

INTRODUCTION: Legislative Recommendations

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

The figure immediately following this Introduction summarizes congressional action on recommendations the National Taxpayer Advocate proposed in her 2001 through 2014 Annual Reports.¹ The National Taxpayer Advocate places a high priority on working with the tax-writing committees and other interested parties to try to resolve problems encountered by taxpayers. In addition to submitting legislative proposals in each Annual Report, the National Taxpayer Advocate meets regularly with members of Congress and their staffs and testifies at hearings on the problems faced by taxpayers to ensure that Congress has an opportunity to receive and consider a taxpayer perspective. The following discussion highlights legislative activity during the 114th Congress relating to the National Taxpayer Advocate's proposals.

Consolidated Appropriations Act, 2016 and Taxpayer Bill of Rights

Shortly before this report went to print, Congress enacted the Consolidated Appropriations Act, 2016.² Most significantly, section 401 of this law codified the provisions of the Taxpayer Bill of Rights (TBOR), which had been adopted administratively by the IRS last year based on the National Taxpayer Advocate's recommendation.³ The National Taxpayer Advocate advocated for this codification in several of her prior Annual Reports to Congress,⁴ and members of both the House and Senate introduced various TBOR bills earlier in the year. Specifically, section 401 of the Consolidated Appropriations Act, 2016 amends IRC § 7803(a) to add a new paragraph that states: "In discharging his duties, the Commissioner shall ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title" and includes the ten TBOR rights. The National Taxpayer Advocate is pleased with this codification of TBOR and will work with the IRS to ensure that this statutory mandate is fulfilled.

Also of note, Congress appropriated \$290,000,000 above the IRS's FY 2016 funding level to be used solely to achieve "measurable improvements in the customer service representative level of service rate, to improve the identification and prevention of refund fraud and identity theft, and to enhance cybersecurity to safeguard taxpayer data."⁵ Congress attached certain conditions to this funding, including that these funds will not be made available until the Commissioner submits a spending plan

- 1 An electronic version of the figure is available on the TAS website at www.TaxpayerAdvocate.irs.gov/2015-Annual-Report. The figure lists all legislative recommendations the National Taxpayer Advocate has made since 2001 and identifies each section of the Internal Revenue Code affected by the recommendations.
- 2 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113 (2015).
- 3 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 401 (2015). See also TBOR, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.
- 4 See National Taxpayer Advocate 2014 Annual Report to Congress 275 (Legislative Recommendation: *Codify the Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections*); National Taxpayer Advocate 2013 Annual Report to Congress 5 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*); National Taxpayer Advocate's Report to Acting Commissioner Daniel Werfel, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (Nov. 4, 2013), available at www.TaxpayerAdvocate.irs.gov/2013AnnualReport; National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*); National Taxpayer Advocate 2007 Annual Report to Congress 478-89 (Key Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology" Payments*).
- 5 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division E, § 113 (2015).

to the Committees on Appropriations of the House of Representatives and the Senate.⁶ The National Taxpayer Advocate welcomes this increase in IRS funding and is hopeful that it will alleviate taxpayer burden in the allocated areas.⁷

Other Consolidated Appropriations Act, 2016 Provisions

Besides TBOR, the Consolidated Appropriations Act, 2016 also enacted several of the National Taxpayer Advocate's previous recommendations to Congress, including:⁸

- **Dual Address Change Notices and Special Consideration for Offers in Compromise for Victims of Payroll Tax Preparer Fraud.**⁹ For the third consecutive year, Congress enacted legislation that incorporates two of the National Taxpayer Advocate's past recommendations. Section 106 of the Consolidated Appropriations Act, 2016 requires the IRS to:
 1. Issue dual address change notices related to an employer making employment tax payments (with one notice sent to both the employer's former and new address); and
 2. Give special consideration to an offer in compromise (OIC) request from a victim of fraud or bankruptcy by a third-party payroll tax preparer.¹⁰ This provision codifies National Taxpayer Advocate recommendations from 2012.
- **Modification of filing dates of returns and statements relating to employee wage information and nonemployee compensation to improve compliance.**¹¹ The provision requires Forms W-2 and W-3 and returns or statements that report non-employee compensation (*e.g.*, Form 1099-MISC) to be filed on or before January 31 of the year following the calendar year to which the returns relate. The provision also provides additional time for the IRS to review refund claims based on the earned income tax credit and the refundable portion of the child tax credit in order to reduce fraud and improper payments. The provision is effective for returns and statements relating

6 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division E, § 113 (2015).

7 The Consolidated Appropriations Act, 2016 legislation also increased funding for Volunteer Income Tax Assistance (VITA), allocating not less than \$15,000,000 for VITA matching grants. See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division E (2015). This is a \$3,000,000 increase over last year's VITA funding, where Congress allocated not less than \$12,000,000 for VITA matching grants. See Consolidated And Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, Division E, 128 STAT. 2130, 2336 (2014). In her 2014 Annual Report to Congress, the National Taxpayer Advocate recommended that the IRS increase VITA funding to maximize the overall resources (federal and matching funds) available for free tax preparation assistance. See National Taxpayer Advocate 2014 Annual Report to Congress 66 (Most Serious Problem: *VITA/TCE Funding: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations*).

8 Relevant portions of the summaries of these new provisions are drawn from House Committee on Ways and Means, Section-By-Section Summary of the Proposed "Protecting Americans From Tax Hikes Act of 2015," available at http://waysandmeans.house.gov/?attachment_id=39841003.

9 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division E, § 106 (2015).

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

11 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 201 (2015).

to calendar years after the date of enactment (*e.g.*, returns filed in 2017). This provision codifies a National Taxpayer Advocate recommendation from 2013 and prior Annual Reports.¹²

- **Safe harbor for *de minimis* errors on information returns and payee statements.**¹³ The provision establishes a safe harbor from penalties for the failure to file correct information returns and for failure to furnish correct payee statements by providing that if the error is \$100 or less (\$25 or less in the case of errors involving tax withholding), the issuer of the information return is not required to file a corrected return and no penalty is imposed. A recipient of such a return (*e.g.*, an employee who receives a Form W-2) can elect to have a corrected return issued to him and filed with the IRS. The provision is effective for returns and statements required to be filed after December 31, 2016. This provision codifies a National Taxpayer Advocate recommendation from 2013.¹⁴
- **Requirements for the issuance of ITINs.**¹⁵ The provision provides that the IRS may issue individual taxpayer identification numbers (ITINs) if the applicant provides the documentation required by the IRS either (a) in person to an IRS employee or to a community-based certified acceptance agent (as authorized by the IRS) or (b) by mail. This provision codifies a National Taxpayer Advocate administrative recommendation from 2008.¹⁶ The provision also provides that an ITIN will expire if an individual fails to file a tax return for three consecutive years. This provision codifies a National Taxpayer Advocate administrative recommendation from 2010.¹⁷
- **Treatment of credits for purposes of certain penalties.**¹⁸ Among other things, the provision, which generally applies to returns filed after December 31, 2015, provides reasonable cause relief from the 20 percent penalty under IRC § 6676 for erroneous claims for refunds or credits. This provision codifies National Taxpayer Advocate recommendations from last year and 2011.¹⁹

12 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 5, at 69, 89, 91, 96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*). Recommendation 2.2 of this study was to eliminate the March 31st deadline for e-filed information reports. All information reports, whether e-filed or filed on paper, would be due at the end of February; National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical as the IRS Develops a Real-Time Tax System*); National Taxpayer Advocate 2011 Annual Report to Congress 284-95 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*); National Taxpayer Advocate 2009 Annual Report to Congress 338-45 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the ‘Pay Refunds First, Verify Eligibility Later’ Approach to Tax Return Processing*).

13 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 202 (2015).

14 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 5, at 69, 89, 91, 96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*). Recommendation 2.3 in this study was to minimize corrections by creating a \$50 *de minimis* threshold for corrections.

15 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 203 (2015).

16 See National Taxpayer Advocate 2008 Annual Report to Congress 126-140 (Most Serious Problem: *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*). This discussion provided several administrative recommendations to the IRS to streamline the ITIN application process, including a recommendation to promote and expand the Certified Acceptance Agent program.

17 See National Taxpayer Advocate 2010 Annual Report to Congress 319-338 (Most Serious Problem: *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*). Among the administrative recommendations to the IRS in this discussion was a recommendation that the IRS 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.

18 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 209 (2015).

19 See National Taxpayer Advocate 2014 Annual Report to Congress 351 (Legislative Recommendation: *Erroneous Refund Penalty: Amend Section 6676 to Permit “Reasonable Cause” Relief*); National Taxpayer Advocate 2011 Annual Report to Congress 544 (Legislative Recommendation: *Amend the Erroneous Refund Penalty to Permit Relief in Case of Reasonable Cause for Claim to Refundable Credits*).

- **Declaratory judgments for IRC § 501(c)(4) and other exempt organizations.**²⁰ The provision permits 501(c)(4) organizations and other exempt organizations to seek review in Federal court of any revocation of exempt status by the IRS. The provision applies to pleadings filed after the date of enactment. This provision codifies a National Taxpayer Advocate recommendation from last year.²¹
- **Suspension of running of period for filing petition of spousal relief and collection cases.**²² The provision suspends the statute of limitations in cases involving spousal relief or collections when a bankruptcy petition has been filed and a taxpayer is prohibited from filing a petition for review by the Tax Court. Under the provision, the suspension is for the period during which the taxpayer is prohibited from filing such a petition, plus 60 days. The provision applies to Tax Court petitions filed after the date of enactment. This provision codifies National Taxpayer Advocate recommendations from 2004 and 2006.²³

The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015

On July 31, 2015, Congress enacted the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015.²⁴ The Act will, beginning in 2016, change the return filing due date for partnerships and certain trusts from the 15th day of the fourth month following the close of the tax year to the 15th day of the third month following the close of the tax year.²⁵ This change codifies a National Taxpayer Advocate recommendation from 2003.²⁶ In addition, beginning in 2016, this legislation moves up the due date, from June 30 to April 15, for taxpayers with a financial interest in or signature authority over certain foreign financial accounts to file FinCEN Form 114, *Report of Foreign Bank and Financial Accounts (FBAR)*.²⁷ The new legislation also provides for a maximum six month extension (*i.e.*, until October 15) to file this form.²⁸ This change codifies a National Taxpayer Advocate recommendation from last year.²⁹

20 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 406 (2015).

21 See National Taxpayer Advocate 2014 Annual Report to Congress 371 (Legislative Recommendation: *EO Judicial And Administrative Review: Allow IRC § 501(c)(4), (c)(5), or (c)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status*). The provision goes beyond the National Taxpayer Advocate's recommendation as it does not limit declaratory judgment rights under IRC § 7428 to organizations exempt under IRC §§ 501(c)(4), (c)(5), and (c)(6).

22 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 424 (2015).

23 See National Taxpayer Advocate 2006 Annual Report to Congress 536-7 (Additional Legislative Recommendation: *Suspend the Period for Filing a Tax Court Petition During Bankruptcy*); National Taxpayer Advocate 2004 Annual Report to Congress 490-1 (Additional Legislative Recommendation: *Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court*).

24 See Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114-41, 129 Stat. 443 (2015).

25 See Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114-41, § 2006, 129 Stat. 443, 457 (2015).

26 See National Taxpayer Advocate 2003 Annual Report to Congress 302 (Key Legislative Recommendation: *Filing Due Date of Partnership and Certain Trusts*).

27 See Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114-41, § 2006, 129 Stat. 443, 458-59 (2015).

28 *Id.* at 459

29 See National Taxpayer Advocate 2014 Annual Report to Congress 331 (Legislative Recommendation: *Foreign Account Reporting: Legislative Recommendations to Reduce the Burden of Filing a Report of Foreign Bank and Financial Accounts (FBAR) and Improve the Civil Penalty Structure*). As the title indicates, this legislative recommendation contained several proposals, one of which was to change the FBAR filing due date to coincide with the due date applicable to a taxpayer's federal income tax return and Form 8938, *Statement of Specified Foreign Financial Assets* (including extensions).

The following sections discuss bills introduced during the 114th Congress that reflect legislative recommendations made by the National Taxpayer Advocate in her prior Annual Reports to Congress.

Taxpayer Rights Act of 2015

On November 30, 2015, Senator Cardin and Representative Becerra introduced companion bills entitled the Taxpayer Rights Act of 2015 (TRA 2015).³⁰ The legislation would codify the TBOR and require the Commissioner of Internal Revenue to develop annual training for all Internal Revenue Service officers and employees regarding taxpayer rights, the Office of the Taxpayer Advocate's case criteria and mission, and Taxpayer Assistance Order procedures.³¹ As noted above, Congress codified the TBOR in the Consolidated Appropriations Act, 2016.³²

TRA 2015 contains many of the National Taxpayer Advocate's prior proposals. The legislation would establish a Community Volunteer Income Tax Assistance Matching Grant Program (VITA grant program).³³ The VITA grant program would be administered in a manner that is substantially similar to the Community Volunteer Income Tax Assistance matching grants demonstration program established under Title I of Division D of the Consolidated Appropriations Act, 2008. The VITA grant program would establish tax preparation sites for low income taxpayers and operate in a manner similar to the Low Income Taxpayer Clinics (LITC) program.³⁴ In addition, the legislation would authorize the Secretary to promote the benefits of and encourage the use of qualified LITCs through the use of mass communications, referrals, and other means and allow IRS employees to refer taxpayers to the LITCs.³⁵

The National Taxpayer Advocate has recommended that the IRS create an effective oversight and penalty regime for return preparers;³⁶ TRA 2015 would require the IRS to regulate any preparers not already regulated, create a penalty for unauthorized preparation of returns, and expand and increase current preparer penalties.³⁷ The legislation also includes registration and disclosure requirements and new penalties for persons facilitating refund delivery products.³⁸

The National Taxpayer Advocate has advocated for numerous changes to the IRS's filing and reporting of federal tax liens.³⁹ Under TRA 2015, the IRS would have to weigh the benefit to the government and the harm to the taxpayer before filing a lien and would have to provide the taxpayer with an opportunity to

30 Taxpayer Rights Act of 2015, S. 2333, 114th Cong. (2015); Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. (2015).

