D. Colo. 2010)	Court held TP in contempt for failure to comply and ordered conditional confinement	Yes	IRS
Sanders v. U.S., 105 A.F.T.R.2d (RIA) 2013 (D. Ariz. 2010)	Court lacking jurisdiction because the summons was issued in aid of collection of assess-ment	Yes	IRS
Schlabach, U.S. v., 105 A.F.T.R.2d (RIA) 337 (E.D. Wash. 2009), *adopted by* 105 A.F.T.R.2d 341 (E.D. Wash. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Seay v. U.S., 105 A.F.T.R.2d (RIA) 1099 (W.D.N.C. 2010), *adopted by, motion denied by* 105 A.F.T.R.2d (RIA) 1103 (W.D.N.C. 2010)	Court adopted magistrate's recommendation and enforced summons.	Yes	IRS
Settle, U.S. v., 105 A.F.T.R.2d (RIA) 1172 (E.D. Cal. 2010), *adopted by* 105 A.F.T.R.2d (RIA) 1542 (E.D. Cal. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Shadley, U.S. v., 105 A.F.T.R.2d (RIA) 824 (E.D. Cal. 2010)	Powell requirements satisfied; court enforced summons	Yes	IRS
Shelly, U.S. v., 105 A.F.T.R.2d (RIA) 906 (N.D. Ohio 2010), *motion denied by* 105 A.F.T.R.2d (RIA) 1873 (N.D. Ohio 2010)	Court granted government's motion for summary judgment finding the tax assessment computation to be accurate and dismissed TP's motion to modify judgment because it cre-ated post-judgment litigation	No	IRS
Shields, U.S. v., 2010 U.S. Dist. LEXIS 35797 (E.D. Tex. 2010), *adopted by* 2010 U.S. Dist. LEXIS 35800 (E.D. Tex. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Silva, U.S. v., 2009 U.S. Dist. LEXIS 91524 (E.D. Cal. 2009)	Powell requirements satisfied; court enforced summons	Yes	IRS
Simmons, U.S. v., 105 A.F.T.R.2d (RIA) 2203 (M.D. Fla. 2010), *adopted by* 105 A.F.T.R.2d 2204 (M.D. Fla. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Smith, U.S. v., 103 A.F.T.R.2d (RIA) 2661 (E.D. Cal. 2009), *adopted by* 104 A.F.T.R.2d (RIA) 5516 (E.D. Cal. 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Smith, U.S. v., 2010 U.S. Dist. LEXIS 38533 (D.N.H. 2010), *adopted by* 2010 U.S. Dist. LEXIS 38534 (D.N.H. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Soliz, U.S. v., 104 A.F.T.R.2d (RIA) 6743 (E.D. Cal. 2009), *aff'd by* 104 A.F.T.R.2d (RIA) 7825 (E.D. Cal. 2009)	Court adopted magistrate's recommendation and enforced summons as limited to both gross and assigned income	Yes	Split
St. Claire v. U.S., 105 A.F.T.R.2d (RIA) 1569 (S.D. Cal. 2010)	Powell requirements satisfied; court rejected confidentiality argument	Yes	IRS
Steinmetz, U.S. v., 2010-1 T.C. (CCH) ¶50131 (D.N.H. 2009), *approved by* 104 A.F.T.R.2d (RIA) 7552 (D.N.H. 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS

Table 1: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	*Pro Se*	Decision
Stevenson, U.S. v., 2009 U.S. Dist. LEXIS 124044 (D. Minn. 2009), *adopted by* 2010 U.S. Dist. LEXIS 5992 (D. Minn. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Sundberg, U.S. v., 105 A.F.T.R.2d (RIA) 454 (E.D. Wis. 2009)	Powell requirements satisfied; court denied TP's motion to dismiss	Yes	IRS
Tanner, U.S. v., 104 A.F.T.R.2d (RIA) 5635 (W.D. Va. 2009), *magistrate's recommendation at* 2009 U.S. Dist. LEXIS 85674 (W.D. Va 2009), *adopted* by 2009 U.S. Dist. LEXIS 85671 (W.D. Va 2009)	Court enforced summons and after compliance with summons discharged TP from any further obligation under the current summons	Yes	IRS
Thomas, U.S. v., 666 F. Supp. 2d 139 (D. Me. 2009), *motion granted by, in part, motion denied by, in part, by* 577 F. Supp. 2d 469 (D. Me. 2009)	Court granted TP's motion to amend pre-sentence report to reflect time previously served and certain agreed-upon facts but not to eliminate assessments for two tax years	No	Split
Thornberry, U.S. v., 102 A.F.T.R.2d (RIA) 7178 (M.D. Fla. 2008), *aff'd by* 346 Fed. App'x. 406 (11th Cir. 2009)	Challenge to contempt order rendered moot when TP complied with underlying summons enforcement order	Yes	IRS
Thurgood, U.S. v., 104 A.F.T.R.2d (RIA) 5537 (D. Utah 2009), *adopted by* 104 A.F.T.R.2d (RIA) 5538 (D. Utah 2009)	Court adopted magistrate's recommendation and enforced summons	No	IRS
Tuka v. U.S., 2009 U.S. Dist. LEXIS 93012 (E.D. Tex. 2009), *adopted by* 2009 U.S. Dist. LEXIS 93010 (E.D. Tex. 2009)	Powell requirements satisfied; TP failed to serve United States	Yes	IRS
Walker v. IRS, 104 A.F.T.R.2d (RIA) 6599 (D. Ariz. 2009)	Court denied TP's motions to quash and for order that debt has been paid in full with legal tender	Yes	IRS
Wang v. U.S., 104 A.F.T.R.2d (RIA) 7261 (W.D. Wash. 2009), *stay granted in part by* 105 A.F.T.R.2d (RIA) 317 (W.D. Wash. 2009)	Third-party summons upheld; court granted short stay to permit TP to seek emergency stay from Ninth Circuit	No	IRS
Wang v. U.S., 105 A.F.T.R.2d (RIA) 957 (D. Minn. 2009)	Court adopted magistrate's recommendation and denied TP's motion to quash third-party summons as moot	No	IRS
Webster, U.S. v., 105 A.F.T.R.2d (RIA) 954 (W.D. Mo. 2009), *adopted by* 105 A.F.T.R.2d (RIA) 955 (W.D. Mo. 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Welsh, U.S. v., 2009 U.S. Dist. LEXIS 79240 (N.D. Utah 2009), *adopted by* 2009 U.S. Dist. LEXIS 79239 (N.D. Utah 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
White v. U.S., 104 A.F.T.R.2d (RIA) 6881 (E.D. Mo. 2009), *aff'd by* 105 A.F.T.R.2d (RIA) 2930 (8th Cir. 2010)	Eighth Circuit affirmed district court and denied TP's petition to quash third-party summons based on unsupported assertion of improper service on TP	Yes	IRS
Williams, U.S. v., 104 A.F.T.R.2d (RIA) 5977 (E.D. Cal. 2009), *adopted by* 104 A.F.T.R.2d (RIA) 6745 (E.D. Cal. 2009)	Court adopted magistrate's recommendation and enforced summons; motion to dismiss pending in district court	Yes	IRS
Wilson-Skelton, U.S. v.,2009 U.S. Dist. LEXIS 120674 (E.D. Tex. 2009), *adopted by* 2009 U.S. Dist. LEXIS 120672 (E.D. Tex. 2009)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Worley, U.S. v., 104 A.F.T.R.2d (RIA) 5974 (M.D. Pa. 2009), *reconsideration denied by* 2009 U.S. Dist. LEXIS 79208 (M.D. Pa. 2009), *mandamus denied by 331* Fed. App'x. 948 (3d Cir. 2009), *appeal dismissed by* 347 Fed. App'x. 744 (3d Cir. 2009)	1st and 4th Amendment claims rejected; TP may invoke 5th Amendment privilege against self-incrimination as to individual questions	Yes	Split
Yokoyama, U.S. v., 105 A.F.T.R.2d (RIA) 1394 (D. Haw. 2010), *adopted by* 105 A.F.T.R.2d (RIA) 1395 (D. Haw. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Yokoyama, U.S. v., 2010 U.S. Dist. LEXIS 7448 (D. Haw. 2010), *adopted by* 2010 U.S. Dist. LEXIS 7451 (D. Haw. 2010)	Court adopted magistrate's recommendation and enforced summons	Yes	IRS
Business Taxpayers			
Atl. Ave. D.B. Fin./Legal Support Group v. U.S., 104 A.F.T.R.2d (RIA) 5586 (S.D. Fla. 2009)	Third-party summons upheld because summons issued in aid of collection and third-party notice exemption applied	No	IRS
Burbank Holdings, LLC v. U.S., 104 A.F.T.R.2d (RIA) 6600 (D. Nev. 2009), *aff'd and adopted by* 2010-1 T.C. (CCH) ¶50681 (D. Nev. 2009)	Court adopted magistrate's recommendation; court denied motion to quash third-party summons	Yes	IRS

Table 1: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	*Pro Se*	Decision
Clearwater Consulting Concepts, LLLP v. U.S., 102 A.F.T.R.2d (RIA) 5307 (D.V.I. 2008), *vacated by* 104 A.F.T.R.2d (RIA) 7313 (D.V.I. 2009)	Court construed magistrate's opinion as recommended disposition and enforced stay on summons	No	TP
Harlan Fund LLC v. U.S. Dep't. of Treasury - I.R.S., 329 Fed. App'x. 540 (5th Cir. 2009)	Powell requirements satisfied; Fifth Circuit affirmed District Court's decision to enforce summons	No	IRS
Hollywood Svcs, Inc. v. I.R.S., 105 A.F.T.R.2d (RIA) 1883 (D. Colo. 2010)	Court granted government's motion to dismiss for lack of jurisdiction, and because TP had not responded to the motion	Yes	IRS
Marcon, Inc. v. U.S., 105 A.F.T.R.2d (RIA) 460 (D. Idaho 2009)	Powell requirements satisfied; third-party summons upheld	No	IRS
Matchwood Foundation v. U.S., 103 A.F.T.R.2d (RIA) 2583 (D. Md. 2009), *reconsideration denied by* 104 A.F.T.R.2d (RIA) 5988 (D. Md. 2009)	Court denied motion for reconsideration and enforced third-party summons	No	IRS
McKouen v. U.S., 2009 U.S. Dist. LEXIS 63344 (W.D. Pa. 2009)	Court dismissed petition to quash summons; TP failed to serve United States	Yes	IRS
Nero Tranding, LLC v. U.S., 570 F.3d 1244 (11th Cir. 2009), reversing and *remanding* 104 A.F.T.R.2d (RIA) 5205 (N.D. Ga. 2007)	In consolidated appeal, the Eleventh Circuit remanded the case so that the District Court for the Northern District of Georgia could conduct further proceeding but upheld the District Court for the Middle District of Florida's decision to enforce the summons	No	Split
Paul Fowler, Inc., U.S. v., 104 A.F.T.R.2d (RIA) 7820 (E.D. Ark. 2009)	Powell requirements satisfied; court enforced summons	No	IRS
Sugarloaf Funding, LLC v. U.S. Dep't. of Treasury, 584 F.3d 340 (1st Cir. 2009)	Powell requirements satisfied; third-party summons upheld	No	IRS
Sunshine Behavioral Health Services v. U.S., 104 A.F.T.R.2d (RIA) 5104 (M.D. Fla. 2009)	Court rejected attorney-client privilege argument as to bank records of trust account of attorney who represented TP in bankruptcy proceeding; attorney had standing to challenge summons as third party named in the summons	No	IRS
Textron Inc. and Subsidiaries, U.S. v., 577 F.3d 21 (1st Cir. 2009) (*en banc*), *cert. denied*, 176 L. Ed. 2d 1219 (2010)	Court found that work product privilege did not shield tax accrual work papers from summons	No	IRS
Twin Palms Resort, LLC v. U.S., 676 F. Supp. 2d 1350 (S.D. Fla. 2009)	Powell requirements satisfied; third-party summons upheld	No	IRS
Twin Palms Resort, LLC v. U.S., 2010 U.S. Dist. LEXIS 10238 (E.D. Tenn. 2010), *adopted by* 2010 U.S. Dist. LEXIS 10048 (E.D. Tenn. 2010)	Court dismissed case without prejudice because TP filed notice of voluntary dismissal	No	IRS
UBS AG, U.S. v., 104 A.F.T.R.2d (RIA) 5247 (S.D. Fla. 2009)	Court denied motion seeking to compel United States to disclose number of accounts targeted by summons that have already been identified by voluntary disclosure or other means	No	IRS
Valero Energy Corp. v. U.S., 100 A.F.T.R.2d (RIA) 6473 (N.D. Ill. 2007), *aff'd by* 569 F.3d 626 (7th Cir. 2009)	Court rejected attorney-client privilege as to documents containing both legal analysis and accounting advice; court rejected tax practitioner-client privilege as inapplicable	No	IRS
Valero Energy Corp. v. U.S., 105 A.F.T.R.2d (RIA) 1829 (W.D. Tex. 2010)	Collateral estoppel applied to TP's argument that summons was overbroad; support of tax-practitioner privilege was acceptable if not barred by collateral estoppel	No	IRS
Viewtech, Inc. v. U.S., 104 A.F.T.R.2d (RIA) 7101 (S.D. Cal. 2009)	Court denied standing to quash because third-party notice exemption applied	No	IRS
Zugerese Trading LLC v. I.R.S., 336 Fed. App'x. 416 (5th Cir. 2009), *aff'g* 579 F. Supp. 2d 781 (E.D. La. 2008)	Fifth Circuit affirmed District Court's decision to enforce summons	No	IRS

Table 2

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

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Individual Taxpayers				
Aldridge v. Comm'r, T.C. Memo. 2009-276	Lien	No abuse of discretion in failing to consider an OIC	No	IRS
Ament v. Comm'r, T.C. Memo. 2010-28	Lien	TFRP assessment was not procedurally deficient	No	IRS
Anson v. Comm'r, T.C. Memo. 2010-119	Levy	Lack of jurisdiction	Yes	IRS
Banks v. Comm'r, T.C. Summ. Op. 2009-85	Lien	No abuse of discretion in failing to consider collection alternatives	No	IRS
Barnes v. Comm'r, T.C. Memo. 2010-30	Levy	Underlying liability as to penalties should have been considered at hearing, remanded to IRS Appeals	Yes	TP
Barry v. Comm'r, T.C. Memo. 2010-57	Lien	No abuse of discretion	Yes	IRS
Bartl v. Comm'r, T.C. Memo. 2010-43	Lien	No abuse of discretion in rejecting OIC	No	IRS
Battle v. Comm'r, T.C. Memo. 2009-171	Lien	Inability to challenge underlying tax liability; No abuse of discretion	Yes	IRS
Blair v. Comm'r, T.C. Memo. 2009-232	Levy	It was unclear why the OIC was rejected, remanded to IRS Appeals	Yes	TP
Beeler v. Comm'r, T.C. Memo. 2009-266	Levy	No abuse of discretion	No	IRS
Blank v. Comm'r, T.C. Summ. Op. 2010-10	Levy	Inconsistency on Form 4340; IRS motion for summary judgment denied	Yes	TP
Booth v. Comm'r, 338 Fed. Appx. 732 (9th Cir. 2009), *aff'g* Tax Ct. No. 16340-07L	Both	Lack of jurisdiction	Yes	IRS
Brandon, Estate of v. Comm'r, 133 T.C. No. 4 (2009)	Lien	Notice was sent to the last known address	No	IRS
Brown v. Comm'r, T.C. Summ. Op. 2009-176	Lien	No abuse of discretion	Yes	IRS
Burke v. Comm'r, T.C. Memo. 2009-282	Levy	No abuse of discretion	Yes	IRS
Butti v. Comm'r, T.C. Memo. 2009-198, *aff'd by* 105 A.F.T.R.2d (RIA) 2274 (2d Cir. 2010)	Lien	No abuse of discretion	Yes	IRS
Caney v. Comm'r, T.C. Memo. 2010-90	Both	No abuse of discretion in rejecting OIC	No	IRS
Carney v. Comm'r, T.C. Memo. 2009-310	Levy	Appeals Officer did not err in determination	Yes	IRS
Casey v. Comm'r, T.C. Memo. 2009-131	Levy	No abuse of discretion	Yes	IRS
Cessna v. Comm'r, T.C. Memo. 2009-301	Lien	No abuse of discretion in rejecting face-to-face hearing	Yes	IRS
Cleveland v. Comm'r, 600 F.3d 739 (7th Cir. 2010), *aff'g* Tax Ct. No. 31367-08	Levy	Lack of jurisdiction	Yes	IRS
Coleman v. Comm'r, T.C. Memo. 2010-51	Both	No abuse of discretion in rejecting collection alternatives	Yes	IRS
Comensoli v. Comm'r, T.C. Memo. 2009-242	Both	TP failed to offer a legitimate challenge to the underlying tax liability	No	IRS
Constantine v. Comm'r, T.C. Summ. Op. 2010-24	Levy	No abuse of discretion in rejecting a collection alternative	Yes	IRS
Crouch v. Comm'r, T.C. Summ. Op. 2009-143	Levy	Abuse of discretion in Appeals Officer's failure to consider TP's challenge to tax liability	Yes	TP
Cyman v. Comm'r, T.C. Memo. 2009-144	Lien	No abuse of discretion	Yes	IRS
Dean v. Comm'r, T.C. Memo. 2009-269	Levy	No abuse of discretion in the use of local standards for housing and utilities expenses as published by the IRS.	No	IRS
Delgado v. Comm'r, T.C. Summ. Op. 2009-158	Levy	No abuse of discretion in rejecting OIC	No	IRS
Dinino v. Comm'r, T.C. Memo. 2009-284	Levy	No abuse of discretion in failing to provide taxpayer with more time to produce financial information	No	IRS
Doose v. Comm'r, T.C. Memo. 2010-18	Levy	No abuse of discretion	Yes	IRS
Elias v. Comm'r, T.C. Memo. 2009-236	Levy	No abuse of discretion in rejecting a face-to-face hearing	Yes	IRS
Enax v. Comm'r, T.C. Memo. 2009-163	Lien	No abuse of discretion in rejecting a face-to-face hearing	Yes	IRS

Appendix Three

Appendix Three

Table 2: Appeals From Collection Due Process (CDP) Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Fairlamb v. Comm'r, T.C. Memo. 2010-22	Levy	Court was unable to determine if there was an abuse of discretion because the reasons given in the determination letter were inadequate, remand to IRS Appeals	No	TP
Fisher v. Comm'r, 105 A.F.T.R.2d (RIA) 2225 (7th Cir. 2010)	Levy	Dismissed for failure to prosecute	Yes	IRS
Flathers v. Comm'r, T.C. Summ. Op. 2009-113	Levy	No abuse of discretion in rejecting OIC	Yes	IRS
Freeland v. Comm'r, 345 Fed. Appx. 829 (3d Cir. 2009), *aff'g* Tax. Ct. No. 9259-07	Levy	No abuse of discretion in rejecting a face-to-face hearing	Yes	IRS
Garcia v. Comm'r, T.C. Summ. Op. 2009-141	Levy	No abuse of discretion in rejecting OIC	Yes	IRS
Ghani v. Comm'r, 354 Fed. Appx. 333 (10th Cir. 2009)	Levy	Lack of jurisdiction	Yes	IRS
Gilmer v. Comm'r, T.C. Memo. 2009-296	Lien	No abuse of discretion	Yes	IRS
Gonzales v. Comm'r, T.C. Memo. 2010-35	Lien	No abuse of discretion	Yes	IRS
Gonzalez v. Comm'r, T.C. Memo. 2010-8	Levy	No abuse of discretion	No	IRS
Granger v. Comm'r, T.C. Memo. 2009-258	Levy	No abuse of discretion in rejecting a request for face-to-face hearing	Yes	IRS
Guden v. Comm'r, T.C. Summ. Op. 2009-199	Lien	No abuse of discretion	Yes	IRS
Harper v. Comm'r, T.C. Summ. Op. 2009-125	Levy	No abuse of discretion	Yes	IRS
Harry v. Comm'r, T.C. Memo. 2009-206	Both	Challenge to underlying tax liability; section 6700 penalty properly assessed	Yes	IRS
Hartmann v. Comm'r, 351 Fed. Appx. 624 (3d Cir. 2009), *aff'g* Tax Ct. No. 04427-08	Levy	No abuse of discretion in rejecting OIC and having the same IRS agent conduct a CDP hearing and review the OIC	Yes	IRS
Hebert v. Comm'r, T.C. Memo. 2010-14	Levy	No abuse of discretion	Yes	IRS
Holmes v. Comm'r, T.C. Memo. 2010-50	Levy	Inability to challenge underlying tax liability; No abuse of discretion	Yes	IRS
Hotchkiss v. Comm'r, T.C. Memo. 2010-32	Levy	No improper ex parte communication	No	IRS
Huntress v. Comm'r, T.C. Memo. 2009-161	Lien	No abuse of discretion in rejecting OIC	Yes	IRS
Hurley v. Comm'r, T.C. Memo. 2009-165	Levy	Inability to challenge underlying tax liability	Yes	IRS
Improta v. Comm'r, 349 Fed. Appx. 420 (11th Cir. 2009), *aff'g* Tax Ct. No. 25833-06L	Levy	Inability to change underlying tax liability	Yes	IRS
Jahn v. Comm'r, 334 Fed. Appx. 501 (3d Cir. 2009), *aff'g* Tax Ct. No. 21387-06	Levy	Dismissed for failure to prosecute	Yes	IRS
Johnson-Thomas v. Comm'r, T.C. Summ. Op. 2010-43	Levy	No abuse of discretion in refusing to abate interest	Yes	IRS
Jordan v. Comm'r, 134 T.C. No. 1 (2010)	Lien	Court found that both TPs (H & W) signed the Form 900 extending the collection period	No	IRS
Judge v. Comm'r, T.C. Memo. 2009-135	Levy	Abuse of discretion in Appeals Officer's refusal to grant short extensions of time to submit Form 433-A; remanded to IRS Appeals	No	TP
Kanofsky v. Comm'r, T.C. Memo. 2010-46	Levy	No abuse of discretion	Yes	IRS
Kay v. Comm'r, T.C. Memo. 2010-59	Levy	No abuse of discretion	Yes	IRS
Keller v. Comm'r, 568 F.3d 710 (9th Cir. 2009)*	Levy	No abuse of discretion in rejecting OIC	No	IRS
Kelso v. Comm'r, T.C. Memo. 2009-125	Levy	No abuse of discretion in rejecting IA	No	IRS
Knop v. Comm'r, T.C. Summ. Op. 2009-142	Levy	No abuse of discretion.	Yes	IRS
Kovacevich v. Comm'r, T.C. Memo. 2009-160	Levy	No abuse of discretion because Appeals Officer error was harmless	Yes	IRS
Lance v. Comm'r, T.C. Memo. 2009-129	Levy	No abuse of discretion in rejecting OIC; Inability to challenge underlying tax liability	Yes	IRS
Landess v. Comm'r, 357 Fed. Appx. 167 (10th Cir. 2009), *aff'g* Tax Ct. No. 20585-07L	Both	Inability to challenge underlying tax liability; No abuse of discretion	Yes	IRS
Lewis v. Comm'r, T.C. Memo. 2009-202	Lien	Notice was sent to TP's last known address	Yes	IRS
Lindberg v. Comm'r, T.C. Memo. 2010-67	Levy	No abuse of discretion	Yes	IRS

Table 2: Appeals From Collection Due Process (CDP) Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Lincir v. Comm'r, T.C. Memo. 2009-153	Levy	No abuse of discretion in not offsetting outstanding overpayments and underpayments	No	IRS
Litwak v. Comm'r, T.C. Memo. 2009-292	Levy	No abuse of discretion in rejecting OIC	No	IRS
Lizalek v. Comm'r, T.C. Memo. 2009-122	Levy	No abuse of discretion	Yes	IRS
Long v. Comm'r, T.C. Memo. 2009-224	Levy	Inability to challenge underlying tax liability; No abuse of discretion	Yes	IRS
Long v. Comm'r, T.C. Memo. 2010-7	Lien	No abuse of discretion	No	IRS
MacDonald v. Comm'r, T.C. Memo 2009-240, *dismissing* T.C. Memo. 2009-63	Levy	Issue was moot	No	IRS
Mantell v. Comm'r, T.C. Summ. Op. 2010-28	Levy	Lack of jurisdiction	No	IRS
Marlow v. Comm'r, T.C. Memo. 2010-113	Levy	Abuse of discretion in determining that the requirements of applicable law or administrative procedure were met	No	TP
Maselli v. Comm'r, T.C. Memo. 2010-19	Levy	No abuse of discretion in rejecting IA	No	IRS
McCollin v. Comm'r, T.C. Memo. 2010-93	Both	Inability to challenge underlying tax liability; No abuse of discretion	Yes	IRS
McKenna v. Comm'r, T.C. Summ. Op. 2010-58	Levy	No abuse of discretion	No	IRS
Meeh v.Comm'r, T.C. Memo. 2009-180	Levy	Remand to IRS Appeals to allow for the pursuit of an IA	Yes	TP
Michael v. Comm'r, 133 T.C. No. 10 (2009)	Levy	Abuse of discretion for 1989 because TP overpaid on liability; No abuse of discretion for 1990 and 1991	No	Split
Mourad v. Comm'r, T.C. Memo. 2009-217	Levy	No abuse of discretion	Yes	IRS
Mueller v. Comm'r, T.C. Memo. 2010-10	Lien	No abuse of discretion	Yes	IRS
Olesen v. Comm'r, T.C. Memo. 2009-307	Lien	TP received notice of deficiency	No	IRS
O'Neil v. Comm'r, T.C. Memo. 2009-183	Both	No abuse of discretion in rejecting OIC	No	IRS
Oropeza v. Comm'r, T.C. Memo. 2009-244	Levy	No abuse of discretion	Yes	IRS
Pearce v. Comm'r, T.C. Memo. 2010-56	Levy	No abuse of discretion in rejecting IA	Yes	IRS
Pickell v. Comm'r, 360 Fed. Appx. 962 (9th Cir. 2010), *aff'g* T.C. Memo 2008-60	Levy	Lack of jurisdiction	Yes	IRS
Pitts v. Comm'r, T.C. Memo. 2010-101	Lien	No abuse of discretion	No	IRS
Powers v. Comm'r, T.C. Memo. 2009-229	Lien	Taxpayer could not show that settlement officer was bias	Yes	IRS
Prince v. Comm'r, 133 T.C. No. 12 (2009)	Levy	No abuse of discretion	Yes	IRS
Reynolds v. Comm'r, T.C. Memo. 2009-181	Levy	Inability to challenge underlying tax liabilities; No abuse of discretion	Yes	IRS
Rice v. Comm'r, T.C. Memo. 2009-169	Levy	No abuse of discretion	Yes	IRS
Roberts v. Comm'r, T.C. Summ. Op. 2010-21	Both	Lack of jurisdiction	Yes	IRS
Rogers v. Comm'r, T.C. Summ. Op. 2010-13	Levy	No abuse of discretion in rejection collection alternatives	Yes	IRS
Romero v. Comm'r, T.C. Memo. 2009-264	Lien	No abuse of discretion in refusing to lower TP's future income value to reflect anticipated termination of taxpayer's disability benefits when considering an OIC	Yes	IRS
Schropp v. Comm'r, T.C. Memo. 2010-71	Lien	No abuse of discretion in rejecting OIC	Yes	IRS
Schwartz v. Comm'r, 348 Fed. Appx. 806 (3d Cir. 2009), *aff'g* T.C. Memo. 2008-117	Levy	No abuse of discretion in rejecting OIC	No	IRS
Silverman v. Comm'r, 105 A.F.T.R.2d (RIA) 1856 (9th Cir. 2010), aff'g Tax Ct. No. 13629-05L	Levy	Inability to challenge underlying tax liability; No abuse of discretion in rejecting face-to-face hearing	No	IRS
Selph v. Comm'r, T.C. Summ. Op. 2010-20	Both	Challenged underlying tax liability	Yes	Split
Severo v. Comm'r, 586 F.3d 1213 (9th Cir. 2009), *aff'g 129 T.C. 160 (2007)*	Lien	IRS collection actions were timely; Bankruptcy did not extinguish tax liability	No	IRS
Smith-Irving v. Comm'r, T.C. Summ. Op. 2009-116	Lien	Abuse of discretion in the filing of the NFTL because it was an error as a matter of law	Yes	TP

Table 2: Appeals From Collection Due Process (CDP) Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Space v. Comm'r, T.C. Memo. 2009-230	Levy	Notice was not mailed to last known address	No	IRS
Sparkman v. Comm'r, T.C. Memo. 2009-308	Both	No abuse of discretion in refusing to remove lien because of interference of home construction	Yes	IRS
Springer v. Comm'r, 580 F.3d 1142 (10th Cir. 2009), *cert. denied*, 130 S. Ct. 1907 (2010)	Levy	Inability to challenge underlying tax liability; TP liable for penalties	No	IRS
Stinchcomb v. Comm'r, T.C. Memo. 2009-259	Lien	No abuse of discretion in refusing to withdraw lien	Yes	IRS
Stockton v. Comm'r, T.C. Memo. 2009-186	Both	No abuse of discretion in rejecting face-to-face hearing	Yes	IRS
Szulczewski v. Comm'r, T.C. Summ. Op. 2009-136	Lien	Notice was not mailed to last known address	Yes	TP
Turner v. U.S., 338 Fed. Appx. 805 (11th Cir. 2009), *aff'g* 102 A.F.T.R.2d 6813 (N.D. Ga. 2008)	Levy	No abuse of discretion	Yes	IRS
Turner v. Comm'r, T.C. Memo. 2010-44	Lien	No genuine issue of material fact	Yes	IRS
Ulrich v. Comm'r, 585 F.3d 1235 (9th Cir. 2009), *aff'g* Tax Ct. No. 7738-06L	Levy	No abuse of discretion	No	IRS
Vela v. Comm'r, T.C. Memo. 2010-100	Lien	No abuse of discretion	No	IRS
Vinatieri v. Comm'r, 133 T.C. No. 16 (2009)	Levy	Appeals officer's determination to allow levy was wrong as a matter of law and thus an abuse of discretion	Yes	TP
Vines v. Comm'r, T.C. Memo. 2009-267	Levy	No abuse of discretion in rejecting collection alternatives	No	IRS
Walthers v. Comm'r, T.C. Memo. 2009-139	Levy	Lack of jurisdiction	Yes	IRS
Westcott v. Comm'r, T.C. Memo. 2010-36	Lien	No abuse of discretion	Yes	IRS
Wheeler v. Comm'r, 356 Fed. Appx. 188 (10th Cir. 2009)	Levy	Court of Appeals upheld Tax Court's granting of summary judgment to IRS; TP was liable for the tax	Yes	IRS
Willhite v. Comm'r, T.C. Memo 2009-263	Levy	TP liable for penalties	Yes	IRS
Williams v. Comm'r, T.C. Memo. 2009-159	Levy	Declining to postpone determination was not an abuse of discretion	No	IRS
Williamson v. Comm'r, T.C. Memo. 2009-188	Levy	No abuse of discretion in rejecting face-to-face hearing	Yes	IRS
Willis v. Comm'r, 348 Fed. Appx. 290 (9th Cir. 2009), *aff'g* Tax Ct. No. 3654-07L	Levy	No abuse of discretion in rejecting face-to-face hearing	Yes	IRS
Willock v. Comm'r, T.C. Memo. 2009-178, *aff'd by* 105 A.F.T.R.2d (RIA) 1166 (4th Cir. 2010)	Lien	No abuse of discretion	Yes	IRS
Wright v. Comm'r, 571 F.3d 215 (2d Cir. 2009)	Levy	Issue was moot	Yes	IRS
Yeomans v. Comm'r, T.C. Memo. 2009-216	Levy	No abuse of discretion in denying abatement of interest	Yes	IRS
Business				
Hassel Family Chiropractic, DC, PC v. Comm'r, T.C. Memo. 2009-127, *aff'd by* 105 A.F.T.R.2d (RIA) 1358 (8th Cir. 2010)	Levy	No abuse of discretion	No	IRS
Independent Staffing Solutions v. Comm'r, T.C. Memo. 2010-102	Lien	No abuse of discretion	No	IRS
Industrial Investment v. Comm'r, 353 Fed. Appx. 90 (9th Cir. 2009), *aff'g* T.C. Memo 2007-93	Levy	No abuse of discretion in recording of CDP hearing meeting with TP's attorney	No	IRS
Ken Ryan, Inc. v. Comm'r, T.C. Summ. Op. 2010-18	Unclear	Challenged underlying tax liability; TP not liable for penalties	No	TP
Leedreau v. Comm'r, T.C. Summ. Op. 2009-195	Levy	TP was liable for taxes owed by LLC	No	IRS
Mayer Inv. Co. v. Comm'r, T.C. Memo. 2010-52	Levy	No abuse of discretion in rejecting OIC	No	IRS
Medical Practice Solutions LLC v. Comm'r· T.C. Memo. 2009-214, *appeal dismissed*, T.C. Memo 2010-98	Levy	Abuse of discretion	Yes	TP
Ron Lykins Inc. v. Comm'r, 133 T.C. No. 5 (2009)	Levy	No abuse of discretion	No	IRS
TGI Enterprise, Inc v. Comm'r, T.C. Memo. 2009-123	Levy	No abuse of discretion in rejecting IA	No	IRS

*This consolidated appeal addresses the sixteen separate Tax Court cases where the same issues were raised.

Table 3 Accuracy-Related Penalties Under IRC §§ 6662(B)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Ackermen v. U.S., 643 F. Supp. 2d 140 (D.D.C. 2009)	6662(b)(1) & (2) - Accuracy-related penalties were attributed to partnership item and claims were late-filed	No	IRS
Akanno v. Comm'r, T.C. Summ. Op. 2009-168	6662(b)(1) & (2) - TP failed to substantiate deductions	No	IRS
Agronin v. Comm'r, T.C. Summ. Op. 2009-189	6662(b)(1) & (2) - TP failed to substantiate deductions	Yes	IRS
Anderson v. Comm'r, T.C. Memo. 2010-1	6662(b)(2) – TPs (H&W) acted with reasonable cause and in good faith despite failing to pay self-employment tax	Yes	TP
Angle, Estate of v. Comm'r, T.C Memo. 2009-227	6662(b)(2) - TPs (H&W) entered into sham transactions to conceal gain	No	IRS
Balice v. Comm'r, T.C. Memo. 2009-196	6662(b)(1) & (2) – TPs (H&W) shifting of income to a sham trust resulted in an omission of gross income	Yes	IRS
Banach v. Comm'r, T.C. Summ. Op. 2010-33	6662(b)(1) – TP acted with reasonable cause and in good faith by consulting attorney and accountant	Yes	TP
Barr v. Comm'r, T.C. Memo. 2009-250	6662(b)(1) - TP's surrender of life insurance policy is ordinary income	No	IRS
Beasley v. Comm'r, T.C. Summ. Op. 2009-93	6662(b)(2) –TPs (H&W) reasonably relied on preparer	No	TP
Billups v. Comm'r, T.C. Summ. Op. 2009-86	6662(b)(1) - TP reasonably relied on advice of accountant though failing to report distributions from qualified employer plan as taxable	Yes	TP
Bomer v. Comm'r, T.C. Summ. Op. 2010-54	6662(b)(1) - TP improperly filed return claiming earned income credit while an inmate at a penal institution	Yes	IRS
Campbell v. Comm'r, 134 T.C. No. 3 (2010)	6662(b)(1) & (2) - TP failed to adequately disclose payments from qui tam settlement on return though disclosure of attorney's fee payment was adequate	No	Split
Carter v. Comm'r, T.C. Memo. 2010-111	6662(b)(2) - TP failed to report capital gains income	No	IRS
Chandler v. Comm'r, T.C. Memo. 2010-92	6662(b)(1) -TP failed to show horse activity was for profit	No	IRS
Conway v. Comm'r, T.C. Summ. Op. 2010-27	6662(b)(2) - TP failed to report rental income. Deductions for charity and employee expenses upheld	Yes	IRS
Dollander v. Comm'r, T.C. Memo. 2009-187	6662(b)(1) & (2) - TPs (H&W) acted in good faith when return preparer failed to include 10-percent additional tax on early distribution from qualified retirement plan though interest and cancellation of debt income were negligently omitted	Yes	Split
Dungca v. Comm'r, T.C. Summ. Op. 2009-144	6662(b)(1) - TPs (H&W) failed to keep adequate records to substantiate gambling losses and expenses	Yes	IRS
Elverson v. Comm'r, T.C. Summ. Op. 2010-36	6662(b)(1) & (2) - TPs (H&W) failed to substantiate Sch. C and Sch. A expenses	Yes	IRS
Espinoza v. Comm'r, T.C. Memo. 2010-53	6662(b)(2) - TP reasonably relied on advice of attorney in failing to report funds from a settlement as taxable income	Yes	TP
Friedman v. Comm'r, T.C. Memo. 2010-45	6662(b)(1) - TPs (H&W) failed to provide CPA with necessary and accurate information and therefore could not reasonably rely on CPA's advice	No	IRS
Gochis v. Comm'r, T.C. Summ. Op. 2009-156	6662(b)(1) - TP prepared own return and failed to establish that his accountant was qualified to give tax advice regarding partnership interest	Yes	IRS
Green v. Comm'r, T.C. Memo. 2010-109	6662(b)(1) & (2) - TPs (H&W) failed to substantiate medical expenses, NOL deductions, and Social Security disability benefit exclusions	Yes	IRS
Guerrero v. Comm'r, T.C. Memo. 2009-164	6662(b)(1) - TPs (H&W) failed to substantiate deductions	Yes	IRS
Halby v. Comm'r, T.C. Memo. 2009-204	6662(b)(2) - TP not entitled to claimed deductions	Yes	IRS
Handy v. Comm'r, T.C. Summ. Op. 2009-123	6662(b)(1) - TP failed to substantiate deductions	No	IRS
Hill v. Comm'r, T.C. Summ. Op. 2010-34	6662(b)(1) - TP failed to report social security benefits as taxable income but did so in good faith with reasonable cause	Yes	TP
Hopson v. Comm'r, T.C. Summ. Op. 2009-130	6662(b)(2) - TPs' (H&W) reliance on tax return preparation software not reasonable cause	Yes	IRS