31 S. 2333, § 308, 114th Cong. (2015); H.R. 4128, § 308, 114th Cong. (2015).

32 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 401 (2015).

33 S. 2333, § 201, 114th Cong. (2015); H.R. 4128, § 201, 114th Cong. (2015).

34 See National Taxpayer Advocate 2014 Annual Report to Congress 55-66 (Most Serious Problem: *VITA/TCE Funding: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations*).

35 See National Taxpayer Advocate 2014 Annual Report to Congress 411-416 (Legislative Recommendation: *Contact Information On Statutory Notices Of Deficiency: Revise IRC § 6212 to Require the IRS to Place Taxpayer Advocate Service Contact Information on the Face of the Statutory Notice of Deficiency and Include Low Income Taxpayer Clinic Information with Notices Impacting that Population*); National Taxpayer Advocate 2014 Annual Report to Congress, vol. 2, 1-26 (Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help from the Clinics*); National Taxpayer Advocate 2007 Annual Report to Congress 551-553 (Legislative Recommendation: *Referral to Low Income Taxpayer Clinics*).

36 See, e.g., National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*), National Taxpayer Advocate 2008 Annual Report to Congress 423-26 (Legislative Recommendation: *The Time Has Come to Regulate Federal Tax Return Preparers*).

37 S. 2333, §§ 202 and 203, 114th Cong. (2015); H.R. 4128, §§ 202 and 203, 114th Cong. (2015). The bill increases the preparer penalty for gross misconduct to 100 percent of the amount of the understatement of tax. *Id.*

38 S. 2333, §§ 202 and 203, 114th Cong. (2015); H.R. 4128, §§ 202 and 203, 114th Cong. (2015).

39 See, e.g., National Taxpayer Advocate 2009 Annual Report to Congress 357-64 (Legislative Recommendation: *Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens*).

appeal the lien determination before the lien is filed.⁴⁰ Additionally, the bill would amend the Fair Credit Reporting Act to require removal of derogatory lien-filing information from credit reports under certain circumstances.⁴¹

TRA 2015 also includes the National Taxpayer Advocate's 2011 recommendation to clarify that the scope and standard of review for taxpayers seeking equitable relief from joint and several liability under IRC § 6015(f) is *de novo*.⁴² In addition, the legislation would require the IRS to have at least one Appeals officer and one settlement officer assigned to each State and made available to the residents of each such State.⁴³ Further, the legislation would allow the National Taxpayer Advocate to appeal to the Commissioner for final determination a decision by the IRS Deputy Commissioner to modify or rescind of a Taxpayer Assistance Order.⁴⁴ Finally, the legislation would codify the National Taxpayer Advocate's authority to issue a Taxpayer Advocate Directive to the IRS.⁴⁵

Taxpayer Bill of Rights Enhancement Act of 2015

On June 16, 2015, Senators Grassley and Thune introduced the Taxpayer Bill of Rights Enhancement Act of 2015, which would amend IRC § 7803 to require the Commissioner of Internal Revenue to ensure that IRS employees are familiar with and act in accordance with taxpayer rights.⁴⁶ As noted above, this provision was enacted in the Consolidated Appropriations Act, 2016.⁴⁷ The proposed legislation would also:

- Hold individuals harmless on improper levy on individual retirement plans.⁴⁸
- Provide authority to the National Taxpayer Advocate to comment on Treasury Regulations.⁴⁹

40 S. 2333, § 301, 114th Cong. (2015) and H.R. 4128, § 301, 114th Cong. (2015).

41 S. 2333, § 302, 114th Cong. (2015) and H.R. 4128, § 302, 114th Cong. (2015).

42 S. 2333, § 303, 114th Cong. (2015) and H.R. 4128, § 303, 114th Cong. (2015). See National Taxpayer Advocate 2011 Annual Report to Congress 531-36 (Legislative Recommendation: *Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) Is De Novo*).

43 S. 2333, § 309, 114th Cong. (2015); H.R. 4128, § 309, 114th Cong. (2015). See National Taxpayer Advocate 2014 Annual Report to Congress 311 (Legislative Recommendation: *Access to Appeals: Require that Appeals Have At Least One Appeals Officer and Settlement Officer Located and Permanently Available within Every State, the District of Columbia, and Puerto Rico*); National Taxpayer Advocate 2009 Annual Report to Congress 346-50 (Legislative Recommendation: *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State*).

44 S. 2333, § 401, 114th Cong. (2015) and H.R. 4128, § 401, 114th Cong. (2015).

45 S. 2333, § 402, 114th Cong. (2015) and H.R. 4128, § 402, 114th Cong. (2015). See National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*). Taxpayer Advocate Directives mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers or all taxpayers. IRM 13.1.4.2.2.5, *Delegation Order No. 250 — Authority to Issue Taxpayer Advocate Directives* (Oct. 31, 2004).

46 S. 1578, § 101, 114th Cong. (2015).

47 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 401 (2015).

48 S. 1578, § 402, 114th Cong. (2015). See National Taxpayer Advocate 2001 Annual Report to Congress 202-214 (Legislative Recommendation: *Reinstatement of Retirement Account*).

49 S. 1578, § 404, 114th Cong. (2015). See National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*).

- Require the IRS to have at least one Appeals officer and one settlement officer located and permanently available in each State, the District of Columbia, and Puerto Rico.⁵⁰

Small Business Taxpayer Bill of Rights Act of 2015

On April 15, 2015, Senator Cornyn and Representative Thornberry introduced the Small Business Taxpayer Bill of Rights Act of 2015, which would enact a number of the National Taxpayer Advocate's previous recommendations.⁵¹ The legislation would prohibit *ex parte* communications between Appeals officers and other IRS employees.⁵² The bill also includes two recommendations relating to collection. First, it would extend the period in which a third party can bring a suit for return of levied funds or proceeds.⁵³ Second, it would waive the installment agreement fee for taxpayers whose adjusted gross income does not exceed 250 percent of the federal poverty level.⁵⁴

Finally, the legislation contains two of the National Taxpayer Advocate's recommendations regarding relief from joint and several liability. The bill would suspend the running of the period for filing a Tax Court petition seeking review of an innocent spouse claim or collection due process determination for the period of time the taxpayer is prohibited because of the automatic stay imposed under section 362 of the Bankruptcy Code from filing the petition, plus 60 additional days.⁵⁵ The legislation would also clarify that the scope and standard of review for taxpayers seeking equitable relief from joint and several liability under IRC § 6015(f) is *de novo*.⁵⁶

Taxpayer Bill of Rights Act of 2015

On February 25, 2015, Representative Roskam introduced the Taxpayer Bill of Rights Act of 2015, which would amend IRC § 7803 to require the Commissioner of Internal Revenue to ensure that IRS employees are familiar with and act in accordance with taxpayer rights.⁵⁷ As noted above, this provision was enacted

50 S. 1578, § 602, 114th Cong. (2015). See National Taxpayer Advocate 2014 Annual Report to Congress 311 (Legislative Recommendation: *Access to Appeals: Require that Appeals Have At Least One Appeals Officer and Settlement Officer Located and Permanently Available within Every State, the District of Columbia, and Puerto Rico*); National Taxpayer Advocate 2009 Annual Report to Congress 346-50 (Legislative Recommendation: *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State*).

51 Small Business Taxpayer Bill of Rights Act of 2015, S. 949, 114th Cong. (2015); H.R. 1828, 114th Cong. (2015).

52 S. 949, § 7, 114th Cong. (2015); H.R. 1828, § 7, 114th Cong. (2015). See National Taxpayer Advocate 2009 Annual Report to Congress 346-50 (Legislative Recommendation: *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State*) (noting the IRS Restructuring and Reform Act of 1998 prohibits *ex parte* communication between Appeals employees and other IRS employees, but recent IRS practices allowing Appeals employees to share office space with other IRS employees foster a perception of a lack of independence).

53 S. 949, § 9, 114th Cong. (2015); H.R. 1828, § 9, 114th Cong. (2015). The bill extends the time for third parties to bring suit from nine months to three years. See National Taxpayer Advocate 2001 Annual Report to Congress 202-09 (Legislative Recommendation: *Return of Levy or Sale Proceeds*).

54 S. 949, § 10, 114th Cong. (2015); H.R. 1828, § 10, 114th Cong. (2015). See National Taxpayer Advocate 2006 Annual Report to Congress 141-56 (Most Serious Problem: *Collection Issues of Low Income Taxpayers*) (recommending the IRS implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required).

55 S. 949, § 11, 114th Cong. (2015); H.R. 1828, § 11, 114th Cong. (2015). See National Taxpayer Advocate 2006 Annual Report to Congress 536-7 (Additional Legislative Recommendation: *Suspend the Period for Filing a Tax Court Petition During Bankruptcy*); National Taxpayer Advocate 2004 Annual Report to Congress 490-92 (Legislative Recommendation: *Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court*).

56 S. 949, § 14, 114th Cong. (2015); H.R. 1828, § 14, 114th Cong. (2015). See National Taxpayer Advocate 2006 Annual Report to Congress 536-7 (Additional Legislative Recommendation: *Suspend the Period for Filing a Tax Court Petition During Bankruptcy*); National Taxpayer Advocate 2011 Annual Report to Congress 531-36 (Legislative Recommendation: *Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) is De Novo*).

57 Taxpayer Bill of Rights Act of 2015, H.R. 1058, 114th Cong. (2015).

in the Consolidated Appropriations Act, 2016.⁵⁸ On April 15, 2015, the bill was approved by the House of Representatives, but the Senate did not act on it.

Consolidate Education Incentives

The National Taxpayer Advocate has recommended consolidating and simplifying various Code provisions to make compliance less difficult.⁵⁹ In March 2015, Senator Schumer and Representative Doggett introduced companion bills that include the National Taxpayer Advocate's recommendation to consolidate the education tax credits known as the Hope Scholarship and the Lifetime Learning Credits.⁶⁰ The proposed legislation would amend the Code to replace the two credits with a new American Opportunity Tax Credit that: (1) allows an income tax credit of up to \$3,000 of the qualified tuition and related expenses of a student who is carrying at least one half of a normal course load; (2) increases the income threshold for reductions in the credit amount based on modified adjusted gross income; (3) allows a lifetime dollar limitation on such credit of \$15,000 for all taxable years; and (4) makes 40 percent of the credit refundable. Additionally, the bill allows an exclusion from gross income of any amount received as a federal Pell grant.

58 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 401 (2015).

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

60 S. 699, 114th Cong. (2015); H.R. 1260, 114th Cong. (2015).

National Taxpayer Advocate Legislative Recommendations with Congressional Action

Alternative Minimum Tax (AMT)				
Repeal the Individual AMT	Repeal the AMT outright.			
National Taxpayer Advocate 2001 Annual Report to Congress 82–100; National Taxpayer Advocate 2004 Annual Report to Congress 383–385; National Taxpayer Advocate 2008 Annual Report to Congress 356–362.				
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 1616	Lee	10/30/2013	Referred to the Finance Committee
	HR 243	Ross	1/14/2013	Referred to Ways & Means Committee
Legislative Activity 112th Congress	HR 86	Bachmann	1/5/2011	Referred to Ways & Means Committee
	HR 99	Dreler	1/5/2011	Referred to Ways & Means Committee
	HR 547	Garrett	2/8/2011	Referred to Ways & Means Committee
	HR 3400	Garrett	11/10/2011	Referred to Ways & Means Committee
	S 727	Wyden	4/5/2011	Referred to the Finance Committee
	S 820	Shelby	4/14/2011	Referred to the Finance Committee
	HR 3804	Huelskamp	1/23/2012	Referred to Ways & Means Committee
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 1366	English	3/7/2007	Referred to the Ways & Means Committee
	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
	HR 3970	Rangel	10/25/2007	Referred to the Ways & Means Committee
	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 112th Congress	S 336	DeMint	2/14/2011	Referred to the Finance Committee
Legislative Activity 110th Congress	S 102	Kerry	1/4/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1861	Harkin	10/7/2005	Referred to the Finance Committee
Legislative Activity 108th Congress	HR 1939	Neal	5/12/2003	Referred to the Ways & Means Committee

Private Debt Collection (PDC)

Repeal PDC Provisions

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

Repeal IRC § 6306, thereby terminating the PDC initiative.

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

Tax Preparation and Low Income Taxpayer Clinics (LITC)

Matching Grants Program 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 114th Congress	Pub. L. No. 114-113, Division E (2015).			
	Bill Number	Sponsor	Date	Status
	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
Legislative Activity 113th Congress	Pub. L. No. 113-235, Division E, 128 STAT. 2130, 2336 (2014).			
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
<p>Referrals to LITCs</p> <p>National Taxpayer Advocate 2007 Annual Report to Congress 551–553.</p> <p>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.</p>				
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 1573	Durbin	9/15/2011	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 171
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
<p>Regulation of Income Tax Return Preparers</p> <p>National Taxpayer Advocate 2002 Annual Report to Congress 216–230; National Taxpayer Advocate 2003 Annual Report to Congress 270–301; National Taxpayer Advocate 2007 Annual Report to Congress 83–95 & 140-155; National Taxpayer Advocate 2008 Annual Report to Congress 423–426; National Taxpayer Advocate 2009 Annual Report to Congress 41–69. National Taxpayer Advocate 2009 Annual Report to Congress 60-74</p> <p>Create an effective oversight and penalty regime for return preparers by taking the following steps:</p> <ul style="list-style-type: none"> ◆ Enact a registration, examination, certification, and enforcement program for federal tax return preparers; ◆ Direct the Secretary of the Treasury to establish a joint task force to obtain accurate data about the composition of the return preparer community and make recommendations about the most effective means to ensure accurate and professional return preparation and oversight; ◆ Require the Secretary of the Treasury to study the impact cross-marketing tax preparation services with other consumer products and services has on the accuracy of returns and tax compliance; and ◆ Require the IRS to take steps within its existing administrative authority, including requiring a checkbox on all returns in which preparers would enter their category of return preparer (<i>i.e.</i>, attorney, CPA, enrolled agent, or unenrolled preparer) and developing a simple, easy-to-read pamphlet for taxpayers that explains their protections. 				
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee

Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
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Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Identity Theft				
Single Point of Contact National Taxpayer Advocates 2013 Annual Report		Designate a single point of contact for identity theft victims to work with the identity theft victim until all related issues are resolved.		
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 2736	Hatch	7/31/2014	Referred to Finance Committee
Public Awareness Campaign for Low Income Taxpayer Clinics				
National Taxpayer Advocate 2014 Annual Report to Congress 411-416; National Taxpayer Advocate 2014 Annual Report to Congress, vol. 2, 1-26; National Taxpayer Advocate 2007 Annual Report to Congress 551 -553.		Authorize the Secretary to promote the benefits of and encourage the use of qualified LITCs through the use of mass communications, referrals, and other means.		
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means 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.			
Legislative Activity 112th Congress	Pub. L. No. 112-41 § 501, 125 Stat. 428, 459 (2011).			
	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
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Refund Delivery Options																																					
National Taxpayer Advocate 2008 Report to Congress 427–441.	Direct the Department of the Treasury and the IRS to (1) minimize refund turnaround times; (2) implement a Revenue Protection Indicator; (3) develop a program to enable unbanked taxpayers to receive refunds on stored value cards (SVCs); and (4) conduct a public awareness campaign to disseminate accurate information about refund delivery options.																																				
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Small Business Issues																																					
Health Insurance Deduction/Self-Employed Individuals																																					
National Taxpayer Advocate 2001 Annual Report to Congress 223; National Taxpayer Advocate 2008 Annual Report to Congress 388–389.	Allow self-employed taxpayers to deduct the costs of health insurance premiums for purposes of self-employment taxes.																																				
Legislative Activity 111th Congress	Pub. L. No. 111-240, § 2504 STAT 2560 (2010).																																				
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Married Couples as Business Co-owners																																					
National Taxpayer Advocate 2002 Annual Report to Congress 172–184.	Amend IRC § 761(a) to allow a married couple operating a business as co-owners to elect out of subchapter K of the IRC and file one Schedule C (or Schedule F in the case of a farming business) and two Schedules SE if certain conditions apply.																																				
Legislative Activity 110th Congress	Pub.L. No. 110-28, Title VIII, § 8215, 121 Stat. 193, 194 (2007).																																				
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Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004—Passed/agreed to in Senate, with an amendment
	S 842	Kerry	4/9/2003	Referred to the Finance Committee
	HR 1640	Udall	4/3/2003	Referred to the Ways & Means Committee
	HR 1558	Doggett	4/2/2003	Referred to the Ways & Means Committee
Income Averaging for Commercial Fishermen				
National Taxpayer Advocate 2001 Annual Report to Congress 226.	Amend IRC § 1301(a) to provide commercial fishermen the benefit of income averaging currently available to farmers.			
Legislative Activity 108th Congress	Pub. L. No. 108-357, § 314, 118 Stat. 1468, 1469 (2004).			
Election to be Treated as an S Corporation				
National Taxpayer Advocate 2004 Annual Report to Congress 390–393.	Amend IRC § 1362(a) to allow a small business corporation to elect to be treated as an S corporation no later than the date it timely files (including extensions) its first Form 1120S, <i>U.S. Income Tax Return for an S Corporation</i> .			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 2271	Franken	3/29/2012	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
Regulation of Payroll Tax Deposits Agents				
National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	<ul style="list-style-type: none"> ◆ Amend the Code to require any person who enters into an agreement with an employer to collect, report, and pay any employment taxes to furnish a performance bond that specifically guarantees payment of federal payroll taxes collected, deducted, or withheld by such person from an employer and from wages or compensation paid to employees; ◆ Amend IRC § 3504 to require agents with an approved Form 2678, <i>Employer/Payer Appointment of Agent</i>, to allocate reported and paid employment taxes among their clients using a form prescribed by the IRS and impose a penalty for the failure to file absent reasonable cause; and ◆ Amend the U.S. Bankruptcy Code to clarify that IRC § 6672 penalties survive bankruptcy in the case of non-individual debtors. 			
Legislative Activity 114th Congress	Pub. L. No. 114-113, Division E, § 106 (2015).			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 900	Mikulski	05/08/2013	Referred to the Finance Committee
Legislative Activity 110th Congress	S 1773	Snowe	7/12/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 3583	Snowe	6/27/2006	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006—The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006—Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614

Issue Dual Address Change Notice				
National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	Issue dual address change notices related to an employer making employment tax payments (with one notice sent to both the employer's former and new address)			
Legislative Activity 114th Congress	Pub. L. No. 114-113, Division E, § 106 (2015).			
Legislative Activity 113th Congress	Pub. L. No. 113-76, Division E, Title I, § 106, 128 Stat. 5, 190 (2014) and Pub. L. No. 113-235, Division E, Title I, § 106, 128 Stat. 2130, 2338 (2014).			
Special Consideration for offer in compromise				
National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	Give special consideration to an offer in compromise (OIC) request from a victim of fraud or bankruptcy by a third-party payroll tax preparer.			
Legislative Activity 113th Congress	Pub. L. No. 113-76, Division E, Title I, § 106, 128 Stat. 5, 190 (2014) and Pub. L. No. 113-235, Division E, Title I, § 106, 128 Stat. 2130, 2338 (2014).			
Simplification				
Reduce the Number of Tax Preferences				
National Taxpayer Advocate 2010 Annual Report to Congress 365–372.	Simplify the complexity of the tax code generally by reducing the number of tax preferences.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
Simplify and Streamline Education Tax Incentives				
National Taxpayer Advocate 2008 Annual Report to Congress 370–372; National Taxpayer Advocate 2004 Annual Report to Congress 403–422.	Enact reforms to simplify and streamline the education tax incentives by consolidating, creating uniformity among, or adding permanency to the various education tax incentives. Specifically, (1) incentives under § 25A should be consolidated with § 222 and possibly § 221, (2) the education provisions should be made more consistent regarding the relationship of the student to the taxpayer, (3) the definitions for “Qualified Higher Education Expenses” and “Eligible Education Institution” should be simplified, (4) the income level and phase-out calculations should be more consistent under the various provisions, (5) all dollar amounts should be indexed for inflation, and (6) after initial use of sunset provisions and simplification amendments, the incentives should be made permanent.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 699	Schumer	3/10/2015	Referred to the Finance Committee
	HR 1260	Doggett	3/4/2015	Referred to the Ways and Means Committee
Legislative Activity 113th Congress	S 835	Schumer	4/25/2013	Referred to the Finance Committee
	HR 1738	Doggett	4/25/2013	Referred to the Ways & Means Committee
	HR 3476	Israel	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
	S 3267	Schumer	6/6/2012	Referred to the Finance Committee
	HR 6522	Israel	9/21/2012	Referred to the Ways & Means Committee

Simplify and Streamline Retirement Savings Tax Incentives				
National Taxpayer Advocate 2008 Annual Report to Congress 373–374; National Taxpayer Advocate 2004 Annual Report to Congress 423–432.		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.		
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
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	Emanuel	4/25/2006	Referred to the Ways & Means Committee
	HR 5367	Emanuel	5/11/2006	Referred to the Ways & Means Committee
IRS Forms Revisions				
National Taxpayer Advocate 2004 Annual Report to Congress 480; National Taxpayer Advocate 2010 Annual Report to Congress 40.		Revise Form 1040, Schedule C, to include a line item showing the amount of self-employment income that was reported on Forms 1099-MISC.		
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee

<p>IRS to Promote Estimated Tax Payments Through the Electronic Federal Tax Payment System (EFTPS)</p> <p>National Taxpayer Advocate 2005 Annual Report to Congress 381–396.</p>	<p>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.</p>			
	Bill Number	Sponsor	Date	Status
<p>Legislative Activity 109th Congress</p>	S 1321RS	Santorum	6/28/2005	<p>9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336</p> <p>9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614</p>
<p>Study of Use of Voluntary Withholding Agreements</p> <p>National Taxpayer Advocate 2004 Annual Report to Congress 478–489; National Taxpayer Advocate 2005 Annual Report to Congress 381-396.</p>	<p>Amend IRC § 3402(p)(3) to specifically authorize voluntary withholdings agreements between independent contractors and service-recipients as defined in IRC § 6041A(a)(1).</p>			
	Bill Number	Sponsor	Date	Status
<p>Legislative Activity 109th Congress</p>	S 1321RS	Santorum	6/28/2005	<p>9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336.</p> <p>9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614</p>
<p>Require Form 1099 Reporting for Incorporated Service Providers</p> <p>National Taxpayer Advocate 2007 Annual Report to Congress 494–496.</p>	<p>Require service recipients to issue Forms 1099-MISC to incorporated service providers and increase the penalties for failure to comply with the information reporting requirements.</p>			
<p>Legislative Activity 111th Congress</p>	<p>Pub. L No. 111-148 § 9006 (2010).</p> <p>However, this Act also contains a reporting requirement for goods sold, which the National Taxpayer Advocate opposes because of the enormous burden it places on businesses. See Legislative Recommendation: Repeal the Information Reporting Requirement for Purchases of Goods over \$600, but Require Reporting on Corporate and Certain Other Payments.</p>			
<p>Require Financial Institutions to Report All Accounts to the IRS by Eliminating the \$10 Threshold on Interest Reporting</p> <p>National Taxpayer Advocate 2007 Annual Report to Congress 501–502.</p>	<p>Eliminate the \$10 interest threshold beneath which financial institutions are not required to file Form 1099-INT reports with the IRS.</p>			
	Bill Number	Sponsor	Date	Status
<p>Legislative Activity 112th Congress</p>	S 1289	Carper	6/28/2011	Referred to the Finance Committee
<p>Legislative Activity 111th Congress</p>	S 3795	Carper	9/16/2010	Referred to the Finance Committee

<p>Revise Form 1040, Schedule C to Break Out Gross Receipts Reported on Payee Statements Such as Form 1099</p> <p>National Taxpayer Advocate 2007 Annual Report to Congress 40.</p>	<p>Administrative recommendation that the IRS add a line to Schedule C so that taxpayers would separately report the amount of income reported to them on Forms 1099 and other income not reported on Forms 1099. If enacted by statute, the IRS would be required to implement this recommendation.</p>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
<p>Include a Checkbox on Business Returns Requiring Taxpayers to Verify that they Filed all Required Forms 1099</p> <p>National Taxpayer Advocate 2007 Annual Report to Congress 40.</p>	<p>Administrative recommendation that the IRS require all businesses to answer two questions on their income tax returns: “Did you make any payments over \$600 in the aggregate during the year to any unincorporated trade or business?” and “If yes, did you file all required Forms 1099?” S 3795 would require the IRS to study whether placing a checkbox or similar indicator on business tax returns would affect voluntary compliance.</p>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
<p>Authorize Voluntary Withholding Upon Request</p> <p>National Taxpayer Advocate 2007 Annual Report to Congress 493–494.</p>	<p>Authorize voluntary withholding agreements between independent contractors and service recipients.</p>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
<p>Require Backup Withholding on Certain Payments When TINs Cannot Be Validated</p> <p>National Taxpayer Advocate 2005 Annual Report to Congress 238–248.</p>	<p>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.)</p>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
<p>Worker Classification</p> <p>National Taxpayer Advocate 2008 Annual Report to Congress 375–390.</p>	<p>Direct Treasury and the Joint Committee on Taxation to report on the operation of the revised worker classification rules and provide recommendations to increase compliance.</p>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee

Taxpayer Bill of Rights and *De Minimis* “Apology” Payments**Taxpayer Bill of Rights**

National Taxpayer Advocate 2014 Annual Report to Congress
 National Taxpayer Advocate 2013 Annual Report to Congress
 National Taxpayer Advocate 2011 Annual Report to Congress 493-518
 National Taxpayer Advocate 2007 Annual Report to Congress 478–48.

Enact a Taxpayer Bill of Rights setting forth the fundamental rights and obligations of U.S. taxpayers.

Legislative Activity 114th Congress

Pub. L. No. 114-113, Division Q § 401 (2015).

Legislative Activity	Bill Number	Sponsor	Date	Status
	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
	S 1578	Grassley	6/16/2015	Referred to the Finance Committee
	S 943	Portman	4/15/2015	Referred to the Finance Committee
	S 951	Ayotte	4/15/2015	Referred to the Finance Committee
	HR 1058	Roskam	2/25/2015	Passed the House of Representatives, and was referred to the Senate Finance Committee on 4/16/2015
Legislative Activity 113th Congress	HR 2768	Roskam	6/22/2013	Passed the House of Representatives, and was referred to the Senate Finance Committee on 8/31/2013
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Ways & Means Committee
	HR 5047	Becerra	4/15/2010	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee

***De Minimis* “Apology” Payments**

National Taxpayer Advocate 2007 Annual 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.

Legislative Activity	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee

Simplify the Tax Treatment of Cancellation of Debt Income

Simplify the Tax Treatment of Cancellation of Debt Income

National Taxpayer Advocate 2008 Annual Report to Congress 391–396.