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Table 3: Accuracy-Related Penalties Under IRC §§ 6662(B)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Hwynn v. Comm'r, T.C. Summ. Op. 2009-88	6662(b)(2) – TPs (H&W) failed to report wages and substantiate deductions but IRS failed to show underpayment was substantial	Yes	TP
Kaufman v. Comm'r, 134 T.C. No. 9	6662(b)(1) &(2) – TPs (H&W) acted with reasonable cause and in good faith by consulting accountant before claiming disallowed deduction	No	TP
Kelly v. Comm'r, T.C. Summ. Op. 2010-4	6662(b)(2) - TPs (H&W) failed to provide return preparer with necessary information and therefore could not reasonably rely on preparer's advice	Yes	IRS
Koelemay v. Comm'r, T.C. Summ. Op. 2009-134	6662(b)(1) - TP reasonably believed early 401(k) disbursement was on his W-2	Yes	TP
Koziej v. Comm'r, T.C. Summ. Op. 2010-40	6662(b)(1) - TPs (H&W) failed to present evidence that bank deposits were loans	Yes	IRS
Koziej v. Comm'r, T.C. Summ. Op. 2010-41	6662)b)(1) - TP failed to present evidence that bank deposits were loans	Yes	IRS
LaPlante v. Comm'r, T.C. Memo. 2009-226	6662(b)(2) - TP, a recreational gambler, acted with reasonable cause and in good faith by disclosing gambling winnings and seeking the advice of a tax expert	No	TP
Liu v. Comm'r, T.C. Summ. Op. 2009-137	6662(b)(1) - TP liable for penalty for unreported interest income but had reasonable cause for failure to pay penalty on premature distribution from annuity	Yes	Split
Longoria v. Comm'r, T.C. Memo. 2009-162	6662(b)(1) & (2) - TP reasonably relied on advice of CPA that settlement award was nontax-able	No	TP
Manning v. Comm'r, T.C. Memo. 2009-157	6662(b)(1) - TPs (H&W) mistakenly made deduction that should have applied to the follow-ing tax year but did not do so negligently	No	TP
Matthies v. Comm'r, 134 T.C. No. 6 (2010)	6662(b)(1) - TPs (H&W) had reasonable basis for position, tax treatment of a bargain sale of a life insurance policy had not yet been addressed by the Tax Court at time of filing	No	TP
Melcher, Estate of v. Comm'r, T.C. Memo. 2009-210	6662(b)(2) - TPs reasonably relied on advice of CPA	No	TP
Mora v. Comm'r, T.C. Summ. Op. 2010-60	6662(b)(1) - TPs (H&W) reasonably relied on tax professional and made a good faith effort to determine correct tax liability	Yes	TP
Morse v. Comm'r, T.C. Memo. 2010-40	6662(b)(1) - TPs (H&W) failed to report wages	Yes	IRS
Musshafen v. Comm'r, T.C. Summ. Op. 2009-115	6662(b)(2) - TP not entitled to foreign income exclusion; TP reasonably relied on tax pre-parer	Yes	TP
O'Neill v. Comm'r, T.C. Summ. Op. 2009-131	6662(b)(2) - TP acted with reasonable cause and in good faith	Yes	TP
Orellana v. Comm'r, T.C. Summ. Op. 2010-51	6662(b)(1) - TP, an IRS revenue agent, failed to report income from Internet sales	Yes	IRS
Prough v. Comm'r, T.C. Memo. 2010-20	6662(b)(2) - TP failed to report early annuity distribution; reliance on third party calcula-tions not reasonable	No	IRS
Prudhomme v. Comm'r, 345 Fed. Appx. 6 (5th Cir. 2009), *aff'g* T.C. Memo. 2008-83	6662(b)(2) – TPs (H&W) did not act in good faith and with reasonable cause in relying on their accountants to prepare their taxes	No	IRS
Ramirez v. Comm'r, T.C. Memo. 2010-108	6662(b)(1) - TPs (H&W) failed to substantiate deductions	Yes	IRS
Rice v. Comm'r, T.C. Memo. 2009-142	6662(b)(1) – TPs (H&W) reasonably relied on preparer	No	TP
Risley v. Comm'r, T.C. Summ. Op. 2009-172	6662(b)(1) - TPs (H&W) made improper deductions related to participation in fraudulent tax shelter	No	IRS
Rodkey v. Comm'r, T.C. Memo. 2009-238	6662(b)(1) - TP improperly deducted child support payments as alimony	Yes	IRS
Rosemann v. Comm'r, T.C. Memo. 2009-185	6662(b)(1) - TP reasonably relied on IRS statement in prior audit for employment status but had no reasonable cause for unsubstantiated deductions	Yes	Split
Scott v. Comm'r, 352 Fed. Appx. 468 (2d Cir. 2009)	6662(b)(2) - TP reported no wages and gave frivolous arguments	Yes	IRS
Sirin v. Comm'r, T.C. Summ. Op. 2010-57	6662(b)(1) - TPs (H&W) could not speak English and had little understanding of federal tax laws but made a good faith effort to file a return and pay tax correctly	No	TP
Slater v. Comm'r, T.C. Summ. Op. 2010-1	6662(b)(2) –TPs (H&W) acted with reasonable cause and in good faith in not including commission compensation paid into an annuity as gross income	Yes	TP
Smiley v. Comm'r, T.C. Summ. Op. 2009-122	6662(b)(1) - TP acted with reasonable cause in failing to report Social Security benefits but without reasonable cause in failure to report interest income	Yes	Split

Table 3: Accuracy-Related Penalties Under IRC §§ 6662(B)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Smith v. Comm'r, 104 A.F.T.R.2d (RIA) 7830 (9th Cir. 2009), *aff'g* T.C. Memo. 2007-368	6662(b)(1) - TPs incorrectly reported expenses from hobbies as expenses of a for-profit business	No	IRS
Stiel, Estate of v. Comm'r, T.C. Memo. 2009-278	6662(b)(2) - TPs (H&W) did not reasonably rely on tax preparer because they failed to review the return	Yes	IRS
Sykes v. Comm'r, T.C. Memo. 2010-84	6662(b)(1) - TPs (H&W) failed to substantiate casualty loss	Yes	IRS
Tarpo v. Comm'r, T.C. Memo. 2009-222	6662(b)(1) & (2) – TPs (H&W) shifted income to a sham trust and failed to substantiate deductions	Yes	IRS
Wallis v. Comm'r, T.C. Memo. 2009-243	6662(b)(1) & (2) – TP, a partner at a law firm, incorrectly reported payments made to liquidate partnership interest as capital gains instead of as ordinary income	Yes	IRS
Warren v. Comm'r, T.C. Memo. 2009-148	6662(b)(1) & (2) – TP failed to file a return resulting in unreported income	Yes	IRS
Woodard v. Comm'r, T.C. Summ. Op. 2009-150	6662(b)(1) & (2) - TP relying on information online not reasonable cause	Yes	IRS
Wright v. Comm'r, T.C. Summ. Op. 2010-50	6662(b)(2) - TP failed to show bank deposits were not income	Yes	IRS
Young v. Comm'r, T.C. Summ. Op. 2009-17[3]	6662(b)(2) - TP failed to substantiate deductions	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedules C, E, F)			
Alpha I, L.P. v. U.S., 105 A.F.T.R.2d (RIA) 2724 (Ct. Fed. Cl. 2010)	6662(b)(1) & (2) - TP was engaged in a tax shelter	No	IRS
Argyle v. Comm'r, T.C. Memo. 2009-218	6662(b)(1) & (2) - TP filing status and deductions denied; TP, a CPA, was negligent in claiming the disallowed deductions	Yes	IRS
Bennett v. Comm'r, T.C. Memo. 2010-114	6662(b)(2) - TP failed to substantiate deductions	Yes	IRS
Bruns v. Comm'r, T.C. Memo. 2009-168	6662(b)(1) & (2) - Certain Sch. C. expenses and all Sch. E expenses disallowed	No	IRS
Campbell v. Comm'r, T.C. Summ. Op. 2009-119	6662(b)(1) - TPs (H&W) failed to substantiate expenses	Yes	IRS
Canterbury Holdings, LLC v. Comm'r, T.C. Memo. 2009-175	6662(b)(1) & (2) - Management fees were capital investment & not deductible; reasonably relied on advice	No	TP
Cavaretta v. Comm'r, T.C. Memo. 2010-4	6662(b)(1) - Civil restitution payments were ordinary and necessary business expenses; penalties upheld for non-contested deficiencies	No	Split
Chow v. Comm'r, T.C. Memo. 2010-48	6662(b)(1) & (2) - Deductions for rental expenses and personal attorney were contrary to the law or unsubstantiated	Yes	IRS
Curcio v. Comm'r, T.C. Memo. 2010-115	6662(b)(1) & (2) - Employee benefit trust not ordinary & necessary business expenses; no reasonable belief	No	IRS
Damer v. Comm'r, T.C. Summ. Op. 2009-145	6662(b)(2) - Deductions for loan payments for their home not deductible	Yes	IRS
Derby v. Comm'r, T.C. Memo. 2010-66	6662(b)(2) - TP reasonably relied on advice from accountant	Yes	TP
Enbridge Energy Co. v. U.S., 354 Fed. Appx. 15 (5th Cir. 2009), *aff'g* 553 F. Supp. 2d 716 (S.D. Tex 2008)	6662(b)(1) – Transaction was a sham conduit; TP not entitled to step-up in basis	No	IRS
Engle v. Comm'r, T.C. Summ. Op. 2009-138	6662(b)(1) - TP failed to substantiate deductions and understated income	Yes	IRS
Farber v. Comm'r, T.C. Memo. 2010-37	6662(b)(1) - TP failed to substantiate deductions	No	IRS
Farquhar v. Comm'r, T.C. Summ. Op. 2010-17	6662(b)(1) - TP failed to substantiate deductions and loss	Yes	IRS
Foriest v. Comm'r, T.C. Summ. Op. 2009-110	6662(b)(1) - TPs (H&W) failed to substantiate deductions or show farming activity was for trade or business and omitted income; reasonably relied on tax preparer	Yes	TP
Foster v. Comm'r, T.C. Memo. 2009-274	6662(b)(1) - TP failed to substantiate deductions	Yes	IRS
Foxworthy, Inc. v. Comm'r, T.C. Memo. 2009-203	6662(b)(1) - TP failed to substantiate deductions and transaction was a sham; not liable for penalty because liable for 6663 fraud penalty	No	IRS
Gentry v. Comm'r, T.C. Summ. Op. 2010-49	6662(b)(2) - TP failed to substantiate deductions and report cost of goods sold; reasonable cause for COGS but not for other deductions	Yes	Split
Gist v. Comm'r, T.C. Summ. Op. 2009-126	6662(b)(1) - TP failed to keep adequate records to substantiate deductions	No	IRS
Goolsby v. Comm'r, T.C. Memo. 2010-64	6662(b)(1) & (2) - TPs (H&W) must recognize gain on property not held for trade or business and include in income excess proceeds of property sale; cannot deduct passive losses	Yes	IRS

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Table 3: Accuracy-Related Penalties Under IRC §§ 6662(B)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Johnson v. Comm'r, T.C. Summ. Op. 2009-124	6662(b)(1) - TPs (H&W) failed to substantiate deductions	Yes	IRS
Jones v. Comm'r, T.C. Memo. 2010-112	6662(b)(2) - TP did not receive Sch K-1 and therefore failed to report income	No	IRS
Jordan v. Comm'r, T.C. Memo. 2009-223	6662(b)(1) - TP had unreported taxable income and failed to substantiate deductions	Yes	IRS
Lam v. Comm'r, T.C. Memo. 2010-82	6662(b)(1) - TP reliance on tax preparation software not reasonable	Yes	IRS
Le v. Comm'r, T.C. Summ. Op. 2009-109	6662(b)(1) - TPs (H&W) failed to substantiate deductions	Yes	IRS
Lenard v. Comm'r, T.C. Summ. Op. 2009-165	6662(b)(1) & (2) - TPs (H&W) failed to report income	Yes	IRS
Leone v. Comm'r, T.C. Summ. Op. 2009-174	6662(b)(1) & (2) - Drag racing activity not trade or business	Yes	IRS
LKF X Investments, LLC v. Comm'r, T.C. Memo. 2009-192	6662(b)(1) & (2) - Partnership lacks economic substance	No	IRS
Madduri v. Comm'r, T.C. Summ. Op. 2009-117	6662(b)(2) - TPs (H&W) incorrectly reported taxable wages as business profit on Schedule C and failed to show reasonable belief	Yes	IRS
Maguire Partners-Master Investments, LLC v. U.S., 104 A.F.T.R.2d (RIA) 7839 (C.D. Cal. 2009)	6662(b)(1) - Partnership basis overstated because lacked economic substance	No	IRS
Milton v. Comm'r, T.C. Memo. 2009-246	6662(b)(1) - TP kept no books or records; reliance on unidentified CPA not reasonable	No	IRS
Morrissey v. Comm'r, T.C. Summ. Op. 2009-135	6662(b)(1) - Deductions disallowed and TPs (H&W) did not show reasonable cause	Yes	IRS
Munson v. Comm'r, T.C. Summ. Op. 2009-164	6662(b)(2) - TP failed to substantiate deductions	Yes	IRS
Nelson v. Comm'r, T.C. Memo. 2010-96	6662(b)(2) - TP deductions disallowed	No	IRS
Nevada Partners Fund, LLC v. U.S., 105 A.F.T.R.2d (RIA) 2133 (S.D. Miss. 2010)	6662(b)(1) & (2) - Transactions lacked economic substance and were part of an abusive tax shelter	No	IRS
Orr v. Comm'r, T.C. Summ. Op. 2010-55	6662(b)(1) - TP diminished mental capacity was reasonable cause	Yes	TP
Pacheco v. Comm'r, T.C. Summ. Op. 2009-112	6662(b)(1) - TP failed to substantiate deductions	Yes	IRS
Palm Canyon X Investments, LLC v. Comm'r, T.C. Memo. 2009-288	6662(b)(1) & (2) – Transactions lacked economic substance	No	IRS
Phemister v. Comm'r, T.C. Memo. 2009-201	6662(b)(1) & (2) - TPs (H&W) failed to report income and made improper deductions	Yes	IRS
Prinster v. Comm'r, T.C. Summ. Op. 2009-99	6662(b)(1) & (2) - TP failed to report income from wrongful termination settlement and substantiate deductions; reasonably relied on attorney advice for settlement but not deductions	Yes	Split
Recovery Group, Inc. v. Comm'r, T.C. Memo. 2010-76	6662(b)(2) - Covenant not to compete must be amortized over 15 yrs; TP reasonably relied on accountants	No	TP
Ringgold Telephone Co. v. Comm'r, T.C. Memo. 2010-103	6662(b)(2) - TP reasonably relied on CPA	No	TP
Robertson v. Comm'r, T.C. Memo. 2009-302	6662(b)(1) - TP failed to file brief and abandoned case	Yes	IRS
Rosato v. Comm'r, T.C. Memo. 2010-39	6662(b)(2) - TPs (H&W) had no reasonable cause for position on employment status	No	IRS
Rosser v. Comm'r, T.C. Memo. 2010-6	6662(b)(1) - TP failed to report payment of personal expenses by corporation as constructive dividends and improperly claimed deduction for investment loss; reliance on tax preparer not reasonable	Yes	IRS
Royster v. Comm'r, T.C. Memo. 2010-16	6662(b)(1) & (2) - TP failed to report income and substantiate deductions	Yes	IRS
Rudnick v. Comm'r, T.C. Memo. 2009-133	6662(b)(2) - TP failed to substantiate deductions	Yes	IRS
Shah v. Comm'r, T.C. Summ. Op. 2010-6	6662(b)(1) & (2) - TP reasonably relied on preparer	Yes	TP
Shellito v. Comm'r, T.C. Memo. 2010-41	6662(b)(2) - TPs (H&W) reasonably relied on advice from CPA for deductions	No	TP
Southgate Master Fund, LLC v. U.S., 651 F. Supp. 2d 596 (N.D. Tex. 2009)	6662(b)(1) & (2) - TP had reasonable and good faith reliance on advice from qualified accountants and tax attorneys	No	TP
Symonette v. Comm'r· T.C. Summ. Op. 2009-90	6662(b)(1) - TPs (H&W) failed to substantiate deductions	Yes	IRS
TIFD-III-E Inc. v. U.S., 660 F. Supp. 2d 367 (D. Conn. 2009), *amending* 104 A.F.T.R.2d (RIA) 6746 (D. Conn. 2009)	6662(b)(1) - TP partnership had a business purpose; the partnership's tax position was supported by substantial authority and a reasonable basis	No	TP
Trask v. Comm'r, T.C. Memo. 2010-78	6662(b)(1) - TP failed to substantiate deductions and rental activity not active	Yes	IRS
Tyson v. Comm'r, T.C. Memo. 2009-176	6662(b)(1) & (2) - TP failed to substantiate deductions	No	IRS

Table 3: Accuracy-Related Penalties Under IRC §§ 6662(B)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Vianello v. Comm'r, T.C. Memo. 2010-17	6662(b)(2) - TP farming not for trade or business	No	IRS
Vlock v. Comm'r, T.C. Memo. 2010-3	6662(b)(2) - TP payments to children and to corporation formed as part of alleged tax-avoidance scheme not deductible as business expenses	No	IRS
Weisberg v. Comm'r, T.C. Memo. 2010-55	6662(b)(2) - TP erroneously deducted flow-through loss of S corporation	Yes	IRS
Whitmarsh v. Comm'r, T.C. Memo. 2010-83	6662(b)(2) - TP failed to establish that insurance broker and accountant that gave advice were competent tax professionals	Yes	IRS
Willock v. Comm'r, T.C. Memo. 2010-75	6662(b)(1) - TP failed to substantiate deductions; TP showed reasonable cause and good faith in part	Yes	Split
Ziegeler v. Comm'r, T.C. Summ. Op. 2010-65	6662(b)(1) & (2) - TP failed to report income	Yes	IRS