Enact one of several proposed alternatives to remove taxpayers with modest amounts of debt cancellation from the cancellation of debt income regime.

Legislative Activity	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	HR 4561	Lewis	2/2/2010	Referred to the Ways & Means Committee

Joint and Several Liability

Tax Court Review of Request for Equitable Innocent Spouse Relief

National Taxpayer Advocate 2001 Annual Report to Congress 128–165.

Amend IRC § 6015(e) to clarify that taxpayers have the right to petition the Tax Court to challenge determinations in cases seeking relief under IRC § 6015(f) alone.

Legislative Activity 109th Congress

Pub. L. No. 109-432, § 408, 120 Stat. 3061, 3062 (2006).

Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court).

National Taxpayer Advocate 2004 Annual Report to Congress 490–92.

Allow a taxpayer seeking review of an innocent spouse claim or a collection case in U.S. Tax Court a 60-day suspension of the period for filing a petition for review, when the U.S. Bankruptcy Court has issued an automatic stay in a bankruptcy case involving the taxpayer's claim.

	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 949	Cornyn	4/15/2015	Referred to the Finance Committee
	HR 1828	Thornberry	4/15/2015	Referred to the Ways and Means Committee
Legislative Activity 113th Congress	S 725	Cornyn	4/15/2013	Referred to the Finance Committee
	HR 3479	Thornberry	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Ways & Means Committee

Clarify that the Scope and Standard of Tax Court Determinations Under IRC § 6015(f) Is *De Novo*.

National Taxpayer Advocate 2011 Annual Report to Congress 531–536.

Amend IRC § 6015 to specify that the scope and standard of review in tax court determinations under IRC § 6015(f) is *de novo*.

	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
	S 949	Cornyn	4/15/2015	Referred to the Finance Committee
	HR 1828	Thornberry	4/15/2015	Referred to the Ways and Means Committee
Legislative Activity 113th Congress	S 725	Cornyn	4/15/2013	Referred to the Finance Committee
	HR 3479	Thornberry	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 60550	Becerra	6/28/2012	Referred to the Ways & Means Committee

Collection Issues

Improve Offer In Compromise Program Accessibility

National Taxpayer Advocate 2006 Annual Report to Congress 507–519.

Repeal the partial payment requirement, or if repeal is not possible, (1) provide taxpayers with the right to appeal to the IRS Appeals function the IRS's decision to return an offer without considering it on the merits; (2) reduce the partial payment to 20 percent of current income and liquid assets that could be disposed of immediately without significant cost; and (3) create an economic hardship exception to the requirement.

	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
	HR 2342	Lewis	5/12/2009	Referred to the Ways & Means Committee

Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens

2009 National Taxpayer Advocate Report to Congress 357–364.

Provide clear and specific guidance about the factors the IRS must consider when filing a Notice of Federal Tax Lien (NFTL) and amend the Fair Credit Reporting Act to set specific timeframes for reporting derogatory tax lien information on credit reports.

	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
	HR 6439	Hastings	11/18/2010	Referred to the Ways & Means Committee

Permit the IRS to Release Levies on Small Business Taxpayers

2011 National Taxpayer Advocate Report to Congress 537–543.

Amend IRC § 6343(a)(1)(d) to: permit the IRS, in its discretion, to release a levy against the taxpayer's property or rights to property if the IRS determines that the satisfaction of the levy is creating an economic hardship due to the financial condition of the taxpayer's business.

	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 4368	McDermott	4/17/2012	Referred to the Ways & Means Committee

Return of Levy or Sale Proceeds					
National Taxpayer Advocate 2001 Annual Report to Congress 202–214.	Amend IRC § 6343(b) to extend the period of time within which a third party can request a return of levied funds or the proceeds from the sale of levied property from nine months to two years from the date of levy. This amendment would also extend the period of time available to taxpayers under IRC § 6343(d) within which to request a return of levied funds or sale proceeds.				
	Bill Number	Sponsor	Date	Status	
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee	
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee	
	S 1578	Grassley	6/16/2015	Referred to the Finance Committee	
	S 949	Cornyn	4/15/2015	Referred to the Finance Committee	
	HR 1828	Thornberry	4/15/2015	Referred to the Ways and Means Committee	
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee	
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee	
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee	
	HR 1677	Rangel	3/26/2007	Referred to the Finance Committee	
Legislative Activity 109th Congress	S 1321 RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614	
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment	
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee	
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in House	
	HR 586	Lewis	2/13/2001	4/18/02–Passed the House with an amendment; referred to the Senate	
Reinstatement of Retirement Accounts					
National Taxpayer Advocate 2001 Annual Report to Congress 202–214.	Amend the following IRC sections to allow contributions to individual retirement accounts and other qualified plans from the funds returned to the taxpayer or to third parties under IRC § 6343: ♦ § 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 114th Congress	S 1578	Grassley	6/16/2015	Finance Committee	
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee	
	HR 1677	Rangel	3/26/2007	Referred to the Finance Committee	
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614	

Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in H.R. 1528 through an amendment and HR 1528 passed in lieu of S 882
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to Senate
	HR 3991	Houghton	3/19/2002	Defeated in the House
Consolidation of Appeals of Collection Due Process (CDP) Determinations National Taxpayer Advocate 2005 Annual Report to Congress 451–470.	Consolidate judicial review of CDP hearings in the United States Tax Court, clarify the role and scope of Tax Court oversight of Appeals' continuing jurisdiction over CDP cases, and address the Tax Court's standard of review for the underlying liability in CDP cases.			
Legislative Activity 109th Congress	Pub. L. No. 109-280, § 855, 120 Stat. 1019 (2006).			
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. 1418, 1600 (2004).			
Waiver of Installment Agreement Fees for Low Income Taxpayers National Taxpayer Advocate 2006 Annual Report to Congress 141–56 (Most Serious Problem: Collection Issues of Low Income Taxpayers).	Implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 949	Cornyn	4/15/2015	Referred to the Finance Committee
	HR 1828	Thornberry	4/15/2015	Referred to the Ways and Means Committee
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
Strengthen the Independence of the IRS Office of Appeals National Taxpayer Advocate 2009 Annual Report to Congress 346-350.	Strengthen the independence of the IRS office of Appeals and require at least one appeals officer and settlement officer in each state. In addition the Office of Appeals should be independent from the IRS, should eliminate prohibited ex parte communications with the IRS.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
	S 1578	Grassley	6/16/2015	Referred to the Finance Committee
	S 949	Cornyn	4/15/2015	Referred to the Finance Committee
	HR 1828	Thornberry	4/15/2015	Referred to the Ways & Means Committee

Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
Penalties and Interest				
Erroneous Refund Penalty				
National Taxpayer Advocate 2014 Annual Report to Congress 351. National Taxpayer Advocate 2011 Annual Report to Congress 544.	Amend section 6676 to clarify that the penalty does not apply to individual taxpayers who acted with reasonable cause and in good faith in erroneously claiming a credit or refund. Taking into account all of taxpayers' facts and circumstances in determining whether they had such reasonable cause would bring this statutory penalty into conformity with the TBOR right to a fair and just tax system.			
Legislative Activity 114th Congress	Pub. L. No. 114-113, Division Q § 209 (2015).			
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
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
	HR 3991	Houghton	3/19/2002	Defeated in the House
Family Issues				
Uniform Definition of a Qualifying Child				
National Taxpayer Advocate 2001 Annual Report to Congress 78–100.	Create a uniform definition of “qualifying child” applicable to tax provisions relating to children and family status.			
Legislative Activity 108th Congress	Pub. L. No. 108-311, § 201, 118 Stat. 1169-1175 (2004).			
Means Tested Public Assistance Benefits				
National Taxpayer Advocate 2001 Annual Report to Congress 76–127.	Amend the IRC §§ 152, 2(b) and 7703(b) to provide that means-tested public benefits are excluded from the computation of support in determining whether a taxpayer is entitled to claim the dependency exemption and from the cost of maintenance test for the purpose of head-of-household filing status or “not married” status.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 22	Houghton	1/3/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 5505	Houghton	10/01/2002	Referred to the Ways & Means Committee
Credits for the Elderly or the Permanently Disabled				
National Taxpayer Advocate 2001 Annual Report to Congress 218–219.	Amend IRC § 22 to adjust the income threshold amount for past inflation and provide for future indexing for inflation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 107th Congress	S 2131	Bingaman	4/15/2002	Referred to the Finance Committee

Electronic Filing Issues				
Scanable Returns				
National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96.	Require electronically prepared paper returns to include scanable 2-D code.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S. 2736	Hatch	7/14/14	Referred to the Finance Committee
Return Filing and Processing				
National Taxpayer Advocate 2013 Annual Report to Congress, Volume 2, 68-96.	Eliminate the March 31st deadline for e-filed information reports. All information reports, whether e-filed or filed on paper, would be due at the end of February.			
Legislative Activity 114th Congress	Pub. L. No. 114-113, Division Q § 201 (2015).			
Safe harbor for de minimis errors returns and payee statements				
National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96.	Safe harbor for <i>de minimis</i> errors on information			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	Pub. L. No. 114-113, Division Q § 202 (2015).			
Legislative Activity 113th Congress	S 2736	Hatch	7/14/14	Referred to the Finance Committee
Direct Filing Portal				
National Taxpayer Advocate 2004 Annual Report to Congress 471-477.	Amend IRC § 6011(f) to require the IRS to post fill-in forms on its website and make electronic filing free to all individual taxpayers.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 110th Congress	S 1074	Akaka	3/29/2007	Referred to the Finance Committee
	HR 5801	Lampson	4/15/2008	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006—Referred to the Finance Committee; Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006—Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Free Electronic Filing For All Taxpayers				
National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96	Revise IRC § 6011(f) to provide that the Secretary shall make electronic return preparation and electronic filing available without charge to all individual taxpayers.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	S 2736	Hatch	7/14/14	Referred to the Finance Committee

Office of the Taxpayer Advocate

Confidentiality of Taxpayer Communications

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

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

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

Access to Independent Legal Counsel

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

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

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

Taxpayer Advocate Directive

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

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

	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 2333	Cardin	11/30/2015	Referred to the Finance Committee
	HR 4128	Becerra	11/30/2015	Referred to the Ways & Means Committee
	S 949	Cornyn	4/15/2015	Referred to the Finance Committee
	HR 1828	Thornberry	4/15/2015	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee

Exempt Organizations (EO)

EO Judicial and Administrative Review

National Taxpayer Advocate 2014 Annual Report to Congress 573–602 371-379.

Amend IRC § 7428 to allow taxpayers seeking exemption as IRC § 501(c)(4), (c)(5), or (c)(6) organizations to seek a declaratory judgment on the same footing as those seeking exempt status as IRC § 501(c)(3) organizations.

Legislative Activity 114th Congress **Pub. L. No. 114-113, Division Q § 406 (2015).**

Other Issues				
Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact				
National Taxpayer Advocate 2008 Annual Report to Congress 419–422.		Modify IRC § 6707A to ameliorate unconscionable impact. Section 6707A of the IRC imposes a penalty of \$100,000 per individual per year and \$200,000 per entity per year for failure to make special disclosures of a “listed transaction.”		
Legislative Activity 111th Congress		Pub. L. No. 111-124, § 2041 Stat. 2560 (2010).		
	Bill Number	Sponsor	Date	Status
	S 2771	Baucus	11/16/2009	Referred to the Finance Committee
	HR 4068	Lewis	11/16/2009	Referred to the Ways & Means Committee
	S 2917	Baucus	12/18/2009	Referred to the Finance Committee
Eliminate Tax Strategy Patents				
National Taxpayer Advocate 2007 Annual Report to Congress 512–524.		Bar tax strategy patents, which increase compliance costs and undermine respect for congressionally-created incentives, or require the PTO to send any tax strategy patent applications to the IRS so that abuse can be mitigated.		
Legislative Activity 112th Congress		Pub. L. No. 112-29 § 14(a), 125 Stat. 284, 327 (2011).		
Disclosure Regarding Suicide Threats				
National Taxpayer Advocate 2001 Annual Report to Congress 227.		Amend IRC § 6103(i)(3)(B) to allow the IRS to contact and provide necessary return information to specified local law enforcement agencies and local suicide prevention authorities, in addition to federal and state law enforcement agencies in situations involving danger of death or physical injury.		
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in HR 1528 through an amendment and HR 1528 passed in lieu of S 882
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
Attorney Fees				
National Taxpayer Advocate 2002 Annual Report to Congress 161–171.		Allow successful plaintiffs in nonphysical personal injury cases who must include legal fees in gross income to deduct the fees “above the line.” Thus, the net tax effect would not vary depending on the state in which a plaintiff resides.		
Legislative Activity 108th Congress		Pub. L. No. 108-357, § 703, 118 Stat. 1418, 1546-48 (2004).		
Attainment of Age Definition				
National Taxpayer Advocate 2003 Annual Report to Congress 308–311.		Amend IRC § 7701 by adding a new subsection as follows: “Attainment of Age. An individual attains the next age on the anniversary of his date of birth.”		
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 4841	Burns	7/15/2004	7/21/2004–Passed the House; 7/22/2004–Received in the Senate
Home-Based Service Workers (HBSW)				
National Taxpayer Advocate 2001 Annual Report to Congress 193–201.		Amend IRC § 3121(d) to clarify that HBSWs are employees rather than independent contractors.		
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
Legislative Activity 107th Congress	S 2129	Bingaman	4/15/2002	Referred to the Finance Committee

Restrict Access to the Death Master File				
National Taxpayer Advocate 2011 Annual Report to Congress 519–523.	Restrict access to certain personally identifiable information in the DMF. The National Taxpayer Advocate is not recommending a specific approach at this time, but outlines below several available options.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	H.J. Res. 59, 113th Cong. § 203 (2013).			
Legislative Activity 112th Congress	S 3432	Nelson	7/25/2012	Referred to the Finance Committee
	HR 6205	Nugent	7/26/2012	Referred to S 835 the Ways & Means Committee
Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes				
National Taxpayer Advocate 2012 Annual Report to Congress 521.	Amend IRC § 7871(a) to include the adoption credit (IRC § 23) in the list of Code sections for which a Native American tribal government is treated as a “State”.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 114th Congress	S 835	Heitkamp	3/23/2015	Referred to the Finance Committee
	HR 1542	Kilmer	3/23/2015	Referred to the Ways and Means Committee
Legislative Activity 113th Congress	S 835	Johnson	7/09/2014	Referred to the Finance Committee
	HR 1738	Kilmer	6/12/2013	Referred to the Ways and Means Committee
Filing Due Dates of Partnerships and certain Trusts				
National Taxpayer Advocate 2003 Annual Report to Congress 302.	Amend Internal Revenue Code section 6072(a) to change the regular filing deadline for partnerships described in Section 6031 and trusts described in Section 6012(a)(4) as follows: <ul style="list-style-type: none"> ◆ For partnerships and trusts making returns on the basis of a calendar year: Change the regular filing deadline from the 15th day of April following the close of the calendar year to the 15th day of March following the close of the calendar year. ◆ For partnerships and trusts making returns on the basis of a fiscal year: Change the regular filing deadline from the 15th day of the fourth month following the close of the fiscal year to the 15th day of the third month following the close of the fiscal year 			
Legislative Activity 114th Congress	Pub. L. No. 114-41 § 2006, 129 Stat. 443, 457 (2015).			
Foreign Account Reporting				
National Taxpayer Advocate 2014 Annual Report to Congress 331.	Align the FBAR filing deadline and threshold(s) with the Form 8938 filing deadline and threshold(s). Change the FBAR filing due date to coincide with the due date applicable to a taxpayer’s federal income tax return and Form 8938 (including extensions).			
Legislative Activity 114th Congress (July 31, 2015)	Pub. L. No. 114-41 § 2006, 129 Stat. 443, 458-459 (2015).			

Individual Taxpayer Identification Numbers (ITINs)

Requirements for the Issuance of ITINs

National Taxpayer Advocate 2008 Annual Report to Congress 126.
National Taxpayer Advocate 2010 Annual Report to Congress 319.

Administrative recommendation that the IRS should promote the Certified Acceptance Agent program and use other federal agencies to perform acceptance agent duties as contemplated in the Treasury Regulation (e.g., the Postal Service performs a similar service in processing passport applications).

Legislative Activity 114th Congress (July 31, 2015)

Pub. L. No. 114-113, Division Q § 203 (2015).

Develop a process to verify that previously issued ITINs have been used for tax administration purposes

National Taxpayer Advocate 2008 Annual Report to Congress 126.
National Taxpayer Advocate 2010 Annual Report to Congress 319

Administrative recommendation the IRS should 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

Legislative Activity 114th Congress

Pub. L. No. 114-113, Division Q § 203 (2015).

LR #1 STATUTE OF LIMITATIONS: Repeal or Fix Statute Suspension Under IRC § 7811(d)

TAXPAYER RIGHTS IMPACTED¹

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

PROBLEM

Under Internal Revenue Code (IRC) § 7811(d)(1), the statutory period of limitations on assessment or collection is suspended “beginning on the date of the taxpayer’s application ... [for a Taxpayer Assistance Order (TAO)] and ending on the date of the National Taxpayer Advocate’s decision with respect to such application.”² Thus, if the IRS significantly harms a taxpayer financially and repeatedly ignores his or her concerns, and the taxpayer asks TAS for help, IRC § 7811(d) rewards the IRS and punishes the taxpayer by granting the IRS with more time to make and collect tax assessments. In this way it undermines TAS’s mission and the taxpayer’s rights to *quality service, finality, privacy (which includes the right to expect that enforcement will be no more intrusive than necessary), and a fair and just tax system.*

The IRS has not implemented statute suspension because its computers cannot reliably track extensions of these periods.³ It remains impossible to track many of these extensions, including extensions on cases that do not meet TAS’s acceptance criteria.⁴

The IRS protects its interests in other ways. If the end of a limitations period is near, the IRS routinely asks the taxpayer to agree to an extension even if TAS is involved. It may also continue enforcement activity on TAS cases, if necessary.⁵ Even if TAS issues a TAO ordering the IRS to suspend collection, TAS will generally agree to modify the TAO if collection is in jeopardy.⁶ If it does not, the Commissioner, Deputy Commissioner, or National Taxpayer Advocate may nonetheless modify or rescind the TAO.⁷

In addition, IRC § 7811(d) only applies to taxpayers who submit written TAO applications, making it elective for those who know how to avoid it (*e.g.*, by calling TAS) and a trap for those who do

1 See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 The periods subject to suspension and the length of any such suspension are subject to a wide variety of interpretations, as discussed below.

3 See, *e.g.*, Memorandum from Commissioner of Internal Revenue, *Taxpayer Advocate Service Statute Suspension Provisions Under IRC Section 7811(d)* (Nov. 10, 2003); Internal Revenue Manual (IRM) 13.1.14, *Suspension of the Statutes of Limitation Under IRC § 7811(d)* (Oct. 31, 2004).

4 Statute suspension does not apply if the application is rejected on the same day it is received. See Treas. Reg. § 301.7811-(e)(1).

5 See, *e.g.*, IRM 5.1.9.4.1(8) (June 24, 2014); IRM 13.1.18.2.4(4) (Feb. 1, 2011); IRM 13.1.10.15, *Suspending Collection Action* (Apr. 9, 2012); *White v. Comm’r*, 899 F. Supp. 767, 773 (D. Mass. 1995).

6 See, *e.g.*, IRM 13.1.20.3.1(5) (Dec. 15, 2007) (“TAS will consider modifying the TAO if there are compelling circumstances that require immediate action by the IRS (*e.g.*, situations where collection is in jeopardy may require the immediate issuance of a Notice of Levy”).

7 IRC § 7811(c).

not.⁸ Further, about 54 percent of the taxpayers who requested TAS assistance in writing in fiscal year (FY) 2015 were unrepresented — the taxpayers most likely to get caught in the trap of inadvertently granting the IRS additional time for enforcement.⁹ If implemented, the statute suspension would also create uncertainty and disputes about deadlines that would otherwise be clear.

A recent decision by the United States Court of Appeals for the 5th Circuit in *Rothkamm* increases the need for Congress to repeal IRC § 7811(d).¹⁰ The 5th Circuit held that IRC § 7811(d) extended the period for filing a wrongful levy claim, a deadline applicable to a third party. Thus, any third party or taxpayer who misses a statutory deadline (e.g., the deadline to file a wrongful levy claim, to request a refund or a collection due process (CDP) hearing, or to petition the tax court) after applying to TAS may now argue that the application extended his or her deadline. This expansion of IRC § 7811(d) and uncertainty concerning the period(s) to which it applies will exacerbate implementation problems and increase uncertainty and controversy.¹¹ Congress should repeal IRC § 7811(d), or at least fix it.

EXAMPLES

Example 1: Statute Suspension Could Penalize Taxpayers Who Seek TAS Assistance

Taxpayer A seeks TAS assistance with a collection matter by submitting a Form 911, *Request for Taxpayer Advocate Service Assistance (and Application for Taxpayer Assistance Order)* to TAS. Taxpayer B has the same problem but does not seek TAS assistance. While TAS is attempting to resolve Taxpayer A's problem, prior to the issuance of a TAO, the IRS retains the discretion to issue a lien or levy to collect the liability if necessary.¹² Because Taxpayer A's request for TAS assistance triggers IRC § 7811(d)(1), he or she is subject to IRS collection for longer than the normal ten-year period, but Taxpayer B is not.¹³ Thus, IRC § 7811(d) penalizes Taxpayer A for seeking TAS assistance.

Example 2: Statute Suspension Will Generate Unnecessary Controversy and Inconsistency

The IRS proposes adjustments to the returns of Taxpayers C, D, and E, and mails a statutory notice of deficiency (SNOD) to each of them on the same day. A SNOD provides a taxpayer with the right to petition the Tax Court if he or she disagrees with the adjustments described in the SNOD and specifies

8 See, e.g., Treas. Reg. §§ 301.7811-1(b) and -1(e)(4).

9 Taxpayer Advocate Management Information System before (TAMIS) query (Oct. 26, 2015).

10 *Rothkamm v. United States*, 802 F.3d 699 (5th Cir. 2015) (hereinafter *Rothkamm*), *rev'g and remanding*, 114 A.F.T.R.2d (RIA) 5919, 2014-2 U.S. Tax Cas. (CCH) 50441 (M.D. La. 2014).

11 See Treas. Reg. § 301.7811-1(e); *Rothkamm* at 700 (assuming without discussion that IRC § 7811(d) suspended the period from the date TAS opened the case until the day TAS closed the case).

12 See, e.g., IRM 5.1.9.4.1(8) (June 24, 2014) ("While TAS is attempting to work with the taxpayer to resolve the tax problem, action to collect the tax, such as filing of NFTL or levy, while not prohibited, will generally be suspended. If the RO believes such action is necessary, e.g., the taxpayer is dissipating assets; TAS should be contacted and advised of Collection's plans in advance."); IRM 13.1.18.2.4(4) (Feb. 1, 2011); IRM 13.1.10.15, *Suspending Collection Action* (Apr. 9, 2012) ("If the RO, Operating Division or Functional Unit refuses to suspend lien filing or levy action, discuss with the Manager whether the issuance of a TAO is appropriate."). See also *White v. Comm'r*, 899 F. Supp. 767, 772 (D. Mass. 1995) (noting a TAO "application merely suspends the running of the period of limitations on collection. It does not immediately suspend the collection activity itself.").

13 IRC § 6502.

the last day for filing.¹⁴ It must also advise the taxpayer of his or her “right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.”¹⁵ None of the taxpayers understand the adjustment or how to file a petition.

Taxpayers C and D both mail Form 911, *Request for Taxpayer Advocate Service Assistance (and Application for Taxpayer Assistance Order)*, to TAS on the same day, but Taxpayer E does not. Taxpayer D has proof the IRS received his Form 911 the next day, but Taxpayer C does not. Unbeknownst to them, Taxpayer C and Taxpayer D’s forms do not actually reach a TAS office for another 15 and 20 days, respectively, due to security screening and interoffice mail delays. Within one day of receiving the Forms 911 (17 and 22 days, respectively, after receipt by the IRS), TAS determines that Taxpayers C and D are eligible for TAS assistance and assigns a case advocate (CA) to assist them.¹⁶ Three days later (20 and 25 days, respectively, after receipt by the IRS), the CA determines Taxpayers C and D are experiencing a “significant hardship” and sends Operation Assistance Requests (OARs) to the Operating Division (OD) to obtain more information. Twenty-six days later — 30 days after TAS’s receipt of each Form 911 (46 and 51 days, respectively, after receipt by the IRS) — the CA receives and reviews the information and determines not to recommend issuing a TAO. Five days later — 35 days after receipt by TAS (51 and 56 days, respectively, after receipt by the IRS), the CA contacts the taxpayers to explain his decision and closes the cases.

Twenty-nine days after the deadline for filing a petition in Tax Court, which is printed on the SNOD, Taxpayers C, D and E each contact a low income taxpayer clinic (LITC). The LITC advises Taxpayer E not to file because his petition would be untimely, but advises Taxpayers C and D to file because they can argue the deadline for filing a petition with the Tax Court was extended by the period the TAO application was pending.¹⁷

Because Taxpayer C’s case is appealable to the 5th Circuit, but Taxpayer D’s is not, the Tax Court is more likely to accept Taxpayer C’s argument that the period was extended, pursuant to *Rothkamm*, even if it holds that Taxpayer D’s is not.¹⁸

If the court accepts Taxpayer C’s or D’s argument, it will have to decide how long the TAO application extended the period. The IRS may argue it was extended from TAS’s receipt until TAS’s determination to accept the case (*i.e.*, by one day for each), from the IRS’s receipt until TAS’s determination to accept the case (*i.e.*, by 16 or 21 days, for Taxpayers C and D, respectively), from TAS’s receipt until its determination that Taxpayers C and D were facing a “significant hardship” and that it would send an OAR and not a TAO (*i.e.*, by three days for each), or from the IRS’s receipt until this determination (*i.e.*, by 20 or 24 days for C and D, respectively); whereas Taxpayers C and D may argue it was extended by the period their

14 IRC § 6212; IRC § 6213(a) (providing that taxpayers have 90 days (150 days if they are outside the United States) from the date of the SNOD to petition the Tax Court); IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3463(a), 112 Stat. 685, 767 (1998) (the IRS “shall include on each notice of deficiency under section 6212 ... the last day on which the taxpayer may file a petition with the Tax Court.”).

15 RRA 98, Pub. L. No. 105-206, § 1102(b), 112 Stat. 685, 703 (1998) (modifying IRC § 6212(a)).

16 The application is not frivolous or subject to a penalty for frivolous submissions. See IRC § 6702(b)(2)(B)(ii)(III) (penalty for frivolous TAO applications).

17 *Rothkamm* held that IRC § 7811(d) tolled the period for filing a wrongful levy claim, which by operation of IRC § 6532(c)(2), extended the period for filing suit.