Table 4 Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Agosto v. Comm'r, T.C. Summ. Op. 2009-191	Deductions denied for business travel and unreimbursed employee expenses not substantiated; deduction allowed for casualty loss of rental property	Yes	Split
Agronin v. Comm'r, T.C. Summ. Op. 2009-189	Deductions denied for unreimbursed employee expenses not substantiated	Yes	IRS
Brown v. Comm'r, T.C. Summ. Op. 2009-89	Deductions denied for travel and meal expenses because TP not away from home	Yes	IRS
Canterbury v. Comm'r, T.C. Summ. Op. 2009-118	Deductions denied for travel expenses because TP not away from home	Yes	IRS
Conway v. Comm'r, T.C. Summ. Op. 2010-27	Deductions denied for unreimbursed travel and work-related expenses not substantiated	Yes	IRS
Coppin v. Comm'r, T.C. Memo. 2009-221	Deductions denied for vehicle and travel expenses not substantiated; deductions denied for clothing, grooming, home office, and meal expenses that were personal	Yes	IRS
De Chacing v. Comm'r, T.C. Summ. Op. 2009-127	Deductions denied for unsubstantiated gift and entertainment expenses, and for personal commuting expenses; deductions allowed for mileage, tools, and work clothes expenses	Yes	Split
Dungca v. Comm'r, T.C. Summ. Op. 2009-144	Deductions denied for meal expenses not substantiated and for gambling losses in excess of winnings; deductions allowed for unreimbursed education and meal expenses	Yes	Split
Durrance v. Comm'r, T.C. Summ. Op. 2010-12	Deductions denied for travel and other incidental expenses because TP not away from home	Yes	IRS
Evans v. Comm'r, T.C. Summ. Op. 2010-7	Deductions denied for unreimbursed employee travel expenses not substantiated	Yes	IRS
Freeman v. Comm'r, T.C. Memo. 2009-213	Deductions denied for personal commuting and unsubstantiated mileage expenses; deductions allowed for substantiated mileage expenses	No	Split
Hager v. Comm'r, T.C. Summ. Op. 2009-101	Deductions denied for vehicle expenses not substantiated	Yes	IRS
Handy v. Comm'r, T.C. Summ. Op. 2009-123	Deductions denied for travel, meal, gift, telephone, and subscription expenses either not substantiated or personal; deductions allowed for agent, office, and postage expenses	No	Split
Hwynn v. Comm'r, T.C. Summ. Op. 2009-88	Deductions denied for unreimbursed employee expenses not substantiated	Yes	IRS
Knight v. Comm'r, T.C. Summ. Op. 2009-106	Deductions denied for travel, vehicle, and job search expenses not substantiated and for other expenses that were personal; deductions allowed for union dues, safety clothing, tool repairs	No	Split
Kyne v. Comm'r, T.C. Summ. Op. 2009-98	Deductions denied for business expenses not substantiated; deductions allowed for substantiated vehicle expenses	Yes	Split
Martin v. Comm'r, T.C. Memo. 2009-234	Deductions denied for unreimbursed employee expenses not substantiated	Yes	IRS
McGowan v. Comm'r, T.C. Memo. 2009-172	Deductions denied for meal expenses not substantiated; deductions allowed for substantiated vehicle expenses	Yes	Split
Menzies v. Comm'r, T.C. Summ. Op. 2009-196	Deductions denied for travel and vehicle expenses not substantiated; deductions allowed for work clothes and other unreimbursed employee expenses under Cohan rule	Yes	Split
Minick v. Comm'r, T.C. Memo. 2010-12	Deductions denied for travel expenses because TP not away from home	Yes	IRS
Orellana v. Comm'r, T.C. Summ. Op. 2010-51	Deductions denied for eBay business expenses not substantiated	Yes	IRS
Ortega v. Comm'r, T.C. Summ. Op. 2009-120	Deduction allowed for education expenses incurred to improve skills and not to qualify for a new trade or business	Yes	IRS
Ramirez v. Comm'r, T.C. Memo. 2010-108	Deductions denied for business expenses not substantiated	Yes	IRS
Rosemann v. Comm'r, T.C. Memo. 2009-185	Deductions denied for vehicle expenses not substantiated and for other expenses that should have been deducted as unreimbursed employee expenses because TP was common law employee and could not deduct business expenses on Schedule C	Yes	IRS
Scott v. Comm'r, T.C. Summ. Op. 2010-47	Deductions denied for personal commuting expenses and for other business expenses not substantiated; deductions allowed for work clothes under Cohan rule, union dues, and meal expenses	Yes	Split
Singleton-Clarke v. Comm'r, T.C. Summ. Op. 2009-182	Deduction allowed for education expenses incurred to improve skills and not to qualify for a new trade or business	Yes	TP

Table 4: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Sloan v. Comm'r, T.C. Summ. Op. 2009-162	Deductions denied for home office expenses because allowable only to extent of offsetting gross income; deductions denied for unreimbursed employee expenses not substantiated	Yes	IRS
Smith v. Comm'r, T.C. Summ. Op. 2009-175	Deductions denied for travel expenses because TP failed to substantiate and establish entitlement to unreimbursed employee travel expenses	Yes	IRS
Tarpo v. Comm'r, T.C. Memo. 2009-222	Deductions denied for all expenses not substantiated or that could not be estimated under Cohan rule except for substantiated licensing fee	Yes	Split
Van Ryswyk v. Comm'r, T.C. Memo. 2009-189	Deductions denied for commission payments because TP failed to show expenses were ordinary and necessary to TP's financial product sale business	No	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedules C, E, F)			
Adler v. Comm'r, T.C. Memo. 2010-47	Deductions denied for greenhouse farming, stamp sale, and vehicle expenses not substantiated	Yes	IRS
Akanno v. Comm'r, T.C. Summ. Op. 2009-168	Dedications denied for vehicle expenses not substantiated	No	IRS
Altria Group, Inc. v. United States, 2009 U.S. Dist. LEXIS 27463 (S.D.N.Y. 2009), *motion for new trial denied by* 2010 U.S. Dist. LEXIS 25160 (S.D.N.Y. 2010)	Deduction denied for interest, depreciation, amortization, and transaction expenses because lease facility transaction was lacking economic substance and failed to transfer tax ownership to TP	No	IRS
Argyle v. Comm'r, T.C. Memo. 2009-218	Deductions denied for travel, meal, and home office expenses not substantiated; deductions denied for legal fees incurred in criminal proceedings arising from personal relationship	Yes	IRS
Armstrong v. Comm'r, T.C. Summ. Op. 2010-3	Deductions denied because business expenses either not substantiated, or not ordinary and necessary, or belonged to TP's corporation	Yes	IRS
Beasley v. Comm'r, T.C. Summ. Op. 2009-93	Deductions denied for charter fishing expenses because no profit objective and therefore not a trade or business	No	IRS
Bennett v. Comm'r, T.C. Memo. 2010-114	Deductions denied for business expenses not substantiated	Yes	IRS
Brown v. Comm'r, T.C. Summ. Op. 2009-171	Deductions allowed for depreciation expenses because computer and music equipment were placed in service	Yes	TP
Bruns v. Comm'r, T.C. Memo. 2009-168	Deductions denied for contract labor and business gift expenses not substantiated; deductions denied for printing expenses because not ordinary and necessary; deductions allowed for depreciation, vehicle, meal, gift, and other business expenses	No	Split
Campbell v. Comm'r, T.C. Summ. Op. 2009-119	Deductions denied for expenses not substantiated or that should have been capitalized; deductions allowed for repair expenses under Cohan rule	Yes	Split
Canterbury Holdings, LLC v. Comm'r, T.C. Memo. 2009-175	Deductions denied for corporate management fees and interest expenses because not ordinary and necessary	No	IRS
Carver v. Comm'r, T.C. Memo. 2009-279	Deductions denied for expenses either personal or not substantiated; deductions allowed for parking and office expenses	Yes	Split
Cavaretta v. Comm'r, T.C. Memo. 2010-4	Deductions allowed for compensatory restitution payment because ordinary and necessary expenses to TP's dental practice	No	TP
Child v. Comm'r, T.C. Memo. 2010-58	Deductions denied for expenses lacking economic substance	No	IRS
Chow v. Comm'r, T.C. Memo. 2010-48	Deductions denied for rental expenses not substantiated; deductions allowed for gambling losses because TP engaged in gambling for profit as professional gambler	Yes	Split
Consolidated Edison Co. of New York v. United States, 90 Fed. Cl. 228 (2009)	Deductions allowed for rental, interest, and other expenses related to leveraged lease transaction that had economic substance	No	TP
Crawford v. Comm'r, T.C. Memo. 2010-54	Deductions denied for promotional activity expenses because TP failed to show expenses were ordinary and necessary, and actually incurred; deductions denied for gambling losses in excess of winnings because TP failed to establish entitlement to deduction in full	Yes	IRS
Curcio v. Comm'r, T.C. Memo. 2010-115	Deductions denied because payments were constructive dividends and not ordinary and necessary business expenses	No	IRS

Table 4: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Damer v. Comm'r, T.C. Summ. Op. 2009-145	Deductions denied for passive activity losses because TP did not materially participate; deductions denied for mortgage interest not paid, and for recording fees and loan expense unrelated to TP's law practice; deductions allowed for amortizable fees and mortgage interest expenses under Cohan rule	Yes	Split
Deneselya v. Comm'r, T.C. Summ. Op. 2009-157	Deductions denied for vehicle expenses not substantiated	Yes	IRS
Derby v. Comm'r, T.C. Memo. 2010-66	Deductions denied for vehicle expenses not substantiated; deductions allowed for substantiated cost of goods sold	Yes	Split
Ding v. Comm'r, T.C. Summ. Op. 2009-186	Deductions denied for start-up consulting expenses because TP failed to establish carrying a trade or business; deductions denied for unreimbursed employee expenses not substantiated; deductions allowed for telephone and equipment expenses under Cohan rule and for unreimbursed employee expenses for home office	Yes	Split
Doherty v. Comm'r, 105 A.F.T.R.2d (RIA) 2181 (8th Cir. 2010), *aff'g* T.C. Memo. 2009-99	Deductions denied for depreciation expenses because TP did not acquire ownership of ATMs and payphones; deductions denied for other business expenses because TP not engaged in a trade or business involving payphones or ATMs	Yes	IRS
Elverson v. Comm'r, T.C. Summ. Op. 2010-36	Deductions denied for expenses because either not substantiated or personal, or TP engaged in accounting and litigation support activity not with profit objective and therefore not a trade or business	Yes	IRS
Engle v. Comm'r, T.C. Summ. Op. 2009-138	Deductions denied for vehicle and depreciation expenses not substantiated	Yes	IRS
Farber v. Comm'r, T.C. Memo. 2010-37	Deductions denied for unreimbursed employee expenses and tax preparation fees not substantiated; deductions allowed for expenses for retail activity not engaged in for profit but limited by income derived from activity	No	Split
Farquhar v. Comm'r, T.C. Summ. Op. 2010-17	Deductions denied for real estate losses and unreimbursed employee expenses because TP failed to establish entitlement	Yes	IRS
Fleming v. Comm'r, T.C. Memo. 2010-60	Deductions denied for business expenses not substantiated; deduction allowed for substantiated advertising expense	Yes	Split
Foriest v. Comm'r, T.C. Summ. Op. 2009-110	Deductions denied for business expenses not substantiated; deductions denied for farming expenses because TP's farming activity neither regular and continuous nor for profit and therefore not a trade or business; deductions allowed for uniform maintenance	Yes	Split
Forrest v. Comm'r, T.C. Memo. 2009-228	Deductions denied because TP's activity as contract attorney not regular and continuous and therefore not a trade or business	Yes	IRS
Foster v. Comm'r, T.C. Memo. 2009-274	Deductions denied for contract labor expenses not substantiated and that could not be estimated under Cohan rule; deductions allowed for wage and rental expenses under Cohan rule	Yes	Split
Fowler v. United States, 104 A.F.T.R.2d (RIA) 6208 (W.D. La. 2009), aff'd on other grounds, 104 A.F.T.R.2d (RIA) 6962 (W.D. La. 2009)	Deductions denied for soybean farming expenses because no profit objective and therefore not a trade or business	No	IRS
Foxworthy, Inc. v. Comm'r, T.C. Memo. 2009-203	Deductions denied for worthless debt because debt either not valid or not worthless; deductions denied for SEC fine and other expenses that were either personal or not substantiated; deduction allowed for wages of sole proprietor TP	No	Split
Fucaloro v. Comm'r, T.C. Summ. Op. 2010-37	Deductions denied for expenses because boxing-related activity not engaged in for profit	Yes	IRS
Gentry v. Comm'r, T.C. Summ. Op. 2010-49	Deductions denied for unsubstantiated expenses for business use of home; deductions allowed for substantiated expenses for business use of vehicle	Yes	Split
Gist v. Comm'r, T.C. Summ. Op. 2009-126	Deductions denied for vehicle expenses not substantiated and for other expenses that were personal	No	IRS
Goolsby v. Comm'r, T.C. Memo. 2010-64	Deductions denied for passive activity losses because TP did not materially participate and therefore not engaged in a trade or business	Yes	IRS
Gordon v. United States, 104 A.F.T.R.2d (RIA) 7740 (S.D.N.Y. 2009)	Deductions denied for legal fees arising from embezzlement scheme charges because not related to carrying on TP's trade or business; deductions allowed for legal fees arising from record falsification charges because incurred for carrying on TP's trade or business as employee of brokerage firm	No	Split

Table 4: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Gralia v. Comm'r, T.C. Memo. 2009-219	Deductions for legal fees and settlement expenses allowed only as miscellaneous itemized deductions because not related to TP's trade or business as real estate developer	No	Split
Hegarty v. Comm'r, T.C. Summ. Op. 2009-153	Deductions allowed for expenses of charter fishing activity conducted through limited liability company because TP materially participated and therefore engaged in a trade or business	Yes	TP
Heller v. Comm'r, T.C. Memo. 2010-116	Deductions denied for mileage expenses not substantiated	Yes	IRS
Helmick v. Comm'r, T.C. Memo. 2009-220	Deductions allowed for horse-breeding and horse-boarding expenses because TP engaged in activity for profit and therefore a trade or business	Yes	TP
HIE Holdings, Inc. v. Comm'r, T.C. Memo. 2009-130	Deductions denied for legal fee expenses that were either not substantiated or personal, or should have been capitalized	No	IRS
Holmes v. Comm'r, T.C. Summ. Op. 2010-42	Deductions denied for vehicle and travel expenses not substantiated	Yes	IRS
Houston v. Comm'r, T.C. Memo. 2009-286	Deductions denied for expenses that were either not substantiated or personal; deductions denied for computer equipment and overdraft fees because expenses not ordinary and necessary; deductions allowed for parking, taxicab, office, and supply expenses under Cohan rule, and for substantiated equipment rental expenses	Yes	Split
Johnson v. Comm'r, T.C. Summ. Op. 2009-124	Deductions denied for legal and professional service fees neither substantiated nor shown to be ordinary and necessary; deductions allowed for mortgage interest expenses	Yes	Split
Jordan v. Comm'r, T.C. Memo. 2009-223	Deductions denied for crushing cost expenses not substantiated and for passive activity losses because TP did not materially participate and therefore not engaged in a trade or business	Yes	IRS
Kurtz v. Comm'r, 575 F.3d 1275 (11th Cir. 2009), *aff'g* T.C. Memo. 2008-111	Deductions denied for meal expenses because TP was crew member on commercial fishing vessel and entitled to no more than 50% of per diem rate	No	IRS
Le v. Comm'r, T.C. Summ. Op. 2009-109	Deductions denied for business expenses not substantiated; deductions allowed for tax return preparation fees under Cohan rule; deductions allowed for unreimbursed union dues, kennel construction, and uniform maintenance expenses	Yes	Split
LeBlanc v. United States, 90 Fed. Cl. 186 (2009)	Deductions denied for losses attributable to abandonment of partnership interest because TP's basis in partnership at time of abandonment was zero	No	IRS
Leone v. Comm'r, T.C. Summ. Op. 2009-174	Deductions denied for drag racing activity expenses because no profit objective and therefore not a trade or business	Yes	IRS
Loveland v. Comm'r, 105 A.F.T.R.2d (RIA) 2182 (8th Cir. 2010), *aff'g* T.C. Memo. 2009-98	Deductions denied for depreciation expenses because TP did not acquire ownership of ATMs and payphones; deductions denied for other business expenses because TP not engaged in a trade or business involving payphones or ATMs	Yes	IRS
Manning v. Comm'r, T.C. Memo. 2009-157	Deductions allowed for commission adjustment payments because expenses were ordinary and necessary to TP's day trading business	No	TP
Montagne v. United States, 90 Fed.Cl. 41(2009)	Deductions denied for horse-training and horse-breeding activity expenses because court lacked jurisdiction over TP's tort, refund, and takings claims against the IRS	Yes	IRS
Morrissey v. Comm'r, T.C. Summ. Op. 2009-135	Deductions denied for legal fees and real estate activity expenses because no profit objective and therefore not a trade or business	Yes	IRS
Munson v. Comm'r, T.C. Summ. Op. 2009-164	Deductions denied for vehicle, home office, and computer expenses not substantiated; deductions allowed for advertising, telephone, internet, and postage expenses under Cohan rule	Yes	Split
Natkunanathan v. Comm'r, T.C. Memo. 2010-15	Deductions denied for business expenses not substantiated; deductions denied for worthless debt because debt arising from fees for TP's services not collected and not included in TP's income	Yes	IRS
Nelson v. Comm'r, T.C. Memo. 2010-96	Deduction for repayment of loan principal denied	No	IRS
Orr v. Comm'r, T.C. Summ. Op. 2010-55	Deductions denied for net gambling losses even though TP was professional gambler; overstatement of both gambling income and losses by identical amounts did not change net gambling loss amount	Yes	IRS