18 Although the Tax Court is a national court with its own precedents, where a case before it is appealable to a circuit court that disagrees with it on a legal issue, it will follow the decision of that court under the so-called *Golsen* rule. See *Golsen v. Comm’r*, 54 T.C. 742, 756-758 (1970), *aff’d*, 445 F.2d 985 (10th Cir. 1971).

cases were open in TAS (*i.e.*, by 30 days) or from the IRS's receipt of Form 911 until TAS closed their cases (*i.e.*, by 51 or 56 days, respectively).¹⁹

Further, the arguments may not be the same for Taxpayers C and D because Taxpayer D retained proof of receipt of Form 911 by the IRS or because Taxpayer D's form traveled more slowly to TAS through IRS security and interoffice mail.²⁰ Thus, a deadline that was previously clear, evenly applied, and easy to administer may now be unclear, unevenly applied, difficult to administer, and subject to litigation.

Example 3: Statute Suspension Could Be a Trap for the Uninformed

Taxpayers F, G, and H each ask TAS for assistance with collection matters. Taxpayer F seeks assistance by calling. Taxpayer G seeks assistance by filing a Form 911, *Request for Taxpayer Advocate Service Assistance (and Application for Taxpayer Assistance Order)*, sending an email, and mailing a letter. Taxpayer H also files Form 911, seeking assistance in resolving a liability due from him and his wife, but he only lists himself as the taxpayer on the Form 911. The IRS does not suspend its collection activity while TAS is evaluating these cases. IRC § 7811(d) only applies to those who submit written TAO applications.²¹ As a result, it extends the period for the IRS to collect from Taxpayers H and G, but not Taxpayer F or H's wife.²² In other words, the IRS has a total of ten years to collect from Taxpayer F and H's wife but more than ten years to collect from Taxpayer H and G.²³

19 Compare IRC § 7811(d)(1) (applying suspension to the “period beginning on the date of the taxpayer’s application ... and ending on the date of the National Taxpayer Advocate’s decision with respect to such application”), with *Rothkamm* at 700 (assuming without discussion that IRC § 7811(d) suspended the period from the day TAS opened the case until the day TAS closed the case), Treas. Reg. § 301.7811-1(e)(1) (specifying the “period beginning on the date the Ombudsman receives an application for a taxpayer assistance order ...and ending on the date on which the Ombudsman makes a *determination* with respect to the application”) (emphasis added), and Treas. Reg. § 301.7811-1(e)(2) (defining the date of the “decision” as “the date on which the taxpayer’s request for a taxpayer assistance order is denied, or agreement is reached with the involved function of the Service, or a taxpayer assistance order is issued (except that when the taxpayer assistance order is reviewed by an official who may modify or rescind the taxpayer assistance order ... the decision date is the date on which such review is completed).”).

20 The filing of forms with TAS is not the same as filing them with the IRS. See, e.g., IRM 13.1.18.6.3, *Taxpayers Delivering Returns to TAS and TAS Date Stamp* (Feb. 1, 2011) (“Any tax return mailed to TAS is not considered filed with the IRS until it is received by an authorized IRS office. As discussed below, there are designated places for filing, and those places do not include a TAS office. Further, the postmark rule described in IRC § 7502 does not apply unless the return was properly addressed to the office with which the return was required to be filed.”).

21 See, e.g., Treas. Reg. §§ 301.7811-1(b) and -1(e)(4).

22 See Treas. Reg. § 301.7811-1(b) (“A request for a TAO shall be made on a Form 911, ‘Request for Taxpayer Advocate Service Assistance (And Application for Taxpayer Assistance Order)’ (or other specified form) or in a written statement that provides sufficient information for the Taxpayer Advocate Service (TAS) to determine the nature of the harm or the need for assistance.”); Treas. Reg. § 301.7811-1(e)(4) (“The statute of limitations is not suspended in cases where the Ombudsman issues an order in the absence of a written application for relief by the taxpayer or the taxpayer’s duly authorized representative.”). See also IRM 13.1.14.4.3, *Special Situations* (Oct. 31, 2004) (“In situations where only one spouse signs the form or written statement, contact the taxpayer who signed the form or written statement to determine the intent of the application.... TAS will not solicit the taxpayer’s signature for the sole purpose of suspending the statute.”). Further uncertainty may result if a taxpayer submits a written application, but does not sign it. *Id.*

23 IRC § 6502.

RECOMMENDATIONS

Repeal statute suspension under IRC § 7811(d). Alternatively, clarify that it:

- (1) Only extends the period for the IRS to collect or assess a liability, and not the period for the taxpayer or a third party to act; and
- (2) Only applies when:
 - a. Expiration of the relevant statutory limitations period for collection or assessment is imminent (*i.e.*, expires within one year);²⁴
 - b. The taxpayer has declined to extend the applicable limitations period;²⁵ and
 - c. The IRS is specifically prohibited by the terms of a TAO from pursuing collection or assessment, as the case may be, for more than seven days.

PRESENT LAW

A TAO Application Extends the Deadline for the IRS to Assess or Collect

In 1988, Congress enacted IRC § 7803(c), renamed the Taxpayer Ombudsman as the National Taxpayer Advocate, and established the Office of the Taxpayer Advocate (referred to as TAS).²⁶ The National Taxpayer Advocate is the taxpayer's voice at the IRS, and TAS is an independent organization within the IRS that helps taxpayers resolve problems and recommends administrative and legislative changes to mitigate and prevent future problems.²⁷ Taxpayers are only eligible for TAS assistance if they are facing an economic burden, are impacted by IRS procedures that have failed to operate as intended, or meet other specific criteria, including impairment of their rights under the Taxpayer Bill of Rights (TBOR).²⁸ Congress provided the National Taxpayer Advocate with the authority to issue TAOs to any office, operating division, or function of the IRS when a taxpayer is experiencing significant hardship as a result of the manner in which the internal revenue laws are being administered.²⁹

IRC § 7811(b) describes what a TAO may require, as follows:

The terms of a Taxpayer Assistance Order may require the Secretary within a specified time period —

- (1) To release property of the taxpayer levied upon, or;

24 See, e.g., IRM 5.1.19.5(1) (Jan. 1, 2006) (“An imminent [collection statute expiration date] CSED is any CSED with 12 months or less remaining on the collection statute.”); IRM 25.6.23.8.1, *Minimum Time Remaining on ASED* (Mar. 23, 2015) (defining an “imminent” assessment statute expiration date (ASED) in non-Tax Equity and Fiscal Responsibility Act (TEFRA) cases submitted to Centralized Case Processing or Technical Services as ranging from four to 12 months).

25 The IRS will generally not solicit an extension unless the ASED is within 180 days. IRM 25.6.22.2.1, *Assessment* (Aug. 26, 2011).

26 The Office of the Taxpayer Ombudsman was created by the IRS in 1979 to serve as the primary advocate, within the IRS, for taxpayers. This position was codified in the Taxpayer Bill of Rights (TBOR 1), included in the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. No. 100-647, Title VI, § 6230, 102 Stat. 3342, 3733 (Nov. 10, 1988). In TBOR 1, Congress added IRC § 7811, granting the Ombudsman (now the National Taxpayer Advocate) the statutory authority to issue TAOs.

27 IRC § 7803(c)(2)(A).

28 See IRM 13.1.7.2, *TAS Case Criteria* (Feb. 4, 2015); IRM 13.1.7.2.3 *TAS Case Criteria 8, Best Interest of the Taxpayer* (Feb. 4, 2015).

29 IRC § 7811(b); Treas. Reg. § 301.7811-1(d).

- (2) To cease any action, take any action as permitted by law, or refrain from taking any action, with respect to the taxpayer under:
- (A) Chapter 64 (relating to collection);
 - (B) Subchapter B of chapter 70 (relating to bankruptcy and receiverships);
 - (C) Chapter 78 (relating to discovery of liability and enforcement of title); or
 - (D) Any other provision of law which is specifically described by the National Taxpayer Advocate in such order.

IRC § 7811(d) describes statute suspension, as follows:

The running of any period of limitation with respect to any action described in subsection (b) [the terms of a TAO, reprinted above] shall be suspended for —

- (1) The period beginning on the date of the taxpayer's application... and ending on the date of the National Taxpayer Advocate's decision with respect to such application; and
- (2) Any period specified by the National Taxpayer Advocate in a Taxpayer Assistance Order issued pursuant to such application.

Until recently, the IRS assumed IRC § 7811(d) only extended the period for the IRS to collect or assess tax.³⁰ By its terms, IRC § 7811(d) suspends “[t]he running of any period of limitation with respect to any action described in subsection (b) [the terms of a TAO].” The flush language of IRC § 7811(b) provides that “[t]he terms of a Taxpayer Assistance Order may require the Secretary...” to take action and not the taxpayer. Thus, IRC § 7811(d) does not appear to extend the deadlines applicable to taxpayers or third

³⁰ See, e.g., IRM 13.1.18.2.4(4) (Feb. 1, 2011); IRM 13.1.10.15, *Suspending Collection Action* (Apr. 9, 2012).

parties. Legislative history,³¹ instructions to Form 911,³² older court decisions,³³ Treasury Regulation examples,³⁴ and memos by IRS attorneys are all consistent with this interpretation.³⁵

A TAO Application Now Extends the Deadline for Taxpayers to File Wrongful Levy Claims in the 5th Circuit

The United States Court of Appeals for the 5th Circuit recently held in *Rothkamm* that the period of limitations for filing a wrongful levy claim was suspended by a taxpayer's application for a TAO.³⁶ It focused on the portion of IRC § 7811(d) that says tolling applies to "any statute of limitations for any action described in § 7811(b)." The court suggested that tolling applied to the wrongful levy claim because "releas[ing] property of the taxpayer levied upon," is an action described in IRC § 7811(b)(1). Thus, the court held that an application for a TAO may extend the statutory period for a taxpayer to take action.

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- 31 H. Rept. 100-1104 II at 215 (1988) (Conf. Rept.) ("Any applicable statute of limitations (e.g., the *statute of limitations under sec. 6501 relating to the assessment or collection of tax*) is suspended starting on the date that the taxpayer files an application for a taxpayer assistance order with the Ombudsman and ending on the date that the Ombudsman makes a decision on the taxpayer's application (or a later date if the Ombudsman's order resulting from a taxpayer's application provides for continued suspension of the statute of limitations. The statute of limitations is not suspended in cases where the Ombudsman issues an order in the absence of an application for relief by the taxpayer.") (Emphasis added).
- 32 Form 911, *Request for Taxpayer Advocate Service Assistance (and Application for Taxpayer Assistance Order)* (2015) ("The signing of this request allows the IRS by law to suspend any applicable statutory periods of limitation relating to the assessment or collection of taxes. However, it does not suspend any applicable periods for you to perform acts related to assessment or collection, such as petitioning the Tax Court for redetermination of a deficiency or requesting a Collection Due Process hearing.")
- 33 See *Demes v. United States*, 52 Fed.Cl. 365, 373 (Fed. Cl. 2002) ("This provision does not go to the tolling of the statute of limitations in court, but rather confers the IRS with discretion to effect tolling upon a taxpayer's request. Plaintiffs therefore cannot sue in a court for a refund under this provision, nor can the court use it as a basis to toll the statute of limitations in plaintiffs' case."). See also *Next Generation Wireless, Ltd. v. United States*, No. 06-CV-838, 2008 WL 4115516 (S.D. Oh. 2008) (considering only whether the application for a TAO extended the period of limitation for filing a wrongful levy claim under IRC § 6532(c)(2) and ignoring IRC § 7811(d)).
- 34 All three examples illustrating statute suspension involve the limitations on IRS collection. Treas. Reg. § 301.7811-1(e)(3) (Examples 1-3).
- 35 See, e.g., IRS Litigation Bulletin (LB) 360, 1990 WL 1086174, 1990 GLB LEXIS 12 (1990) ("The legislative history identifies the limitations period in section 6501 (assessment and collection of tax) as a statute subject to the suspension. Thus, we believe that only those statutes of limitation that would continue to run to the detriment of the Service when an application for a TAO is filed, are subject to the suspension.... We do not believe that section 6511 – limitation on credit or refund – would be suspended."); Program Manager Tech. Adv. (PMTA) 2007-00429, *Suspension of the Statutes of Limitations Under Section 7811(d)* 4 (Mar. 9, 2001) (concluding a broad interpretation of IRC § 7811(d) to toll the period to take "any action" included in a TAO application would be "inconsistent with the statutory language and inconsistent with the examples provided in the regulations...").
- 36 *Rothkamm* did not directly hold that IRC § 7811(d) extended the period for filing suit. Rather, it held that IRC § 7811(d) extended the period for filing an administrative claim, and that the IRS's denial of the timely-filed administrative claim extended the period for filing suit by operation of IRC § 6532(c)(2). A future decision could clarify that IRC § 7811(d) does not extend jurisdictional deadlines for filing in court, but this case still invites litigation in this area. Compare *Volpicelli v. United States*, 777 F.3d 1042 (9th Cir. 2015) (holding the limitations period for filing suit to challenge a wrongful levy was subject to equitable tolling because it was procedural and not jurisdictional) with *Becton Dickinson & Co. v. Wolckenhauer*, 215 F.3d 340 (3d Cir. 2000) (holding that the limitations period for filing suit to challenge a wrongful levy was jurisdictional, and thus, not subject to equitable tolling). *Rothkamm* also held that Mrs. Rothkamm was a "taxpayer" for purposes of IRC § 7811(d) because the levy on her assets paid the tax of another. For additional discussion of this case, see Significant Cases, *infra*.

REASONS FOR CHANGE

The IRS Cannot Program Its Computers to Take Advantage of Extended Deadlines Under IRC § 7811(d)

IRC § 7811(d) was enacted in 1988 but not implemented. In 2003, at the National Taxpayer Advocate's request, the IRS Commissioner formally announced the IRS would not implement IRC § 7811(d) because of two major technical difficulties.³⁷ First, the IRS's Integrated Data Retrieval System (IDRS) could not reflect multiple assessment statute expiration dates (ASEDs) or collection statute expiration dates (CSED) for a husband and wife on a joint liability. For example, if a wife applied for a TAO on a joint liability, but the husband did not, IDRS could not properly reflect an extended ASED or CSED for her without improperly reflecting an extended ASED or CSED for him.

Second, the codes the IRS uses to update IDRS (called transaction codes) could not update a single tax year to reflect multiple CSEDs for different assessments. For example, assume a taxpayer timely reported an unpaid liability on her 2009 return filed on April 15, 2010, which the IRS could collect for ten years (*i.e.*, until April 15, 2020). Two years later, the IRS audited the 2009 return and on April 15, 2012, assessed another liability, which it could collect for ten years (*i.e.*, until April 15, 2022). If the taxpayer later applied for a TAO, triggering a nine-month extension of the CSED for both assessments, TAS could not properly update both CSEDs on IDRS. If TAS tried to update IDRS to extend them, IDRS would incorrectly move the CSED for the first 2009 assessment (from the balance due return) to equal the CSED for the audit adjustment for 2009 that occurred two years later (*i.e.*, from 2020 to 2022), and then add nine months to both CSEDs. As a result, IDRS would incorrectly show that the IRS had an additional two years (*i.e.*, 12 years and nine months) to collect the first assessment.³⁸

In other words, the IRS could not accurately track the extensions of the ASED and CSED, as required by IRC § 7811(d). Although IDRS may now be able to reflect different ASEDS and CSEDs for each spouse, it is still unable to extend the CSED correctly when multiple assessments apply to the same year, as illustrated above.³⁹

Statute Suspension Is Not Needed to Protect the Government

U.S. Appeals Court for the 5th Circuit Judge Higginbotham's dissent in *Rothkamm* quoted various authorities for the following proposition:

All suspension provisions [including 7811(d)] are designed and intended to avoid prejudice to the IRS's ability to collect during periods of time in which collection or assessment is prohibited [or otherwise impeded]⁴⁰

37 See, e.g., Memorandum from Commissioner of Internal Revenue, *Taxpayer Advocate Service Statute Suspension Provisions Under IRC Section 7811(d)* (Nov. 10, 2003); IRM 13.1.14, *Suspension of the Statutes of Limitation Under IRC § 7811(d)* (Oct. 31, 2004).

38 National Taxpayer Advocate FY 2003 Objectives Report to Congress, App. V, 4 (*Suspension of Statute of Limitations Periods*). See also IRM 5.19.10.4.5(3) (Feb. 1, 2014) ("Input of TC 550 will update all CSEDs on the module to the same date. Care must be taken when inputting a TC 550 to a module with multiple CSEDs. If correcting one CSED will cause the other CSEDs to be incorrect, then a TC 550 cannot be done.")

39 See IRM 5.19.10.4.5, *Resolving a Module with CSED Problems* (Feb. 1, 2014).

40 *Rothkamm* at 717 n.14. (quoting *In re Turner*, 182 B.R. 317, 329 (Bankr. N.D. Ala. 1995), *adhered to on reconsideration*, 195 B.R. 476 (Bankr. N.D. Ala. 1996) and citing *In re Gore*, 182 B.R. 293, 304 (Bankr. N.D. Ala. 1995)).

No legislative history addresses why IRC § 7811(d) was enacted.⁴¹ However, it seems to address concerns expressed by IRS Commissioner Egger in 1981 that granting an independent Ombudsman (the predecessor to the National Taxpayer Advocate) legal authority to stop collection activity could “seriously impair the Service’s ability to collect revenue.”⁴² These concerns have not materialized.

As the government has not implemented IRC § 7811(d), it has found other ways to protect its interests. The IRS routinely asks the taxpayer to agree to extend limitations periods even if TAS is assisting them. Moreover, the IRS is not required to suspend enforcement while TAS is evaluating an application for a TAO.⁴³ Even if TAS issues a TAO ordering the IRS to suspend enforcement, TAS will generally agree to modify the TAO if collection is in jeopardy and if it does not, the IRS Commissioner or Deputy Commissioner may nonetheless modify or rescind the TAO.⁴⁴ Thus, the government can protect its interests without statute suspension.

The Automatic Statute Suspension Period Will Be Subject to Dispute

Under IRC § 7811(d)(1) statute suspension applies to the “period beginning on the date of the taxpayer’s application... and ending on the date of the... decision with respect to such application.”⁴⁵ Treas. Reg. § 301.7811-1(e)(1) specifies that the period begins on the date TAS “receives an application for a taxpayer assistance order”⁴⁶ and ends on the date TAS “makes a determination with respect to the application.” Thus, the National Taxpayer Advocate’s position is that the suspension period ends when TAS makes its first determination.

TAS makes a number of determinations on TAO applications.⁴⁷ It first determines whether the taxpayer qualifies for TAS assistance based on TAS’s case acceptance criteria. For 99 percent of the cases that TAS

41 Technical and Miscellaneous Revenue Act of 1988 (TBOR I), Pub. L. 100–647, Title VI, § 6230(a), 102 Stat. 3733 (Nov. 10, 1988) (enacting IRC § 7811(d)).

42 *Taxpayers’ Bill of Rights: Hearings Before the Subcomm. on Oversight of the Internal Rev. Serv. of the S. Comm. on Fin. on S. 850*, 97th Cong. 57 (June 2, 1981) (Statement of Roscoe L. Egger, Jr., Commissioner of Internal Revenue), reprinted at <http://www.unclefed.com/TxprBoR/1981/81Egger.html>.

43 See, e.g., IRM 13.1.18.2.4(4) (Feb. 1, 2011); IRM 13.1.10.15, *Suspending Collection Action* (Apr. 9, 2012) (“If the RO, Operating Division or Functional Unit refuses to suspend lien filing or levy action, discuss with the Manager whether the issuance of a TAO is appropriate.”). See also *White v. Comm’r*, 899 F. Supp. 767, 773 (D. Mass. 1995) (noting a TAO “application merely suspends the running of the period of limitations on collection. It does not immediately suspend the collection activity itself.”).

44 See, e.g., IRC § 7811(c) (permitting the Deputy Commissioner or Commissioner to modify or rescind a TAO, even if issued directly by the National Taxpayer Advocate); IRM 13.1.20.3.1(5) (Dec. 15, 2007) (“TAS will consider modifying the TAO if there are compelling circumstances that require immediate action by the IRS (e.g., situations where collection is in jeopardy may require the immediate issuance of a Notice of Levy).”).

45 The statute says the date of the “National Taxpayer Advocate’s decision.” Under IRC § 7811(f), however, the term “National Taxpayer Advocate” includes any designee of the National Taxpayer Advocate. The National Taxpayer Advocate has delegated her TAO authority to Area Directors, Local Taxpayer Advocates, the Executive Director, Case Advocacy, and the Deputy National Taxpayer Advocate. Treas. Reg. § 301.7811–1(a)(2); IRM 1.2.50.2, *Delegation Order 13-1 (Rev. 1)* (Mar. 17, 2009); IRM 13.1.20.2, *Determining When to Issue a Taxpayer Assistance Order* (Feb. 1, 2011).

46 Particularly in cases where there is a significant delay between the date the taxpayer mailed the application and the date TAS received it, the date the suspension period begins could be subject to dispute, as illustrated by the example above. Disputes may also arise when TAS receives a TAO application originally delivered to the IRS and not TAS because TAS and the IRS are sometimes treated as separate entities for purposes of filing. See, e.g., IRM 13.1.18.6.3, *Taxpayers Delivering Returns to TAS and TAS Date Stamp* (Feb. 1, 2011) (“Any tax return mailed to TAS is not considered filed with the IRS until it is received by an authorized IRS office. As discussed below, there are designated places for filing, and those places do not include a TAS office. Further, the postmark rule described in IRC § 7502 does not apply unless the return was properly addressed to the office with which the return was required to be filed.”).

47 See, e.g., IRM 13.1.18.1, *Processing Taxpayer Advocate Service (TAS) Cases* (Feb. 1, 2011).

accepted and closed in FY 2015, it made this determination and entered them into its case management system (called the Taxpayer Advocate Management Information System (TAMIS)) within four days.⁴⁸ Because TAS does not currently track cases that it does not accept (*i.e.*, because they do not meet TAS criteria), it is impossible to track many of these short extensions.⁴⁹

TAS employees must also determine whether the taxpayer is facing a significant hardship before taking action (*i.e.*, issuing an OAR, a TAO, or closing the case).⁵⁰ For 77 percent of the cases that TAS closed in FY 2015, it made the significant hardship determination within seven days.⁵¹ Because a taxpayer's circumstances can change, TAS may make more than one significant hardship determination during the course of its assistance.

Once TAS makes its first determination, which is usually a determination about whether to accept the case, the suspension period should end, even if TAS later determines the taxpayer is experiencing a significant hardship, determines to issue an OAR instead of a TAO, determines to issue a TAO, or determines to close the case. The taxpayer may not always be informed of the operative date and it is likely to be subject to dispute.⁵² However, the United States Court of Appeals for the 5th Circuit held in *Rothkamm*, *without any analysis*, that the period ended on the day TAS closed its case.

To reduce burden to taxpayers and the IRS of tracking short extensions, the National Taxpayer Advocate previously recommended legislation to create an exception to statute suspension in cases where the extension would be for seven days or less.⁵³ This would help reduce controversy surrounding extensions that are less likely to be important and that may not even be possible to track unless accepted under TAS case acceptance criteria. However, confusion and litigation will likely continue until Congress repeals or clarifies IRC § 7811(d).

Statute Suspension Could Penalize Taxpayers for Seeking Assistance

If statute suspension were applied in cases where IRS enforcement was not actually suspended, then taxpayers who come to TAS would be at a disadvantage. They would be subject to enforcement for longer periods than taxpayers who did not come to TAS.

48 TAMIS Query (Nov. 23, 2015).

49 Statute suspension does not apply if the application is rejected on the same day it is received. See Treas. Reg. § 301.7811-(e)(1) ("For the purpose of computing the period suspended, all calendar days except the date of receipt of the application shall be included.").

50 See, e.g., IRM 13.1.18.1, *Processing Taxpayer Advocate Service (TAS) Cases* (Feb. 1, 2011).

51 TAMIS Query (Nov. 23, 2015). It made the significant hardship determination within 23 days in 90 percent of its closed cases and within 90 days in 99 percent for FY 2015.

52 Treas. Reg. § 301.7811-1(e)(2) defines the date of the "decision" as "the date on which the taxpayer's request for a taxpayer assistance order is denied, or agreement is reached with the involved function of the Service, or a taxpayer assistance order is issued (except that when the taxpayer assistance order is reviewed by an official who may modify or rescind the taxpayer assistance order... the decision date is the date on which such review is completed)." Some may argue that this regulatory language suggests an earlier decision or determination by TAS (e.g., a determination regarding eligibility for TAS assistance or significant hardship) may not end the suspension period, as illustrated above, particularly in cases where TAS issues a TAO.

53 In response to this proposal, Rep. Lewis sponsored H.R. 586, 107th Cong § 224 (2001), which passed the House and was referred to the Senate on April 18, 2002; Rep. Houghton sponsored H.R. 3991, 107th Cong. Title II § 204 (2001), which was defeated in the House on March 19, 2002; and Rep. Portman sponsored H.R. 1528, 108th Cong. § 106 (2003), which passed the Senate on May 19, 2004. See National Taxpayer Advocate 2002 Annual Report to Congress 159.

Perhaps for this reason, some Chief Counsel attorneys have even suggested that the IRS cannot rely on IRC § 7811(d) unless IRS enforcement activity was actually prohibited by internal procedures.⁵⁴ However, this view was limited to a specific fact pattern and is not necessarily the IRS's current official position. If statute suspension penalizes taxpayers from seeking assistance from TAS, then it encumbers the taxpayer's *right to quality service, finality, privacy* (which includes the right to expect that enforcement will be no more intrusive than necessary), and *to a fair and just tax system*.

Statute Suspension Is a Trap for the Uninformed and Elective for Others

Statute suspension only applies to those who submit written TAO applications to TAS or who are granted TAOs that expressly provide for statute suspension.⁵⁵ Well-informed taxpayers who know that statute suspension only applies to written TAO applications could take advantage of its electivity. To avoid giving the IRS more time for enforcement, they could simply request TAS assistance by phone.⁵⁶ By contrast, similarly situated but uninformed taxpayers who file Forms 911 could be subject to IRS enforcement for longer periods.

Statute Suspension Could Affect Thousands Each Year

TAS received 227,189 cases in FY 2015.⁵⁷ Of these, 37,484 were opened in response to correspondence from the taxpayer.⁵⁸ A sample of TAS cases received in FY 2008 found that about 49.2 percent of those received by correspondence included Form 911.⁵⁹ Assuming taxpayers submitted Forms 911 at about the same rate in FY 2015, statute suspension could apply to 18,442 taxpayers in FY 2015 alone (37,484 x 49.2 percent). Further, about 54 percent of the taxpayers who asked for TAS assistance by correspondence in FY 2015 were unrepresented — or potentially 9,959 of the 18,442 who may have been subject to statute suspension.⁶⁰ Unrepresented taxpayers are the least likely to be aware that they may have inadvertently granted the IRS additional time to assess or collect their liabilities.

Statute Suspension Could Frustrate TAS's Mission

If TAS were to level the playing field by requiring a signed TAO application (thereby triggering statute suspension) before accepting a case, then statute suspension could discourage taxpayers who need help from seeking assistance, frustrating TAS's mission. Such a policy could also prevent TAS from offering prompt assistance to taxpayers by phone, particularly those without immediate access to the technology required to submit a written TAO application electronically (*e.g.*, a fax machine or scanner and Internet access). Legislation could clarify that written TAO applications are not required to trigger statute suspension, but then TAS would need to ensure taxpayers are aware that even a request by phone could suspend the statute, potentially discouraging taxpayers from seeking assistance.