Table 4: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Outerbridge v. Comm'r, T.C. Memo. 2009-173	Deductions denied for rent and office expenses because TP failed to establish carrying on a trade or business	Yes	IRS
Pacheco v. Comm'r, T.C. Summ. Op. 2009-112	Deductions denied for business expenses not substantiated; deductions allowed for advertising and referral fee expenses under Cohan rule	Yes	Split
Pate v. Comm'r, 105 A.F.T.R.2d (RIA) 896 (5th Cir. 2010), *aff'g* T.C. Memo. 2008-272	Deductions denied for cattle-raising activity expenses, except for allowable legal expenses that were remanded, because TP engaged in activity with tax-driven motive and therefore not a bona fide trade or business	Yes	IRS
Phemister v. Comm'r, T.C. Memo. 2009-201	Deductions denied for emergency physician and retail activity business expenses not substantiated; deductions denied for horse activity expenses because no profit objective	Yes	IRS
Prinster v. Comm'r, T.C. Summ. Op. 2009-99	Deductions denied for business expenses not substantiated	Yes	IRS
Purdy v. Comm'r, T.C. Summ. Op. 2010-26	Deductions denied for legal fees on Schedule C because TP was common law employee and could not deduct business expenses	Yes	IRS
Ragassa v. Comm'r, T.C. Summ. Op. 2009-166	Deductions denied for work clothes and unsubstantiated business expenses	Yes	IRS
Robertson v. Comm'r, T.C. Memo. 2009-302	Deductions denied for business expenses because TP failed to file a brief and abandoned case	Yes	IRS
Robinson Knife Mfg. Co., Inc. v. Comm'r, 600 F.3d 121 (2d Cir. 2010), *rev'g* T.C. Memo. 2009-9	Deductions allowed for trademark licensee's payment of royalties because TP's sales-based royalty payments not properly allocable to property produced, and therefore capitalization not required	No	TP
Rosser v. Comm'r, T.C. Memo. 2010-6	Deductions denied for investment loss, personal credit card charges, insurance, medical, and other expenses because TP failed to establish entitlement to expenses that belonged to TP's corporation	Yes	Split
Royster v. Comm'r, T.C. Memo. 2010-16	Deductions denied for mileage expenses not substantiated	Yes	IRS
Rudnick v. Comm'r, T.C. Memo. 2009-133	Deductions denied for legal fees, and for unreimbursed employee and other business expenses not substantiated; deductions denied for nondeductible start-up expenses	Yes	IRS
Senulis v. Comm'r, T.C. Summ. Op. 2009-97	Deductions denied for business expenses not substantiated; deductions denied for travel expenses because TP not away from home; deductions allowed for substantiated internet expenses, and for vehicle and meal expenses estimated based TP's credible testimony	Yes	Split
Shah v. Comm'r, T.C. Summ. Op. 2010-6	Deduction allowed for education expenses incurred to improve skills and not to qualify for a new trade or business; deductions denied for office expenses not substantiated and for travel expenses because TP not away from home	Yes	IRS
Shellito v. Comm'r, T.C. Memo. 2010-41	Deductions denied for Schedule F employee healthcare benefit expenses because TP received no compensation and purported employment agreement was merely formalistic	No	IRS
Snyder v. Comm'r, 105 A.F.T.R.2d (RIA) 2180 (8th Cir. 2010), *aff'g* T.C. Memo. 2009-97	Deductions denied for depreciation expenses because TP did not acquire ownership of ATMs and payphones; deductions denied for other business expenses because TP not engaged in a trade or business involving payphones or ATMs	Yes	IRS
Stahl v. United States, 673 F. Supp. 2d 1233 (E.D. Wash. 2009)	Corporation's deductions denied for medical care and meals provided to non-employee TP; TP's deductions denied for meal expenses when TP was not an employee	No	IRS
Symonette v. Comm'r, T.C. Summ. Op. 2009-90	Deductions denied for vehicle and depreciation expenses not substantiated	Yes	IRS
Thompson v. Comm'r, T.C. Summ. Op. 2009-111	Deductions denied for travel expenses because TP not away from home	Yes	IRS
Tilman v. United States, 644 F. Supp. 2d 391 (S.D.N.Y. 2009)	Deductions denied for expenses that were personal	Yes	IRS
Trask v. Comm'r, T.C. Memo. 2010-78	Deduction denied for amortization and repair expenses not substantiated; deductions allowed for property tax expenses because ordinary and necessary to TP's rental real estate business	Yes	IRS
Tyson v. Comm'r, T.C. Memo. 2009-176	Deductions denied because expenses were related to rental transaction lacking economic substance; deductions denied for business expenses not substantiated; deductions denied for employee benefit plan expenses because no employment agreement; deduction allowed for substantiated meal expenses	No	Split

Table 4: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Vianello v. Comm'r, T.C. Memo. 2010-17	Deductions denied for worthless debt because debt not worthless; deductions denied for other business expenses because either TP not engaged in a trade or business of farming, loan acquisition, and debt collection, or expenses should have been capitalized	No	IRS
Vlock v. Comm'r, T.C. Memo. 2010-3	Deductions denied because expenses either not ordinary and necessary to TP's insurance business or for purported compensation expenses that TP failed to establish were for services actually rendered	No	IRS
V.R. De Angelis M.D., P.C. v. Comm'r, 574 F.3d 789 (2d Cir. 2009), *aff'g* T.C. Memo. 2007-360, *cert. denied*, 130 S. Ct. 1904 (2010)	Deductions denied because payments were personal distributions to partners	No	IRS
Wellpoint, Inc. v. Comm'r, 599 F.3d 641 (7th Cir. 2010), *aff'g* T.C. Memo. 2008-236	Deductions denied for legal fees that should have been capitalized and for settlement expenses that were partial restoration of acquired assets to the assets' rightful owners	No	IRS
Wheeler v. Comm'r, T.C. Summ. Op. 2009-151	Deductions denied for mileage expenses not substantiated	No	IRS
Willock v. Comm'r, T.C. Memo. 2010-75	Deductions denied for unsubstantiated consulting fees, depreciation expenses, and losses from marketing activity; deductions denied for expenses either personal or not substantiated; deductions allowed for farming activity engaged in for profit	Yes	Split
Wolfgram v. Comm'r, T.C. Memo. 2010-69	Deductions denied for business expenses not substantiated and for bed-and-breakfast activity because no profit objective and therefore not a trade or business; deductions denied for personal commuting and for expenses that should have been capitalized	Yes	IRS
Young v. Comm'r, T.C. Summ. Op. 2009-173	Deductions denied for unreimbursed employee expenses because either not substantiated or TP failed to establish carrying out a trade or business	Yes	IRS

Appendix Three

Table 5 Gross Income Under IRC § 61 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Akanno v. Comm'r, T.C. Summ. Op. 2009-168	Unreported interest and rental income	No	IRS
Balice v. Comm'r, T.C. Memo. 2009-196	Underreported insurance commission income attributed to sham trust	Yes	IRS
Barr v. Comm'r, T.C. Memo. 2009-250	Unreported income from surrender of life insurance policy under IRC 72(e)	Yes	IRS
Barrett v. Comm'r, 105 A.F.T.R.2d (RIA) 1278 (11th Cir. 2010), *aff'g* 104 A.F.T.R.2d 6365 (M.D. Fla. 2009)	Taxpayer challenged inclusion of wages in gross income	Yes	IRS
Beard v. Comm'r, T.C. Memo. 2009-184 *appeal filed* No. 09-3741 (7th Cir. Nov. 9, 2009)	Overstatement of basis as omission from gross income	No	TP
Bigley v. Comm'r, T.C. Memo. 2010-29	Unreported income under IRC 74(a)	Yes	IRS
Campbell v. Comm'r, 134 T.C. No. 3 (2010)	Unreported *qui tam* settlement income	No	IRS
Caro v. Comm'r, T.C. Summ. Op. 2009-184	Unreported gambling income	No	TP
Child v. Comm'r, T.C. Memo. 2010-58	Unreported income	No	IRS
Colegrove v. Comm'r, T.C. Summ. Op. 2010-44	Unreported retirement plan distribution	Yes	IRS
Conway v. Comm'r, T.C. Summ. Op. 2010-27	Unreported rental income	Yes	IRS
Davenport v. Comm'r, T.C. Memo. 2009-248	Unreported wage income	Yes	IRS
Domeny v. Comm'r, T.C. Memo. 2010-9	Settlement proceeds under IRC 104(a)(2)	No	TP
Doyle v. Comm'r, T.C. Summ. Op. 2009-187	Unreported interest income	Yes	IRS
Duma v. Comm'r, T.C. Memo. 2009-304	Unreported income	Yes	IRS
Espinoza v. Comm'r, T.C. Memo. 2010-53	Settlement proceeds under IRC 104(a)(2)	Yes	IRS
Evans v. Comm'r, T.C. Memo. 2010-62	Unreported ordinary and interest income	Yes	IRS
Felt v. Comm'r, T.C. Memo. 2009-245	Unreported capital gains, discharge of indebtedness, and other income	No	Split
Florance v. Comm'r, T.C. Memo. 2009-154	Unreported nonemployee compensation	Yes	IRS
Florance v. Comm'r, T.C. Memo. 2009-155	Unreported nonemployee compensation	Yes	IRS
Foxworthy, Inc. v. Comm'r, T.C. Memo. 2009-203	Unreported income from "offshore employee leasing" transactions, interest, investment, capital gains, and other income	No	IRS
Fuller v. Comm'r, T.C. Summ. Op. 2009-91	Unreported discharge of indebtedness income	No	IRS
Gochis v. Comm'r, T.C. Summ. Op. 2009-156	Unreported partnership income and retirement plan distribution	Yes	Split
Green v. Comm'r, T.C. Memo. 2010-109	Unreported pension income; capital losses	Yes	IRS
Guyton, United States v., 105 A.F.T.R.2d (RIA) 1617 (11th Cir. 2010), *aff'g* 103 A.F.T.R.2d 2112 (M.D. Fla. 2009)	Gains realized before death are income to decedent's estate	Yes	IRS
Hakim v. Comm'r, T.C. Summ. Op. 2009-92	Unreported discharge of indebtedness income	Yes	IRS
Hamilton v. Comm'r, T.C. Memo. 2009-271	Unreported pension, capital gain, wage, and other income	Yes	IRS
Hellesen v. Comm'r, T.C. Memo. 2009-143	Settlement proceeds under IRC 104(a)(2)	Yes	IRS
Hennessey v. Comm'r, T.C. Memo. 2009-132	Settlement proceeds under IRC 104(a)(2)	Yes	IRS
Hill v. Comm'r, T.C. Summ. Op. 2010-34	Unreported Social Security income	Yes	IRS
Hodges v. Comm'r, T.C. Memo. 2009-179	Unreported income	Yes	IRS
Holmes v. Comm'r, T.C. Summ. Op. 2010-42	Parsonage housing allowance under IRC 107	Yes	TP
Holmes v. Comm'r, T.C. Memo. 2010-42	Unreported income	Yes	IRS
Jensen v. Comm'r, T.C. Memo. 2010-77	Unreported discharge of indebtedness income	Yes	IRS
Johnson v. Comm'r, T.C. Memo. 2009-156	Settlement proceeds under IRC 104(a)(2)	Yes	IRS
Jones v. Comm'r, T.C. Memo. 2010-112	Unreported pass-through entity income	No	IRS

Table 5: Gross Income Under IRC § 61 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Jordan v. Comm'r, T.C. Memo. 2009-223	Unreported income	Yes	Split
Kelley v. Comm'r, T.C. Summ. Op. 2010-19	Unreported Social Security benefits	Yes	IRS
Langille v. Comm'r, T.C. Memo. 2010-49	Unreported Schedule C, rental, and interest income	Yes	IRS
LaPlante v. Comm'r, T.C. Memo. 2009-226	Underreported gambling income	No	IRS
Lawson v. Comm'r, T.C. Memo. 2009-147	Unreported compensation, unemployment benefits, Alaska Permanent Fund Dividends, and business income	Yes	IRS
Linkugel v. Comm'r, T.C. Summ. Op. 2009-180	Unreported discharge of indebtedness income	No	TP
Lizalek v. Comm'r, T.C. Memo. 2009-122	Unreported income; assignment of income	Yes	IRS
Longoria v. Comm'r, T.C. Memo. 2009-162	Settlement proceeds under IRC 104(a)(2)	No	IRS
Manning v. Comm'r, T.C. Memo. 2009-157, *motion for litigation costs denied* T.C. Memo. 2009-277	Unreported income	No	TP
Martin v. Comm'r, T.C. Summ. Op. 2009-121	Unreported discharge of indebtedness income	Yes	TP
Matthies v. Comm'r, 134 T.C. No. 6 (2010)	Unreported income from bargain sale of insurance policy	No	IRS
McGowan v. Comm'r, T.C. Memo. 2009-172	Unreported income	Yes	IRS
McGowen v. Comm'r, T.C. Memo. 2009-285	Income received from termination of life insurance contract under IRC 72(e)	No	IRS
McMormick v. Comm'r, T.C. Memo. 2009-239	Unreported discharge of indebtedness income	Yes	Split
Melvin v. Comm'r, T.C. Memo. 2009-199	Unreported discharge of indebtedness income	No	IRS
Morgan v. Comm'r, T.C. Summ. Op. 2010-29	Unreported nonemployee compensation	Yes	IRS
Morse v. Comm'r, T.C. Memo. 2010-40	Unreported wage income	Yes	IRS
Musshafen v. Comm'r, T.C. Summ. Op. 2009-115	Unreported income not excludable as foreign earned income under IRC 911(a)	Yes	IRS
Natkunanathan v. Comm'r, T.C. Memo. 2010-15	Unreported income from qualified business stock exclusion under IRC 1202	Yes	IRS
Nelson v. U.S., 105 A.F.T.R.2d (RIA) 627 (N.D. Fla. 2009), *adopted by* 105 A.F.T.R.2d (RIA) 635 (N.D. Fla. 2010)	Refund suit for wage income	Yes	IRS
Nino v. Comm'r, T.C. Memo. 2009-293	Unreported wage income	Yes	IRS
O'Neill v. Comm'r, T.C. Summ. Op. 2009-131	Unreported pension income	Yes	IRS
Orellana v. Comm'r, T.C. Summ. Op. 2010-51	Unreported income	Yes	IRS
Orr v. Comm'r, T.C. Summ. Op. 2010-55	Unreported retirement benefits income	Yes	IRS
Payne v. Comm'r, 357 Fed. Appx. 734 (8th Cir. 2009), *aff'g* T.C. Memo. 2008-66	Unreported discharge of indebtedness income	Yes	IRS
Phemister v. Comm'r, T.C. Memo. 2009-201	Unreported income	Yes	IRS
Prinster v. Comm'r, T.C. Summ. Op. 2009-99	Settlement proceeds under IRC 104(a)(2)	Yes	IRS
Pugh v. Comm'r, T.C. Memo. 2009-138	Unreported income	Yes	IRS
Richmond v. Comm'r, T.C. Memo. 2009-207	Unreported Social Security benefits and interest income	Yes	IRS
Rivera v. Comm'r, T.C. Memo. 2009-215	Unreported wage income	Yes	IRS
Rosser v. Comm'r, T.C. Memo. 2010-6	Constructive dividends under IRC 61(a)(7), IRC 301	Yes	Split
Royster v. Comm'r, T.C. Memo. 2010-16	Unreported capital gains, state income tax refund, interest, and retirement income	Yes	IRS
Samples v. Comm'r, T.C. Memo. 2009-167	Unreported wage income	Yes	IRS
Save v. Comm'r, T.C. Memo. 2009-209	Settlement proceeds under IRC 104(a)(2)	Yes	IRS
Scott v. Comm'r, 352 Fed. Appx. 468 (2d Cir. 2009)	Unreported wage income	Yes	IRS
Shollenberger v. Comm'r, T.C. Memo. 2009-306	Unreported gambling income	Yes	IRS
Simmons v. Comm'r, T.C. Memo. 2009-283	Unreported income	Yes	IRS
Sirin v. Comm'r, T.C. Summ. Op. 2010-57	Overreported income	No	TP

Appendix Three

Table 5: Gross Income Under IRC § 61 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Slater v. Comm'r, T.C. Summ. Op. 2010-1	Deferred compensation under IRC 409A	Yes	IRS
Soltan v. Comm'r, T.C. Memo. 2010-91	Unreported wage income	Yes	IRS
Stadnyk v. Comm'r, 105 A.F.T.R.2d 1130 (6th Cir. 2010), *aff'g* T.C. Memo. 2008-289	Settlement proceeds under IRC 104(a)(2)	No	IRS
Strand v. Comm'r, T.C. Summ. Op. 2009-103	Unreported military retirement pension income; gain not realized on divorce division of community property prior to effective date of IRC 1041	No	IRS
Taylor v. Comm'r, T.C. Memo. 2009-235	Unreported wage and settlement income under IRC 104(a)(2)	Yes	IRS
Ulloa v. Comm'r, T.C. Memo. 2010-68	Unreported income	Yes	IRS
Van Ryswyk v. Comm'r, T.C. Memo. 2009-189	Unreported nonemployee compensation	No	IRS
Waamiq-Ali v. Comm'r, T.C. Memo. 2010-86	Unreported income	Yes	IRS
Wells v. Comm'r, T.C. Memo. 2010-5	Settlement proceeds under 104(a)(2)	Yes	IRS
Willock v. Comm'r, T.C. Memo. 2010-75	Unreported loan repayment income	Yes	TP
Wong v. Comm'r, T.C. Summ. Op. 2009-152	Unreported income	Yes	IRS
Seaver v. Comm'r, T.C. Memo. 2009-270	Unreported Social Security Disability income under IRC 86(a); unreported discharge of indebtedness income	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedules C, E, F)			
Bakersfield Energy Partners, LP v. Comm'r, 568 F.3d 767 (9th Cir. 2009), *aff'g* 128 T.C. No. 17 (2007)	Overstatement of basis as omission from gross income	No	TP
Cole v. Comm'r, T.C. Memo. 2010-31	Unreported income	No	IRS
Coleman, In re, 417 B.R. 712 (S.D. Miss. 2009)	Separate taxation of C corporation and shareholders, unreported dividend income	No	IRS
Derby v. Comm'r, T.C. Memo. 2010-66	Unreported business income	Yes	Split
Enayat v. Comm'r, T.C. Memo. 2009-257	Unreported constructive dividend, officer's compensation, and business income	No	IRS
Foriest v. Comm'r, T.C. Summ. Op. 2009-110	Unreported Schedule C income	Yes	IRS
Freda v. Comm'r, T.C. Memo. 2009-191	Unreported ordinary income from trademark misappropriation settlement	No	IRS
Intermountain Ins. Serv. of Vail, LLC v. Comm'r, 134 T.C. No. 11 (2010), *supplementing T.C. Memo. 2009-195*	Overstatement of basis as omission from gross income	No	TP
Koziej v. Comm'r, T.C. Summ. Op. 2010-40	Unreported business income	Yes	IRS
Koziej v. Comm'r, T.C. Summ. Op. 2010-41	Unreported business income	Yes	IRS
Lenard v. Comm'r, T.C. Summ. Op. 2009-165	Unreported business and self-employment income	Yes	IRS
Leone v. Comm'r, T.C. Summ. Op. 2009-174	Unreported capital gain income	Yes	IRS
Robertson v. Comm'r, T.C. Memo. 2009-302	Unreported business income	Yes	IRS
Tarpo v. Comm'r, T.C. Memo. 2009-222	Unreported income; improperly reported capital gains	Yes	IRS
UTAM, LTD. V. Comm'r, T.C. Memo. 2009-253	Overstatement of basis as omission from gross income	No	TP
Wilmington Partners, L.P. v. Comm'r, T.C. Memo 2009-193	Overstatement of basis as omission from gross income	No	TP
Wright v. Comm'r, T.C. Summ. Op. 2010-50	Unreported business income	Yes	IRS

Table 6

Failure to File Penalty Under IRC § 6651(A)(1) and Estimated Tax Penalty Under IRC § 6654

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers			
Adler v. Comm'r, T.C. Memo. 2010-47	6651(a)(1); 6654; No evidence or reasonable cause or exception presented	Yes	IRS
Carver v. Comm'r, T.C. Memo. 2009-279	6651(a)(1); No evidence of reasonable cause presented	Yes	IRS
Charania, Estate of v. Comm'r, 133 T.C. No. 7 (2009), *aff"d in part, rev'd in part*, 2010 WL 2404423 (1st Cir. June 17, 2010)	6651(a)(1); Legal complexities arising from other matters is not reasonable cause	No	IRS
Cunningham v. Comm'r, T.C. Memo. 2009-194	6651(a)(1); Reliance on tax preparer with established qualifications is not evidence of reasonable cause	Yes	IRS
Davenport v. Comm'r, T.C. Memo. 2009-248	6651(a)(1); 6654; No evidence of reasonable cause presented; IRS failed to meet burden of production with respect to 6654 penalty	Yes	Split
Davidson v. Comm'r, T.C. Memo. 2010-38	6651(a)(1); No evidence of reasonable cause presented	Yes	IRS
Duma v. Comm'r, T.C. Memo. 2009-304	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Elis v. Comm'r, 346 Fed.Appx. 346 (10th Cir. 2009), *aff"g in part, rev'g in part* T.C. Memo. 2007-207	6651(a)(1); 6654; No evidence of reasonable cause presented; 6654 penalties remanded for recalculation	No	Split
Evans v. Comm'r, T.C. Memo. 2010-62	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Felt v. Comm'r, T.C. Memo. 2009-245	6651(a)(1); TP failed to show wife lacked access to information to file her own return; No evidence of reasonable cause presented	No	IRS
Florance v. Comm'r, T.C. Memo. 2009-154	6651(a)(1); No evidence of reasonable cause presented	Yes	IRS
Florance v. Comm'r, T.C. Memo. 2009-155	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Fuertes, Estate of v. U.S., 104 A.F.T.R.2d (RIA) 6527 (N.D. Tex. 2009)	6651(a)(1); Reliance on attorney was a delegation of duty, not reliance on legal advice; No evidence of reasonable cause presented	No	IRS
Hamilton v. Comm'r, T.C. Memo. 2009-271	6651(a)(1); 6654; No evidence of reasonable cause presented; IRS failed to meet burden of production with respect to 6654 penalty	Yes	Split
Harris v. Comm'r, T.C. Summ. Op. 2010-63	6651(a)(1); No evidence of reasonable cause presented	Yes	IRS
Hellesen v. Comm'r, T.C. Memo. 2009-143	6651(a)(1); No evidence of reasonable cause presented	Yes	IRS
Hodges v. Comm'r, T.C. Memo. 2009-179	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Holmes v. Comm'r, T.C. Memo. 2010-42	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Humes v. Comm'r, T.C. Summ. Op. 2009-100	6651(a)(1); 6654; No evidence of reasonable cause presented for 2004; Illness is evidence of reasonable cause for 2003; IRS failed to meet burden of production with respect to 6654 penalty for 2003; TP met an exception to 6654 for 2004	Yes	Split
Kalinoski v. Comm'r, T.C. Summ. Op. 2010-30	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Kelso v. Comm'r, T.C. Memo. 2009-125	6651(a)(1); No evidence of reasonable cause presented	No	IRS
Kindred v. Comm'r, T.C. Memo. 2010-107	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	No	IRS
Kirshenbaum v. Comm'r, T.C. Summ. Op. 2009-179	6651(a)(1); No evidence of reasonable cause presented	Yes	IRS
Lizalek v. Comm'r, T.C. Memo. 2009-122	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Lukovsky v. Comm'r, T.C. Memo 2010-117	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	No	IRS
McGowan v. Comm'r, T.C. Memo. 2009-172	6651(a)(1); 6654; Nonfiler; No evidence of reasonable cause or exception presented	Yes	IRS
McKenna v. Comm'r, T.C. Summ. Op. 2010-58	6651(a)(1); 6654; Nonfiler; No evidence of reasonable cause or exception presented	No	IRS
Mora v. Comm'r, T.C. Summ. Op. 2010-60	6651(a)(1); No evidence of reasonable cause presented	Yes	IRS
Mourad v. Comm'r, T.C. Memo. 2009-217	6651(a)(1); No evidence of reasonable cause presented	Yes	IRS
Natkunanathan v. Comm'r, T.C. Memo. 2010-15	6651(a)(1) No evidence of reasonable cause presented	Yes	IRS
Nino v. Comm'r, T.C. Memo. 2009-293	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS

Table 6: Failure to File Penalty Under IRC § 6651(A)(1) and Estimated Tax Penalty Under IRC § 6654

Case Citation	Issue(s)	*Pro Se*	Decision
Patmon v. Comm'r, T.C. Memo. 2009-299	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Proske, Estate of v. Comm'r, 105 A.F.T.R.2d (RIA) 2613 (D.N.J. 2010)	6651(a)(1); IRS abused discretion in denial of extension to file return; Return treated as timely filed	No	TP
Rivera v. Comm'r, T.C. Memo. 2009-215	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Samples v. Comm'r, T.C. Memo. 2009-167	6651(a)(1); No evidence of reasonable cause presented	Yes	IRS
Selph v. Comm'r, T.C. Summ. Op. 2010-20	6651(a)(1); Illness as reasonable cause for 2000 and 2001; No evidence of reasonable cause presented for 1999	Yes	Split
Senulis v. Comm'r, T.C. Summ. Op. 2009-97	6651(a)(1); 6654; No evidence of reasonable cause; IRS failed to meet burden of production with respect to 6654 penalty	Yes	Split
Simmons v. Comm'r, T.C. Memo. 2009-283	6651(a)(1); 6654; Issue not address because fraud; No evidence of exception presented	Yes	IRS
Soltan v. Comm'r, T.C. Memo. 2010-91	6651(a)(1); 6654; Nonfiler; No evidence of reasonable cause; IRS failed to meet burden of production with respect to 6654 penalty	Yes	Split
Springer v. Comm'r, 580 F.3d 1142 (10th Cir 2009), *aff'g* 231 Fed. Appx. 793 (10th Cir. 2007), *petition for cert. denied* 130 S. Ct. 1907 (2010)	6651(a)(1); 6654; TP challenged the assessment of the tax and penalty due to IRS's alleged violation of the Paperwork Reduction Act	No	IRS
Stoddard v. U.S., 664 F. Supp. 2d 774 (E.D. Mich. 2009)	6654: Reasonable cause not an exception to 6654; No evidence of exception presented	No	IRS
Storaasli v. Comm'r, T.C. Memo. 2010-99	6654; Nonfiler; No evidence of exception presented	Yes	IRS
Taylor v. Comm'r, T.C. Memo. 2009-235	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Thomas v. Comm'r, T.C. Summ. Op. 2009-146	6651(a)(1); Reliance on CPA having filed second extension not reasonable cause	Yes	IRS
Trask v. Comm'r, T.C. Memo. 2010-78	6651(a)(1); Nonfiler; No evidence of reasonable cause presented	Yes	IRS
Twaragowski v. Comm'r, T.C. Summ. Op. 2009-192	6651(a)(1); No evidence of reasonable cause presented	Yes	IRS
U.S. v. Morehouse, 103 A.F.T.R.2d (RIA) 2668 (W.D. Wash. 2009), *summary judgment granted by* 104 A.F.T.R.2d (RIA) 5001 (D. Or. 2009)	6651(a)(1); 6654; Nonfiler; No evidence of reasonable cause or exception presented	No	IRS
Ulloa v. Comm'r, T.C. Memo. 2010-68	6651(a)(1); 6654; Nonfiler; Summary Judgment; Taxpayer reported all zeros on return; No evidence of reasonable cause presented; Denied as to 6654 because issue of material fact existed for 2003; No evidence of exception presented for 2004-2006.	Yes	Split
Van Ryswyk v. Comm'r, T.C. Memo. 2009-189	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	No	IRS
Waarmiq-Ali v. Comm'r, T.C. Memo. 2010-86	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Walzer v. Comm'r, T.C. Memo. 2009-200	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Warren v. Comm'r, T.C. Memo. 2009-148	6651(a)(1); TP liability not discharged in Bankruptcy; No evidence of reasonable cause presented	Yes	IRS
Wolfgram v. Comm'r, T.C. Memo. 2010-69	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedules C, E, F)			
American Friends of Yeshivat Ohr Yerushalayim, Inc. v. U.S., 104 A.F.T.R.2d (RIA) 5747(E.D.N.Y. 2009)	6651(a)(1); No evidence of reasonable cause presented	No	IRS
Benton Workshop, Inc. v. U.S., 104 A.F.T.R. 2d (RIA) 6034 (E.D. Ark. 2009)	6651(a)(1); Corp. president illness not reasonable cause	No	IRS
Chow v. Comm'r, T.C. Memo. 2010-48	6651(a)(1); TPs (H&W) claimed they filed a return (questionable copy of return not admitted); No evidence of reasonable cause presented	Yes	IRS
Eleverson v. Comm'r, T.C. Summ. Op. 2010-36	6651(a)(1); No evidence of reasonable cause presented	Yes	IRS
Enayat c. Comm'r, T.C. Memo. 2009-257	6651(a)(1); No evidence of reasonable cause presented	No	IRS
Foxworthy, Inc. v. Comm'r, T.C. Memo. 2009-203	6651(a)(1); No evidence of reasonable cause presented	No	IRS
Grunsted v. Comm'r, T.C Summ. Op. 2009-159	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS

Table 6: Failure to File Penalty Under IRC § 6651(A)(1) and Estimated Tax Penalty Under IRC § 6654

Case Citation	Issue(s)	*Pro Se*	Decision
Hager v. Comm'r, T.C. Summ. Op. 2009-101	6651(a)(1); 6654; No evidence of reasonable cause presented; IRS failed to meet burden of production with respect to 6654 penalty	Yes	Split
Heller v. Comm'r, T.C. Memo. 2010-116	6651(a)(1); No evidence of reasonable cause presented	Yes	IRS
HIE Holdings, Inc. v. Comm'r, T.C. Memo. 2009-130	6651(a)(1); No evidence of reasonable cause presented	No	IRS
Houston v. Comm'r, T.C. Memo. 2009-286	6651(a)(1); 6654; No evidence of reasonable cause or exception presented	Yes	IRS
Lawson v. Comm'r, T.C. Memo. 2009-147	6651(a)(1); Nonfiler; No evidence of reasonable cause presented	Yes	IRS
McNair Eye Center, Inc. v. Comm'r, T.C. Memo. 2010-81	6651(a)(1); Reliance on CPA as reasonable cause	No	IRS
Nicholas Acoustics & Specialty Co. v. U.S., 2010 WL 2505472 (S.D. Miss. 2010)	6651(a)(1); No evidence of reasonable cause presented	No	IRS
N.Y. Guangdong Finance, Inc. v. Comm'r, 588 F.3d 889 (5th Cir. 2009), *aff'g* T.C. Memo. 2008-62	6651(a)(1); Companies that may be exempt from tax by treaty still required to file return; No evidence of reasonable cause presented	No	IRS
Phemister v. Comm'r, T.C. Memo. 2009-201	6651(a)(1); Nonfiler; No evidence of reasonable cause presented	Yes	IRS
Weisberg v. Comm'r, T.C. Memo. 2010-55	6651(a)(1); No evidence of reasonable cause presented	Yes	IRS
Windheim v. Comm'r, T.C. Memo. 2009-136	6651(a)(1); 6654; IRS failed to shown TP was beneficial owner of partnership interest	Yes	TP

Appendix Three

Table 7

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

Case Citation	Issues	*Pro Se*	Decision	Amount
Individual Taxpayers (But Not Sole Proprietorships)				
Battle v. Comm'r, T.C. Memo. 2009-171	Taxpayer petitioned for review of IRS decision to proceed with collection activity. Taxpayer failed to raise any issues relating to underlying liability and asserted frivolous arguments.	Yes	IRS	$20,000
Bigley v. Comm'r, T.C. Memo. 2010-29	Taxpayer petitioned for redetermination of deficiency and additions to income tax and argued that he was not a taxpayer because he had no earnings from federally privileged activities.	Yes	IRS	$5,000
Burke v. Comm'r, T.C. Memo. 2009-282	Taxpayer petitioned for a redetermination of the decision to levy his account to collect a failure to pay penalty and argued that because he appealed the court's decision he did not have to pay the tax due in the interim and should not be assessed a penalty for failing to pay.	Yes	TP	
Constantine v. Comm'r, T.C. Summ. Op. 2010-24	Taxpayer petitioned for review of IRS decision to proceed with collection activity and argued the IRS cannot collect income taxes because the Pocket Commission granted to the IRS denies that authority. Taxpayer eventually filed returns and agreed that he was liable for federal income tax.	Yes	TP	
Cyman v. Comm'r, T.C. Memo. 2009-144	Taxpayer petitioned for review of IRS decision to sustain a federal tax lien and asserted frivolous arguments. Taxpayer eventually ceased raising frivolous arguments.	Yes	TP	
Davenport v. Comm'r, T.C. Memo. 2009-248	Taxpayer petitioned for redetermination of deficiency and additions to income tax and argued that the compensation he received was not wages and therefore not taxable.	Yes	IRS	$25,000
Enax v. Comm'r, T.C. Memo. 2009-163	Taxpayer petitioned for review of IRS decision to uphold a federal tax lien and asserted frivolous arguments.	Yes	IRS	$5,000
Florance v. Comm'r, T.C. Memo. 2009-155	Taxpayer petitioned for redetermination of deficiency and additions to income tax and accused the Court of criminal activity, objected to Special Trial Judges, objected to the introduction of IRS records as evidence, argued the IRS had no jurisdiction in the Court, and asserted he was not a taxpayer.	Yes	IRS	$17,500
Florance v. Comm'r, T.C. Memo. 2009-154	Taxpayer petitioned for redetermination of deficiency and additions to income tax and accused the Court of criminal activity, objected to Special Trial Judges, objected to the introduction of IRS records as evidence, argued the IRS had no jurisdiction in the Court, and asserted he was not a taxpayer.	Yes	IRS	$15,000
Hamilton v. Comm'r, T.C. Memo. 2009-271	Taxpayer petitioned for redetermination of deficiency and additions to income tax and argued that only Federal employees are subject to income tax.	Yes	IRS	$2,000
Hines v. U.S., 658 F. Supp. 2d 139 (D.C. Cir. 2009), *appeal dismissed for mootness*, 2009 U.S. App. LEXIS 25213 (D.C. Cir. Nov. 9, 2009)	Taxpayer filed a complaint against the U.S. asserting that levies attached to his Social Security benefits and other assets were unlawful and argued the IRS did not follow proper processes when attaching the levies and that he was not a taxpayer.	No	TP	
Hodges v. Comm'r, T.C. Memo. 2009-179	Taxpayer petitioned for redetermination of deficiency and additions to income tax and asserted none of the compensation he earned was taxable income.	Yes	IRS	$15,000
Holmes v. Comm'r, T.C. Memo. 2010-50	Taxpayer petitioned for review of a proposed levy action and asserted frivolous arguments.	Yes	IRS	$10,000
Holmes v. Comm'r, T.C. Memo. 2010-42	Taxpayer petitioned for redetermination of deficiency and additions to income tax and argued that paying income tax is voluntary, income tax based on Form 1040 is an illegal kickback, only international or foreign commerce activity is taxable, he is domiciled in the compact state of Texas, he is not a U.S. person, domestic partnership, domestic corporation, estate, or trust, employees are only those who are public servants, income tax is prohibited by the 13th Amendment, Secretary of the Treasury as used in the Internal Revenue Code applies only to the Secretary of the Treasury of Puerto Rico, the capitalization of his name in court documents creates the impression that he is a fictional legal entity not entitled to constitutional rights, and his wages are not includable in gross income.	Yes	IRS	$10,000
Kay v. Comm'r, T.C. Memo. 2010-59	Taxpayer petitioned for review of IRS decision to sustain a federal tax lien and the assessment of a frivolous return penalty and asserted frivolous arguments.	Yes	IRS	$500

Table 7: Frivolous Issues Penalty and Related Appellate-Level Sanctions Under IRC § 6673

Case Citation	Issues	*Pro Se*	Decision	Amount
Knittel v. Comm'r, T.C. Memo. 2009-149	Taxpayer petitioned for redetermination of deficiency and additions to income tax and argued that his income is not taxable, he had no obligation to file a return, and he is not a United States person.	Yes	IRS	$7,500
Lindberg v. Comm'r, T.C. Memo. 2010-67	Taxpayer petitioned for review of IRS decision to collect via levy and the imposition of a frivolous return penalty and asserted frivolous arguments.	Yes	IRS	$1,000
Lizalek v. Comm'r, T.C. Memo. 2009-122	Taxpayers (H&W) petitioned for redetermination of deficiency and additions to tax and made arguments relating to Office of Management and Budget control numbers on tax forms and the Paperwork Reduction Act.	Yes	TP	
Nino v. Comm'r, T.C. Memo. 2009-293	Taxpayer petitioned for redetermination of deficiency and additions to income tax and asserted frivolous arguments.	Yes	IRS	$2,000
Powell v. Comm'r, T.C. Memo. 2009-174	Taxpayer petitioned for review of IRS decision to collect via levy and asserted that compensation for services is not taxable and other frivolous arguments. Taxpayer's motion to withdraw counsel was granted.	Yes	IRS	TP: $25,000 TP's Counsel: $4,725
Powers v. Comm'r, T.C. Memo. 2009-229	Taxpayer petitioned for review of IRS decision to collect tax deficiency and argued he is a non-taxpayer, that his Constitutional rights were violated, and that his CDP hearing was conducted incorrectly.	Yes	TP	
Precourt v. Comm'r, T.C. Memo. 2010-24	Taxpayer petitioned for redetermination of deficiency and additions to income tax and argued he had received no income in the constitutional sense and failed to appear in court.	Yes	IRS	$25,000
Pugh v. Comm'r, T.C. Memo. 2009-138	Taxpayer petitioned for redetermination of deficiency and asserted frivolous arguments of common law immunity from taxation.	Yes	IRS	$15,000
Reynolds v. Comm'r, T.C. Memo. 2009-181	Taxpayer petitioned for review of IRS decision to proceed with a levy and argued he owed no taxes.	Yes	TP	
Rivera v. Comm'r, T.C. Memo. 2009-215	Taxpayer petitioned for redetermination of deficiency and additions to income tax. Taxpayer argued that the IRS failed to prove he is the taxpayer & refused to acknowledge employment facts.	Yes	IRS	$3,000
Samples v. Comm'r, T.C. Memo. 2009-167	Taxpayer petitioned for redetermination of deficiency and additions to income tax and argued that income tax is an indirect excise tax, and due to the fact that none of his income was produced by taxable activity and he is not a corporation; none of his income is taxable.	Yes	IRS	$5,000
Ulloa v. Comm'r, T.C. Memo. 2010-68	Taxpayer petitioned for redetermination of deficiency and additions to income tax and argued that income from third party payers is not taxable because they are not located in Puerto Rico, Guam, the Virgin Islands, and American Samoa, so they are not "valid payers."	Yes	IRS	$5,000
Waamiq-Ali v. Comm'r, T.C. Memo. 2010-86	Taxpayer petitioned for redetermination of deficiency and additions to income tax and argued that employers have to pay income tax on behalf of employees, wages are not taxable income, and the IRS does not have the authority to prepare substitutes for return.	Yes	TP	
Williamson v. Comm'r, T.C. Memo. 2009-188	Taxpayer petitioned for review of IRS decision to proceed with levy and asserted frivolous arguments.	Yes	IRS	$3,000
Section 6673 Penalty Not Requested or Imposed but Taxpayer Warned to Stop Asserting Frivolous Arguments				
Carney v. Comm'r, T.C. Memo. 2009-310	Taxpayer petitioned for review of IRS decision to proceed with levy and asserted frivolous arguments.	Yes		
Elias v. Comm'r, T.C. Memo. 2009-236	Taxpayer petitioned for review of IRS decision to proceed with collection activity and asserted frivolous arguments.	Yes		
Hebert v. Comm'r, T.C. Memo. 2010-14	Taxpayer petitioned for review of IRS decision to proceed with levy and asserted frivolous arguments.	Yes		
Manjaro v. Comm'r, T.C. Memo. 2010-25	Taxpayer petitioned for review of IRS decision to proceed with levy and argued that wages are not taxable.	Yes		
Simmons v. Comm'r, T.C. Memo. 2009-283	Taxpayer petitioned for redetermination of deficiency and additions to income tax. Taxpayer argued that income deposited in unincorporated business trust organizations was not subject to income tax and asserted frivolous arguments.	Yes		

Appendix Three

Table 7: Frivolous Issues Penalty and Related Appellate-Level Sanctions Under IRC § 6673

Case Citation	Issues	*Pro Se*	Decision	Amount
Turner v. Comm'r, T.C. Memo. 2010-44	Taxpayer petitioned for review of IRS decision to sustain lien and asserted arguments relating to the Paperwork Reduction Act.	Yes		
U.S. Courts of Appeals' Decisions on Appeal of Section 6673 Penalties Imposed by US Tax Court				
Boggs v. Comm'r, 569 F.3d 235 (6th Cir. 2009)	Penalty affirmed	Yes	IRS	$10,000
Montero v. Comm'r, 354 Fed. Appx. 173 (5th Cir. 2009)	Penalty affirmed	Yes	IRS	$20,000
Roytburd v. Comm'r, 355 Fed. Appx. 618 (3d Cir. 2009)	Penalty affirmed	Yes	IRS	$5,000
Stimer v. Comm'r, 337 Fed. Appx. 699 (9th Cir. 2009)	Penalty affirmed	Yes	IRS	
U.S. Courts of Appeals' Decisions on Sanctions Under Section 7482 (c)(4), FRAP Rule 38, or Other Authority				
Barrett v. U.S., 105 A.F.T.R.2d (RIA) 1278 (11th Cir. 2010), *aff'g* 104 A.F.T.R.2d (RIA) 6365 (M.D. Fla. 2009)	Taxpayer brought suit against the U.S. claiming he had overpaid his taxes for 5 years and argued that private employees are not subject to taxation.	Yes	TP	
Boggs v. Comm'r, 569 F.3d 235 (6th Cir. 2009), *on appeal from* T.C. Memo 2008-81	Taxpayers (H&W) petitioned for redetermination of deficiency and penalties and argued that their wages were not taxable under the 16th Amendment of the Constitution.	Yes	IRS	$8,000
U.S. v. Bruner, 105 A.F.T.R.2d (RIA) 1084 (8th Cir. 2010), *aff'g* 102 A.F.T.R.2d (RIA) 7246 (W.D. Ark. 2008)	Taxpayer appealed decision of district court to grant summary judgment and proceed with foreclosure on real property and asserted frivolous arguments.	Yes	IRS	$5,000
Collard v. Comm'r, 354 Fed. Appx. 24 (5th Cir. 2009), *aff'g* T.C. order of dismissal in Docket No. 22683-08	Taxpayer appealed Tax Court decision to dismiss for failure to state a claim and asserted frivolous arguments.	Yes	IRS	$8,000
Pollinger v. I.R.S. Oversight Board, 362 Fed. Appx. 5 (11th Cir. 2010), *on appeal from* 103 A.F.T.R.2d (RIA) 1873 (N.D. Fla. 2009)	Taxpayer brought suit claiming reckless behavior on the part of the government with regard to its tax collection efforts and argued that seizing his wages for income tax was an illegal seizure of life and liberty.	Yes	TP	
Roytburd v. Comm'r, 355 Fed. Appx. 618 (3d Cir. 2009), *on appeal from* T.C. Memo. 2008-198	Taxpayer appealed Tax Court decision and asserted frivolous arguments.	Yes	IRS	$4,000
Taylor v. Comm'r, 350 Fed. Appx. 913 (5th Cir. 2009), *aff'g* T.C. order of dismissal in Docket No. 22094-08	Taxpayers (H&W) appealed Tax Court decision to dismiss for failure to state a claim and asserted frivolous arguments.	Yes	IRS	$16,000
Section 7482 (c)(4), FRAP Rule 38, or Other Authority Penalty Not Requested or Imposed but Taxpayer Warned to Stop Asserting Frivolous Arguments				
Landess v. Comm'r, 357 Fed. Appx. 167 (10th Cir. 2009), *aff'g* T.C. bench opinion in Docket No. 20585-07L	Taxpayer appealed Tax Court decision, claiming error in applying wrong standard of review and in granting the Commissioner's motion for partial summary judgment.	Yes	IRS	
Landess v. Comm'r, 357 Fed. Appx. 171 (10th Cir. 2009), *aff'g* T.C. bench opinion in Docket No. 20586-07L	Taxpayer appealed Tax Court decision, claiming error in applying wrong standard of review and in granting the Commissioner's motion for partial summary judgment.	Yes	IRS	

Table 8 Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Anderson, U.S. v., 104 A.F.T.R.2d (RIA) 7609 (W.D. N.Y. 2009)	Federal tax liens not foreclosed against the TP's jointly owned real property.	No	TP
Barczyk, U.S. v., 105 A.F.T.R.2d (RIA) 1619 (E.D. Mich. 2010)	Federal tax liens foreclosed against TPs' jointly owned real property. Non-liable spouse's interest valued at 50%.	No	IRS
Beninati, U.S. v., 632 F.Supp.2d 116 (D. Mass. 2009)	Federal tax liens foreclosed against TPs' (H&W) real property.	Yes	IRS
Brown, U.S. v., 105 A.F.T.R.2d (RIA) 1450 (D.N.J. 2010)	Federal tax liens valid and enforceable against TP's real property.	Yes	IRS
In re Callahan, 419 B.R. 109 (D. Mass. 2009)	Valid federal tax lien does not exist.	No	TP
Criner, U.S. v., 105 A.F.T.R.2d (RIA) 2343 (N.D. Okla. 2010)	Federal tax liens valid and foreclosed against TP's real property.	No	IRS
Davenport, U.S. v., 2010 WL 1882023 (E.D. Wash. 2010)	Federal tax liens properly attached and foreclosed against TPs' (H&W) real property.	Yes	IRS
DeTar, et. al., U.S. v., 104 A.F.T.R.2d (RIA) 5572 (W.D. Mich. 2009)	Federal tax liens foreclosed against TP's real property held by nominee.	Yes	IRS
Dix, U.S. v., 103 A.F.T.R.2d (RIA) 1448 (E.D. Wis. 2009)	Federal tax liens foreclosed against TPs' (H&W) real property.	Yes	IRS
Evans, U.S. v., 340 Fed. Appx. 990 (5th Cir. 2009)	Affirmed lower court's decision to foreclose federal tax liens against TP's real property.	Yes	IRS
Filson, U.S. v., 347 Fed. Appx. 987 (5th Cir. 2009)	Affirmed lower court's decision to foreclose federal tax liens against TPs' (H&W) real property.	Yes	IRS
Hersperger, U.S. v., 105 A.F.T.R.2d (RIA) 1797 (W.D. Pa. 2010)	Federal tax liens foreclosed against TPs' (H&W) real property.	No	IRS
Hockensmith, U.S. v., 104 A.F.T.R.2d (RIA) 5133 (M.D. Pa. 2009)	Federal tax liens foreclosed against TP's real property.	Yes	IRS
Jaegar, U.S. v., 104 A.F.T.R.2d (RIA) 7569 (D. Conn. 2009)	Federal tax liens foreclosed against TP's real property.	Yes	IRS
Kimmell, U.S. v., 105 A.F.T.R.2d (RIA) 1607 (D. Colo. 2010)	Federal tax liens foreclosed against TPs' (H&W) real property.	Yes	IRS
Ledford, U.S. v., 105 A.F.T.R.2d (RIA) 1325 (D. Colo. 2010)	Federal tax liens foreclosed against TPs' (H&W) real property.	Yes	IRS
Miller, U.S. v., 104 A.F.T.R.2d (RIA) 6876 (E.D. Mich. 2009)	Federal tax liens valid and foreclosed against TP's real property.	Yes	IRS
Miller, U.S. v., 105 A.F.T.R.2d (RIA) 2636 (S.D. Ala. 2010)	Federal tax liens valid and foreclosed against TP's real property.	No	IRS
Morehouse, U.S. v., 104 A.F.T.R.2d (RIA) 5001 (D. Or. 2009)	Federal tax liens foreclosed against TP's jointly owned property.	No	IRS
Morehouse, U.S. v., 103 A.F.T.R.2d (RIA) 2668 (W.D. Wash. 2009)	Federal tax liens foreclosed against TP's jointly owned property.	No	IRS
Morgan, U.S. v., 105 A.F.T.R.2d (RIA) 442 (M.D. Fla. 2010)	Federal tax liens foreclosed against TPs' (H&W) real property held by nominee.	Yes	IRS
Mueller, U.S. v., 104 A.F.T.R.2d (RIA) 6578 (S.D. Tex. 2009)	TPs' (H&W) motion to dismiss suit to foreclose federal tax liens against TPs' property denied.	Yes	IRS
Navolio, U.S. v., 103 A.F.T.R.2d (RIA) 2466 (M.D. Fla. 2009)	TP's motion to stay foreclosure of federal tax liens denied.	Yes	IRS
Navolio, U.S. v., 334 Fed. Appx. 204 (11th Cir. 2009)	Affirmed lower court's decision to foreclose federal tax liens against TP's real property.	Yes	IRS
Northern States Investments, Inc., U.S. v., 670 F. Supp. 2d 778 (N.D. Ill. 2009)	Federal tax liens foreclosed against TPs' (H&W) real property held by nominee.	No	IRS
Offiler, U.S. v., 336 Fed. Appx 907 (11th Cir. 2009)	Affirmed lower court's decision to foreclose federal tax liens against TP's real property.	Yes	IRS
Oyer, U.S. v., 104 A.F.T.R.2d (RIA) 5855 (D. Kan. 2009)	Federal tax liens foreclosed against TPs' (H&W) real property.	Yes	IRS
Palmer, U.S. v., 103 A.F.T.R.2d (RIA) 2679 (W.D. Wash. 2009)	Federal tax liens foreclosed against TPs' (H&W) real property held by nominee.	Yes	IRS
Perez, U.S. v., 105 A.F.T.R.2d (RIA) 942 (S.D. Tex. 2010)	IRS lien has priority over subsequent purchase of land by a 3rd party. Federal tax liens foreclosed against TPs' (H&W) real property and mineral interests.	No	IRS
Simons, U.S. v., 105 A.F.T.R.2d (RIA) 1104 (D. Utah 2010)	Federal tax liens foreclosed against TPs' (H&W) real property.	Yes	IRS
Springer, U.S. v., 105 A.F.T.R.2d 1192 (N.D. Okla. 2010)	Federal tax liens valid and foreclosed against TP's real property held by nominee.	Yes	IRS

Table 8: Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

Case Citation	Issue(s)	*Pro Se*	Decision
Stephens, U.S. v., 670 F. Supp. 2d 1145 (D. Mon. 2010)	Federal tax liens foreclosed against TP's real property.	No	IRS
Stuler, U.S. v., 105 A.F.T.R.2d (RIA) 764 (W.D. Pa. 2010)	Federal tax liens foreclosed against TP's real property.	Yes	IRS
Uptergrove v. U.S., 104 A.F.T.R.2d (RIA) 5637 (E.D. Cal. 2009)	TPs (H&W) motion for relief from judgment to foreclose federal tax lien real property denied.	Yes	IRS
Walsh, U.S. v., 105 A.F.T.R.2d (RIA) 1794 (D. Me. 2010)	Valid federal tax lien exists.	No	IRS
Wesselman, U.S. v., 105 A.F.T.R.2d (RIA) 2021 (S.D. Ill. 2010)	Federal tax liens valid and foreclosed against TP's real property held by nominee.	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedules C, E, F)			
Ausilio, Estate of v. U.S., 105 A.F.T.R.2d (RIA) 346 (E.D. Mich. 2010)	Federal tax liens enforced against decedent TP's real property.	No	IRS
Cabral, U.S. v., 103 A.F.T.R.2d (RIA) 2501 (E.D. Ca. 2009)	Federal tax liens foreclosed against TPs' (H&W) real property.	Yes	IRS
Carinos Ambulance Service, U.S. v., 104 A.F.T.R.2d (RIA) 7311 (D.P.R. 2009)	Federal tax liens not foreclosed against TP's real property as issue of material fact remained as to whether the U.S. holds superior interest in the property.	Yes	TP
Marquez et. al., U.S. v., 105 A.F.T.R.2d (RIA) 649 (N.D. Cal. 2010)	Federal tax liens foreclosed against TPs' real property.	No	IRS
Paternoster v. U.S., 640 F. Supp. 2d 983 (S.D. Ohio 2009)	TP's wife moved to quiet title to real property and for IRS to release lien on the property upon death of TP.	No	IRS
Porter, U.S. v., 104 A.F.T.R.2d (RIA) 6234 (S.D. Iowa 2009)	Federal tax liens valid and foreclosed against TP's real property.	Yes	IRS
Reid, U.S. v., 104 A.F.T.R.2d (RIA) 5389 (S.D. Miss. 2009)	Federal tax liens foreclosed against TPs' (H&W) real property.	Yes	IRS
Tellez, U.S. v., 678 F. Supp. 2d 437 (W.D. Tx. 2009)	TPs' (H&W) motion to set aside default judgment to reduce tax balance to judgment and foreclose on TPs' real property granted.	No	TP
Toler, U.S. v., 666 F. Supp. 2d 872 (S.D. Ohio 2009)	Federal tax liens valid and foreclosed on certain parcels of real property owned by TPs (H&W) but held by alter-ego. Material issues exist as to ownership of other parcels and whether conveyance was fraudulent.	No	Split
Vacante, U.S. v., 105 A.F.T.R.2d (RIA) 2538 (E.D. Cal. 2010)	Federal tax lien not foreclosed on TPs (H&W) real property as material issue remained as to whether TP treated his employees as independent contractors or employees for the purposes of employment taxes.	Yes	TP

Table 9 Family Status Issues Under IRC §§ 2, 24, 32, and 151

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers			
Addie v. Comm'r, T.C. Summ. Op. 2009-129	EITC	Yes	TP
Adler v. Comm'r, T.C. Memo. 2010-47	Dependency Exemption	Yes	IRS
Akanno v. Comm'r, T.C. Summ. Op. 2009-168	Dependency Exemption	No	IRS
Bitzberger v. Comm'r, T.C. Summ. Op. 2009-178	CTC, Dependency Exemption	Yes	IRS
Bjelland v. Comm'r, T.C. Memo. 2009-297	CTC, Dependency Exemption, Filing Status	Yes	Split
Bomer v. Comm'r, T.C. Summ. Op. 2010-54	EITC	Yes	IRS
Brown v. Comm'r, T.C. Summ. Op. 2010-56	Dependency Exemption	Yes	IRS
Byles v. Comm'r, T.C. Summ. Op. 2010-25	Dependency Exemption, EITC, Filing Status	Yes	IRS
Childress v. Comm'r, T.C. Summ. Op. 2009-133	CTC, Dependency Exemption, Filing Status	Yes	IRS
Cochran v. Comm'r, T.C. Summ. Op. 2010-14	Dependency Exemption, EITC, Filing Status	Yes	IRS
Conner v. Comm'r, T.C. Summ. Op. 2010-8	CTC, Dependency Exemption, EITC, Filing Status	Yes	TP
Dyer v. Comm'r, T.C. Summ. Op. 2009-148	CTC, Dependency Exemption	Yes	IRS
Eleverson v. Comm'r, T.C. Summ. Op. 2010-36	Dependency Exemption	Yes	IRS
Flores v. Comm'r, T.C. Summ. Op. 2010-11	CTC, Dependency Exemption, EITC, Filing Status	Yes	Split
Gaitor v. Comm'r, T.C. Memo. 2010-70	CTC, Dependency Exemption, Filing Status	Yes	TP
Gessic v. Comm'r, T.C. Memo. 2010-88	CTC, Dependency Exemption	Yes	IRS
Ghaleb v. Comm'r, T.C. Summ. Op. 2010-46	CTC, Dependency Exemption	Yes	IRS
Hardaway v. Comm'r, T.C. Summ. Op. 2009-132	CTC, Dependency Exemption, EITC, Filing Status	Yes	IRS
Hendrickson v. Comm'r, T.C. Summ. Op. 2010-45	CTC, Dependency Exemption	No	IRS
Hill v. Comm'r, T.C. Summ. Op. 2009-188	CTC, Dependency Exemption, EITC, Filing Status	Yes	Split
Himes v. Comm'r, T.C. Memo. 2010-97	CTC, Dependency Exemption	Yes	IRS
Jackson v. I.R.S., 103 A.F.T.R.2d (RIA) 2667 (E.D. Mo. 2009)	Dependency Exemption, EITC, Filing Status	Yes	IRS
Jimenez v. Comm'r, T.C. Summ. Op. 2009-108	CTC, Dependency Exemption, Filing Status	Yes	IRS
Kirshenbaum v. Comm'r, T.C. Summ. Op. 2009-179	Dependency Exemption	Yes	IRS
Litton v. Comm'r, T.C. Summ. Op. 2010-16	CTC, Dependency Exemption, Filing Status	Yes	TP
Mamoudou v. Comm'r, T.C. Summ. Op. 2010-9	Dependency Exemption	No	IRS
Mann v. Comm'r, T.C. Summ. Op. 2009-104	CTC, Dependency Exemption, EITC, Filing Status	Yes	Split
McClure v. Comm'r, T.C. Summ. Op. 2009-181	Dependency Exemption	Yes	IRS
Moore v. Comm'r, T.C. Summ. Op. 2009-105	EITC, Filing Status	No	IRS
Mora v. Comm'r, T.C. Summ. Op. 2010-60	CTC, Dependency Exemption	Yes	IRS
Mosley v. Comm'r, T.C. Summ. Op. 2009-140	CTC, Dependency Exemption	Yes	IRS
Newkirk v. Comm'r, T.C. Summ. Op. 2009-128	CTC, Dependency Exemption, EITC, Filing Status	Yes	IRS
Reyes v. U.S., 105 A.F.T.R.2d (RIA) 830 (E.D. Cal. 2010), *granting motion in part, denying motion in part, dismissing claim* 105 A.F.T.R.2d (RIA) 782 (E.D. Cal. 2009)	EITC	Yes	IRS
Richmond v. Comm'r, T.C. Memo. 2009-207	CTC, EITC	Yes	IRS
Sanchez v. Comm'r, T.C. Summ. Op. 2009-167	CTC, Dependency Exemption	Yes	IRS
Scott v. Comm'r, T.C. Memo. 2009-211	EITC	No	Split
Sheikh v. Comm'r, T.C. Memo. 2010-33	CTC, Dependency Exemption	Yes	IRS

Table 9: Family Status Issues Under IRC §§ 2, 24, 32, and 151

Case Citation	Issue(s)	*Pro Se*	Decision
Statin, U.S. v., 105 A.F.T.R.2d 931 (5th Cir. 2010)	EITC	No	IRS
Stone v. Comm'r, T.C. Summ. Op. 2009-194	CTC, Dependency Exemption, EITC	Yes	IRS
Taboh v. Comm'r, T.C. Summ. Op. 2009-163	Dependency Exemption, EITC, Filing Status	Yes	Split
Thomas v. Comm'r, T.C. Memo. 2010-11	CTC, Dependency Exemption	Yes	IRS
Thompson v. Comm'r, T.C. Summ. Op. 2009-197	CTC, Dependency Exemption, EITC, Filing Status	Yes	Split
Twaragowski v. Comm'r, T.C. Summ. Op. 2009-192	CTC, Dependency Exemption, Filing Status	Yes	IRS
White v. Comm'r, T.C. Summ. Op. 2010-48	Dependency Exemption	Yes	IRS
Wolfgram v. Comm'r, T.C. Memo. 2010-69	Dependency Exemption	Yes	IRS

Table 10 Relief From Joint and Several Liability Under IRC § 6015

Case Citation	Issue(s)	*Pro Se*	Intervenor	Decision
Acoba v.Comm'r, T.C. Summ. Op. 2010-64	6015(f) (underpayment)	Yes	No	IRS
Adkison v. Comm'r, 592 F.3d 1050 (9th Cir. 2010), *aff'g on other grounds* 129 T.C. 97 (2007)	6015(c); availability of relief due to pending partnership proceedings in district court	No	No	IRS
Bozick v. Comm'r, T.C. Memo. 2010-61	6015(f) (underpayment)	No	No	TP
Bruen v. Comm'r, T.C. Memo. 2009-249	6015(f) (underpayment)	No	Yes	Split
Caldwell v. Comm'r, T.C. Summ. Op. 2009-95	6015(f) (underpayment); only issue was two year rule of Treas. Reg. 1.6015-5(b)(1) considered in Lantz	Yes	No	TP
Deihl v. Comm'r, 134 T.C. No. 7 (2010)	6015(g); effect of prior proceedings as a bar to relief; effect of subsequent death of spouse on 6015(c) election.	No	No	Split
DeMattos v. Comm'r, T.C. Memo. 2010-110	6015(b), (c), (f) (understatement, underpayment)	Yes	Yes	IRS
Denton v. Comm'r, T.C. Summ. Op. 2009-87	6015(f) (understatement)	Yes	Yes	TP
Franc v. Comm'r, T.C. Memo. 2010-79	6015(f) (underpayment)	Yes	No	IRS
Garcia v. Comm'r, T.C. Summ. Op. 2009-147	6015(f) (underpayment)	Yes	Yes	TP*
Gormeley v. Comm'r, T.C. Memo. 2009-252, *appeal docketed*, No.10-1574 (3rd Cir. Mar. 5, 2010)	6015 (b), (c), (f) (understatement) petition not timely filed; whether a joint return was filed is a determination on merits	No	No	IRS
Greer v. Comm'r, 595 F.3d 338 (6th Cir. 2009) *aff'g* T.C. Memo. 2009-20	6015(b), (f) (understatement)	No	No	IRS
Haigh v. Comm'r, T.C. Memo. 2009-140	6015(b), (c), (f) (understatement)	Yes	No	IRS
Harper v. Comm'r, T.C. Summ. Op. 2009-125	6015(f) (underpayment); petition not timely filed; IRS not required to consider claim in CDP hearing held after final notice of determination	Yes	No	IRS
Iljazi v. Comm'r, T.C. Summ. Op. 2010-59	6015(f) (underpayment); only issue was two year rule of Treas. Reg. 1.6015-5(b)(1) considered in Lantz	No	No	TP
Johnson v. Comm'r, T.C. Memo. 2009-156	6015(b), (f) (understatement)	Yes	No	IRS
Jones v. Comm'r, T.C. Memo. 2010-112	6015(b), (f) (understatement)	No	No	Split
Kannard v. Comm'r, T.C. Summ. Op. 2010-22	6015(b), (c), (f) (understatement)	Yes	Yes	IRS
Kaufman v. Comm'r, T.C. Memo. 2010-89	6015(f) (underpayment); TP not entitled to refund because spouse's estate, not TP, paid the tax	No	No	IRS
Kosola v. Comm'r, T.C. Memo. 2010-34	6015(f) (underpayment)	No	Yes	TP
Lantz v. Comm'r, 607 F.3d 479 (7th Cir. 2010) *rev'g* 132 T. C. 131 (2009)	6015 (f) (underpayment); Treas. Reg. 1.6015-5(b)(1) application of a two-year rule to claims for relief under section 6015(f) is a valid interpretation of section 6015(f).	No	No	IRS
Maluda v. Comm'r, T.C. Memo. 2009-281, *appeal docketed*, No.10-1753 (3rd Cir. Mar. 24, 2010)	6015 (underpayment)	No	No	IRS
McCasland v. Comm'r, T.C. Summ. Op. 2010-52	6015(f) (underpayment); only issue was two year rule of Treas. Reg. 1.6015-5(b)(1) considered in Lantz	No	No	TP
McDaniel v. Comm'r, T.C. Memo. 2009-137	6015(c) (understatement)	No	Yes	TP*
Molsbee v. Comm'r, T.C. Memo. 2009-231	6015(g) (prior proceedings bar relief)	Yes	No	IRS
Olson v. Comm'r, T.C. Memo. 2009-294	6015(b), (f) (understatement)	Yes	No	IRS
Phemister v. Comm'r, T.C. Memo. 2009-201	6015(b), (c), (f) (understatement)	Yes	No	Split
Rogers v. Comm'r, T.C. Summ. Op. 2010-13	6015(f) (underpayment)	Yes	No	IRS
Schepers v. Comm'r, T.C. Memo. 2010-80	6015(f) (understatement, underpayment)	No	No	IRS

Table 10: Relief From Joint and Several Liability Under IRC § 6015

Case Citation	Issue(s)	*Pro Se*	Intervenor	Decision
Smith v. Comm'r, T.C. Memo. 2009-237	6015(b), (f) (underpayment)	Yes	No	IRS
Stegawski v. Comm'r, T.C. Summ. Op. 2009-96	6015(f) (underpayment); only issue was two year rule of Treas. Reg. 1.6015-5(b)(1) considered in Lantz	Yes	Yes	TP
Stewart v. Comm'r, T.C. Summ. Op. 2010-31	6015(b), (c), (f) (understatement)	Yes	No	IRS
Sykes v. Comm'r, T.C. Memo. 2009-197	6015(b), (c), (f) (understatement)	No	Yes	IRS
Torres v. Comm'r, T.C. Summ. Op. 2009-170	6015(f) (underpayment)	Yes	Yes	IRS
Venables v. Comm'r, T.C. Summ. Op. 2010-62	6015(f) (underpayment)	Yes	No	TP
U.S. v. Wallace, No. 1:09-CV-87, 2010 WL 2302377 (S.D. Ohio Apr. 28, 2010)	District Court did not have jurisdiction to determine innocent spouse claim raised as a defense in a collection suit; claim for relief untimely because made more than two years after collection activity.	Yes	No	IRS

*The IRS agreed that the TP was entitled to relief; only the intervenor was opposed.

Acronym Glossary - Annual Report to Congress 2010

Acronym	Definition
AARS	Appeals Account Resolution Specialist
ABA	American Bar Association
ACDS	Appeals Centralized Database System
ACS	Automated Collection System
ACSS	Automated Collection System Support
ACTC	Additional Child Tax Credit or Advance Child Tax Credit
ADA	Americans With Disabilities Act
ADR	Alternative Dispute Resolution or Address Research System
AGI	Adjusted Gross Income
AICPA	American Institute of Certified Public Accountants
AIS	Automated Insolvency System
AJCA	American Jobs Creation Act of 2004
AIMS	Audit Information Management System
ALE	Allowable Living Expenses
ALS	Automated Lien System
AM	Accounts Management
AMS	Accounts Management System
AMT	Alternative Minimum Tax
ANMF	Automated Non Master File
ANPR	Advance Notice of Proposed Rulemaking
AOIC	Automated Offer In Compromise
APA	Advance Pricing Agreement or Administrative Procedure Act
ARC	Annual Report to Congress
AQMS	Appeals Quality Measurement System
ARRA	America Recovery and Reinvestment Act
ASA	Average Speed of Answer
ASED	Assessment Statute Expiration Date
ASFR	Automated Substitute for Return
ATAO	Application for Taxpayer Assistance Order
ATFRS	Automated Trust Fund Recovery System
ATIN	Adoption Taxpayer Identification Number
ATP	Abusive Transaction Program
AUR	Automated Underreporter
AWSS	Agency Wide Shared Services
BMF	Business Master File
BNA	Bureau of National Affairs
BPR	Business Performance Review
CADE	Customer Account Data Engine
CAF	Centralized Authorization File

Acronym	Definition
CAP	CAWR Automated Program
CARE	Customer Assistance, Relationships & Education
CAS	Customer Account Services
CAWR	Combined Annual Wage Reporting
CBO	Congressional Budget Office
CBPP	Center on Budget & Policy Priorities
CBRS	Currency & Banking Retrieval System
CCISO	Cincinatti Campus Innocent Spouse Operations
CCP-LU	Centralized Case Processing
CDP	Collection Due Process
CDPTS	Collection Due Process Tracking System
CDE	Compliance Data Environment
CDW	Compliance Data Warehouse
CEAS	Correspondence Examination Automation Support
CFf	Collection Field Function
CI	Criminal Investigation
CIP	Compliance Initiative Project
CIS	Correspondence Imaging System
CLD	Communications, Liaison and Disclosure
CNC	Currently Not Collectible
COBRA	Consolidated Omnibus Budget Reconciliation Act
CODI	Cancellation Of Debt Income
COIC	Centralized Offer In Compromise
COTR	Contract Officer Technical Representative
CONOPS	Concept of Operations
CPE	Continuing Professional Education
CPS	Collection Process Study
CQMS	Collection Quality Management System
CRIS	Compliance Research Information System
CSCO	Compliance Services Collection Operation
CSED	Collection Statute Expiration Date
CSI	Campus Specialization Initiative
CSR	Customer Service Representative
CTC	Child Tax Credit
DA	Disclosure Authorization
DAC	Disability Access Credit
DART	Disaster Assistance Review Team
DATC	Doubt As To Collectibility
DATL	Doubt As To Liability

Appendix Four

Acronym	Definition
DDb	Dependent Data Base
DDP	Daily Delinquency Penalty
DFO	Designated Federal Official
DI	Desktop Integration or Debt Indicator
DIF	Discriminant Index Function
DLN	Document Locator Number
DOD	Department of Defense
DOJ	Department of Justice
DoMA	Defense of Marriage Act
EA	Enrolled Agent
EAJA	Equal Access to Justice Act
EAR	Electronic Account Resolution
EBT	Electronic Benefits Transfer
EGTRRA	Economic Growth and Tax Relief Reconciliation Act (of 2001)
EFTPS	Electronic Federal Tax Payment System
EIN	Employer Identification Number
EITC	Earned Income Tax Credit
ELMS	Enterprise Learning Management System
ELS	Electronic Lodgment Service
ERIS	Enforcement Revenue Information System
EO	Exempt Organization
EP	Employee Plans
EQRS	Embedded Quality Review System
ERIS	Enforcement Revenue Information System
ERO	Electronic Return Originator
ERISA	Employee Retirement Income Security Act
ERSA	Employee Retirement Savings Account
ES	Estimated Tax Payments
ESL	English as a Second Language
ESOP	Employee Stock Ownership
ESP	Economic Stimulus Payment
ETA	Effective Tax Administration
ETACC	Electronic Tax Administration Advisory Committee
ETARC	Electronic Tax Administration and Refundable Credits
ETLA	Electronic Tax Law Assistance
FA	Field Assistance
FAFSA	Free Application for Financial Student Aid
FBAR	Foreign Bank Account Report
FCRA	Fair Credit Reporting Act
FDCPA	Fair Debt Collection Practices Act
FDIC	Federal Deposit Insurance Corporation

Acronym	Definition
FEMA	Federal Emergency Management Agency
FICA	Federal Insurance Contribution Act
FMV	Fair Market Value
FOIA	Freedom Of Information Act
FPAA	Final Partnership Administrative Adjustment
FPLP	Federal Payment Levy Program
FRA	Federal Records Act
FLSA	Fair Labor Standards Act
FSRP	Facilitated Self-Assistance Research Project
FTA	First-Time Abatement
FTC	Federal Trade Commission or Foreign Tax Credit
FTD	Federal Tax Deposit or Failure To Deposit
FTE	Full Time Equivalent
FTF	Failure To File
FTHBC	First-Time Homebuyer Credit
FTI	Federal Tax Information
FTL	Federal Tax Lien
FTP	Failure To Pay
FTS	Fast Track Settlement
FUTA	Federal Unemployment Tax
FY	Fiscal Year
GCCF	Gulf Coast Claims Facility
GCI	Geographic Coverage Initiative
GCM	General Counsel Memorandum
GE	Government Entities
GID	Gender Identity Disorder
GLD	Governmental Liaison and Disclosure
GAO	Government Accountability Office or General Accounting Office
HCTC	Health Coverage Tax Credit
IA	Installment Agreement
IAT	Integrated Automation Technology
ICAS	Internet Customer Account Services
ICP	Integrated Case Processing
ICS	Integrated Collection System
IDAP	IDRS Decision Assisting Program
IDFP	IRS Directory for Practitioners
IDRS	Integrated Data Retrieval System
IDS	Inventory Delivery System
IMD	Internal Management Document
IMF	Individual Master File
IMRS	Issue Management Resolution System

Acronym	Definition
IPM	Integrated Production Model
IOAA	Independent Offices Appropriation Act
IPSU	Identity Protection Specialized Unit
IRB	Internal Revenue Bulletin
IRC	Internal Revenue Code
IRDM	Information Reporting and Document Matching
IRM	Internal Revenue Manual
IRMF	Information Returns Master File
IRP	Information Returns Processing
IRS	Internal Revenue Service
IRSAC	Internal Revenue Service Advisory Council
IRSN	Internal Revenue Service Number
ITIN	Individual Taxpayer Identification Number
JCT	Joint Committee on Taxation
JGTRA	Jobs and Growth Tax Relief Reconciliation Act (of 2003)
JOC	Joint Operations Center
LB&I	Large Business and International Operating Division
LCTU	Large Corporation Technical Unit
LEM	Law Enforcement Manual
LEP	Limited English Proficiency
LIHTC	Low Income Housing Tax Credit
LILO	Lease-In Lease-Out
LITC	Low Income Taxpayer Clinic
LLC	Limited Liability Company
LOS	Level of Service
LTA	Local Taxpayer Advocate
M&P	Media and Publications
MAGI	Modified Adjusted Gross Income
MFDRA	Mortgage Forgiveness Debt Relief Act
MFT	Master File Tax
MIRSA	My IRS Account Application
MITS	Modernization and Information Technology Services
MLI	Multilingual Initiative or Most Litigated Issue
MWP	Making Work Pay Credit
NAEA	National Association of Enrolled Agents
NCOA	National Change of Address
NFTL	Notice of Federal Tax Lien
NMF	Non-Master File
NOD	Notice of Deficiency
NQRS	National Quality Review System
NRP	National Research Program

Acronym	Definition
NTA	National Taxpayer Advocate
OAR	Operations Assistance Request
OD	Operating Division
OIC	Offer in Compromise
OECD	Organisation for Economic Co-Operation and Development
OMB	Office of Management and Budget
OPERA	Office of Program Evaluation, Research, & Analysis
OPI	Office of Penalty and Interest Administration or Over the Phone Interpreter
OPR	Office of Professional Responsibililty
OSP	Office of Servicewide Penalties
OTA	Office of Tax Analysis
OTBR	Office of Taxpayer Burden Reduction
OUO	Official Use Only
PCA	Private Collection Agency
PCAOB	Public Company Accounting Oversight Board
PCI	Potentially Collectible Inventory
PDC	Private Debt Collection
PIPDS	Privacy, Information and Data Security
PLR	Private Letter Ruling
POA	Power Of Attorney
POP	Phone Optimization Project
PPACA	Patient Protection and Affordable Care Act
PPIA	Partial Payment Installment Agreement
PPS	Practitioner Priority Service
PRA	Paperwork Reduction Act
PREA	Premature Referral and Acceptance
PTIN	Preparer Tax Identification Number
PY	Processing Year
QETP	Questionable Employment Tax Practices
QRP	Questionable Refund Program
RAL	Refund Anticipation Loan
RCA	Reasonable Cause Assistant
RCP	Reasonable Collection Potential
RGS	Report Generating Software
RO	Revenue Officer
ROFT	Record of Federal Tax Liability
ROI	Return on Investment
ROTERS	Records of Tax Enforcement Results
RPS	Revenue Protection Strategy
RRA 98	(Internal Revenue Service) Restructuring and Reform Act of 1998

Appendix Four

Acronym	Definition
RPC	Return Preparer Coordinator
RPS	Revenue Protection Strategy
RPP	Return Preparer Program
RSED	Refund Statute Expiration Date
SAMS	Systemic Advocacy Management System
SAR	Strategic Assessment Report
SARP	State Audit Report Program
SB/SE	Small Business/Self Employed Operating Division
SBJPA	Small Business Job Protection Act
SEC	Securities and Exchange Commission
SEP	Special Enforcement Program
SERP	Servicewide Electronic Research Program
SFR	Substitute for Return
SL	Stakeholder Liaison
SNOD	Statutory Notice of Deficiency
SOI	Statistics of Income
SP	Submission Processing
SPC	Submission Processing Center(s)
SPDER	Office of Servicewide Policy, Directives, and Electronic Research
SPEC	Stakeholder Partnerships, Education & Communication
SPOC	Single Point of Contact
SSA	Social Security Administration
SSI	Supplemental Security Income
SSN	Social Security Number
STC	Student Tax Clinic
SVC	Stored Value Card
TAB	Taxpayer Assistance Blueprint
TAC	Taxpayer Assistance Center
TACT	Taxpayer Communications Taskgroup
TAD	Taxpayer Advocate Directive
TAMIS	Taxpayer Advocate Management Information System
TANF	Temporary Assistance to Needy Families
TAP	Taxpayer Advocacy Panel
TAS	Taxpayer Advocate Service

Acronym	Definition
TCE	Tax Counseling for the Elderly
TDA	Taxpayer Delinquent Account
TDRA	Tip Rate Determination Agreement
TDI	Taxpayer Delinquent Investigation
TE	Tax Examiner or Tax Exempt
TEFRA	Tax Equity and Fiscal Responsibility Act of 1982
TEC	Taxpayer Education and Communication
TE/GE	Tax Exempt & Government Entities Operating Division
TEI	Tax Executives Institute
TFRP	Trust Fund Recovery Penalty
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number
TIPRA	Tax Increase Prevention and Reconciliation Act (of 2005)
TOP	Treasury Offset Program
TOS	Terms of Service
TPP	Third Party Payer
TPPA	Third Party Payroll Agent
TRA 97	Taxpayer Relief Act of 1997
TRHCA	Tax Relief and Health Care Act (of 2006)
TY	Tax Year
UAA	Undeliverable As Addressed
UAL	Uniform Acknowledgement Letter
UDOC	Uniform Definition of a Child
UOU	Universal Postal Union
URP	Underreporter
USPS	United States Postal Service
USPTO	United States Patent and Trademark Office
VAT	Value Added Tax
VITA	Volunteer Income Tax Assistance
VTO	Virtual Translation Office
W & I	Wage and Investment Operating Division
WFTRA	Working Families Tax Relief Act
WO	Whistleblower Office

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Brooklyn, NY 11201
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