54 IRS CCA 199910043, 1999 IRS CCA LEXIS 99 (Jan. 14, 1999) (“the Service may rely on IRC § 7811(d) and B.C. § 105(a) to toll the periods only where, pursuant to its own internal procedures, the Service was prohibited from collecting the taxes it seeks to have declared priority or nondischargeable and actually made no attempt to collect those taxes. Additionally, courts may well require evidence of abuse of the system by the debtor, *e.g.*, that the application was filed as a delaying tactic.”).

55 See, *e.g.*, Treas. Reg. 301.7811-1(b) and -1(e)(4).

56 *Id.*

57 TAMIS query (Oct. 26, 2015).

58 *Id.*

59 TAS Technical Analysis and Guidance, *Special Study* (Dec. 2010).

60 TAMIS query (Oct. 26, 2015).

Statute Suspension Will Generate Litigation

A TAO application may now extend the period for taxpayers and third parties to take action, at least in the 5th Circuit under *Rothkamm*. Some taxpayers could file TAO applications because they want more time to meet statutory deadlines. A more likely scenario, however, is that those who seek TAS assistance and later discover they missed an important deadline will argue the deadline was extended by IRC § 7811(d).⁶¹

The IRS May Now Feel Obligated to Implement Statute Suspension

Some IRS attorneys concluded that the IRS was not legally required to implement statute suspension because IRC § 7811(d) only protects the IRS and does not extend periods applicable to taxpayers.⁶² Because *Rothkamm* has questioned that assumption, the IRS may now feel a greater obligation to implement it notwithstanding the technical difficulties and inequities of doing so.

Implementation of IRC 7811(d) Would Be More Difficult If Applied to Taxpayer Deadlines

As described above, the IRS's computer systems cannot accurately reflect the ASED and CSED extensions provided by IRC § 7811(d). These difficulties would multiply if the IRS were also required to track the extension of statutory deadlines applicable to taxpayers. For example, there is no obvious way for employees to change the refund statute expiration date (RSED) or filing deadline for a CDP hearing that is reflected on IRS systems.⁶³ Moreover, it is not even clear which taxpayer deadlines would be extended under *Rothkamm*. Although taxpayers will argue that under the reasoning of *Rothkamm* “any” statutory deadline, including jurisdictional ones, can be extended by operation of IRC § 7811(d), the court in *Rothkamm* only held that IRC § 7811(d) extended the period for a third party to file a wrongful levy claim with the IRS.⁶⁴

EXPLANATION OF RECOMMENDATIONS

TAS helps taxpayers resolve problems with the IRS when they are facing an economic burden as a result of IRS action or inaction, or when the IRS is ignoring their facts and circumstances and creating devastating problems for them. IRC § 7811(d) operates primarily, if not solely, to penalize taxpayers for seeking assistance from TAS and to reward the IRS for creating those problems by awarding it with additional time for

61 Although frivolous TAO applications could trigger a frivolous submissions penalty, a submission by a taxpayer facing a potentially significant hardship under IRC § 7811(a)(2) (e.g., incurring significant costs (including fees for professional representation) if relief is not granted) is unlikely to be frivolous. See IRC § 6702(b)(2)(B)(ii)(III) (penalty for frivolous TAO applications).

62 Compare LB 360, 1990 WL 1086174, 1990 GLB LEXIS 12 (1990) (concluding that because IRC § 7811(d) only protects the IRS by tolling collection and assessment periods, the IRS was not legally required to implement it), with PMTA 2007-00429, *Suspension of the Statutes of Limitations Under Section 7811(d)* (Mar. 9, 2001) (assuming statute suspension only applies to protect the IRS's interest but still declining to conclude its implementation was not mandatory). Further, the 5th Circuit decision stated that the IRS has no discretion under IRC § 7811(d). *Rothkamm* at 713 (“Congress did not provide the IRS with that discretion under § 7811(d), and the only discretion granted in the regulations is the discretion granted to the Ombudsman to lengthen the period of tolling beyond the date of the decision on the TAO application.”).

63 See, e.g., IRM 25.15.15, *Mirror Modules for Requests for Relief from Joint and Several Liability* (July 30, 2014) (discussing RSEDs) and IRM 21.5.6.4.8, *-D Freeze* (Mar. 3, 2014) (same); IRM 5.19.4, *Enforcement Actions* (Nov. 26, 2014) (discussing CDP filing deadline).

64 If IRC § 7811(d)(1) was inapplicable, Mrs. Rothkamm's suit would have been over seven months late, but her case was open in TAS for less than six months, according to the court. Had the court held that IRC § 7811(d)(1) merely extended the time for filing suit, the suit would still have been late. Rather, the court held that the suit was timely only because IRC § 7811(d)(1) extended the period for her to file an administrative claim. The IRS's consideration and subsequent denial of her timely-filed administrative claim extended the period for filing suit by operation of IRC § 6532(c)(2). As noted above, a future decision could clarify that IRC § 7811(d)(1) does not extend jurisdictional deadlines for filing in court.

enforcement, thereby undermining taxpayer rights and TAS's mission. It throws previously clear rules and deadlines into disarray in an inconsistent, elective, and arbitrary manner. It invites litigation over which deadlines it extends and for how long. It requires the IRS to track unspecified changes to unspecified deadlines that the IRS does not and cannot track, even if it could identify all of the deadlines it should track and what changes it should make to them. For these reasons, IRC § 7811(d) must be repealed.

In the alternative, if IRC § 7811(d) cannot be repealed, then Congress could address some of the problems with IRC § 7811(d) by clarifying that it only suspends the periods for collection or assessment and only applies in cases where it is most likely to be relevant. It is most likely to be relevant only when a TAO specifically and explicitly bars enforcement for more than seven days, expiration of the relevant statutory limitations period is imminent (*i.e.*, would otherwise expire within one year), and the IRS has asked the taxpayer to extend the applicable limitations period but the taxpayer has declined. Such situations should be rare because taxpayers who are working with TAS almost always agree to extend the limitations period upon request. To reiterate, however, the National Taxpayer Advocate's primary recommendation is to repeal IRC § 7811(d).

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MATH ERROR AUTHORITY: Authorize the IRS to Summarily Assess Math and “Correctable” Errors Only in Appropriate Circumstances

TAXPAYER RIGHTS IMPACTED¹

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

PROBLEM

The IRS has the authority to correct math or clerical errors — arithmetic mistakes and the like — on a return using summary assessment (or “math error”) procedures.² When it makes a summary assessment, taxpayers cannot obtain judicial review before paying, unless they can determine whether and how to respond to an often-confusing IRS notice more quickly than under regular deficiency procedures.³ The IRS has had problems using its summary assessment authority to address discrepancies and mismatches that go beyond simple arithmetic mistakes.⁴ Yet, the Administration has proposed legislation that would allow the Treasury Department to expand the IRS’s summary assessment authority to other “correctable” errors by regulation — without specific authorization from Congress — where:

1. The information provided by the taxpayer does not match the information contained in government databases;
2. The taxpayer has exceeded the lifetime limit for claiming a deduction or credit; or
3. The taxpayer has failed to include with his or her return documentation that is required by statute.⁵

1 See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Internal Revenue Code (IRC) §§ 6213(b), (g)(2).

3 Compare IRC § 6211(a) with IRC § 6213(b)(2).

4 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 163; National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 91-2; National Taxpayer Advocate 2011 Annual Report to Congress 74; National Taxpayer Advocate 2006 Annual Report to Congress 311; National Taxpayer Advocate 2003 Annual Report to Congress 113; National Taxpayer Advocate 2002 Annual Report to Congress 25, 186; National Taxpayer Advocate 2001 Annual Report to Congress 33. See also *Hearing on Improper Payments in the Administration of Refundable Tax Credits Before the Subcommittee on Oversight, Committee on Ways and Means*, 112th Cong. (May 25, 2011) (statement of Nina E. Olson, National Taxpayer Advocate); *Hearing on Complexity and the Tax Gap, Making Tax Compliance Easier and Collecting What’s Due Before the Committee on Finance*, 112th Cong. (June 28, 2011) (statement of Nina E. Olson, National Taxpayer Advocate); *Hearing on The National Taxpayer Advocate’s 2014 Annual Report to Congress, Before the House Subcomm. on Gov’t Ops., Comm. on Oversight and Gov’t Reform*, 114th Cong. (Apr. 15, 2015) (statement of Nina E. Olson, National Taxpayer Advocate).

5 Department of the Treasury, *General Explanations of the Administration’s Fiscal Year 2016 Revenue Proposals*, February 2015, at 245-246, available at http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx. For concerns about this proposal, see, e.g., *Hearing on The National Taxpayer Advocate’s 2014 Annual Report to Congress, Before the House Subcomm. on Gov’t Ops., Comm. on Oversight and Gov’t Reform*, 114th Cong. (Apr. 15, 2015) (statement of Nina E. Olson, National Taxpayer Advocate).

This proposal would allow the IRS to assume a taxpayer's return is wrong and assess a tax deficiency based on circumstances that are more complicated than they appear.

If the IRS uses summary assessment procedures to address complex issues that require additional fact finding, the assessments are more likely to be wrong, and confusing math error notices are likely to become even more difficult to understand.⁶ Confusing notices may prevent some taxpayers, particularly low income taxpayers, from responding timely. Those who miss the deadline lose the right to challenge the adjustment in court before paying. The IRS also wastes resources when its assessments are inaccurate because it has to review additional documentation, process abatement requests and amended returns, try to respond to calls and letters, and potentially even attempt to collect inaccurate assessments from taxpayers who are entitled to the benefits they claimed. Thus, expanding summary assessment procedures into more complicated areas could erode the *rights to quality service, to pay no more than the correct amount of tax, to privacy, to challenge the IRS's position and be heard, to appeal an IRS decision in an independent forum, and to a fair and just tax system*, while wasting IRS resources.

EXAMPLES

Example 1: Unreliable Database Mismatches Could Trigger Math Error Authority

Not all government databases are reliable for tax purposes. The IRS has the authority to assess tax using math error procedures when a taxpayer claims the Earned Income Tax Credit (EITC) for a child who is shown on the Federal Case Registry (FCR) as being in someone else's custody.⁷ A study that Congress required the Treasury Department to undertake with the National Taxpayer Advocate found that *about 39 percent* of the returns selected solely based on FCR data mismatches were actually correct.⁸ Because FCR data is not sufficiently reliable, the IRS has adopted the National Taxpayer Advocate's recommendation not to assess math errors based on mismatches between returns and FCR data.⁹

Example 2: Mismatches Could Allow the IRS to Make Summary Assessments Based on the IRS's Estimate of the Mere Probability of an Error

The IRS's "Dependent Database" (DDb), combines unreliable data from the FCR with other more reliable government data (*e.g.*, the Social Security Administration's Kidlink data, which links a child's Social Security number (SSN) to its mother's SSN, and in many instances, the father's SSN).¹⁰ The IRS runs each return that claims a dependent or other family-status benefit through DDb filters (*e.g.*, EITC,

⁶ See, *e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 163.

⁷ In 2001, Congress authorized the IRS to use of summary assessment procedures to deny EITC, beginning in 2004, where data from the FCR of Child Support Orders indicates the taxpayer claiming a child is actually the non-custodial parent. *Economic Growth and Tax Relief Reconciliation Act of 2001*, Pub. L. No. 107-16, § 303(g), 115 Stat. 38, 56-57 (2001) (codified at IRC § 6213(g)(2)(M)). The House Conference Report requested a study of the FCR database by the Department of Treasury, in consultation with the National Taxpayer Advocate, of the accuracy and timeliness of the data in the FCR; the efficacy of using math error authority in this instance in reducing costs due to erroneous or fraudulent claims; and the implications of using math error authority in this instance, given the findings on the accuracy and timeliness of the data. H.R. Conf. Rep. 107-84 at 147 (2001). See also National Taxpayer Advocate 2002 Annual Report to Congress 189 (Legislative Recommendation: *Math Error Authority*).

⁸ See IRS, Federal Case Registry Final Report, Project 5-02-12-3-005 (CR-39) (July 2003) ("almost 39% of the FCR children were allowed per examination... With the exclusion of no reply cases... the rate of FCR children that are allowed per examination increases to 53.5%").

⁹ It is not clear that the IRS would have conducted the FCR study without a mandate to do so.

¹⁰ For a description of the DDb, see Internal Revenue Manual (IRM) 4.19.14, *EITC/Revenue Protection Strategy* (Jan. 1, 2015). Exam receives a majority of its EITC work from the DDb. IRM 4.19.14.1, *Earned Income Tax Credit (EITC) Revenue Protection Strategy (RPS)* (Jan. 1, 2015).

dependent exemptions, filing status, Child and Dependent Care Credit, Child Tax Credit, and education benefits, etc.).¹¹

The IRS assumes that the more inconsistencies (or “mismatches”) there are between the return and the DDb (or the more “rules” it breaks) the more likely the return is to contain errors.¹² In other words, the IRS uses the DDb to infer the probability of error, but it is not a binary (yes/no) determination. TAS has seen instances where a return has broken all of the rules contained in the DDb and the taxpayer is still eligible for the exemption or credit claimed. It would be unprecedented to give the IRS summary assessment authority based on some unstated *probability* that it is correct. Yet, because the DDb is a government database that the IRS may consider to be inconsistent with a return, there is a potential it could be used in this way under the correctable error proposal.

Example 3: The IRS Does Not Try to Reconcile Inconsistencies Before Charging a Math Error

The IRS may assess tax using math error procedures when a taxpayer claims a dependent, but does not include the dependent’s correct taxpayer identification number (TIN).¹³ Because a TIN is a long string of numbers, taxpayers sometimes enter them incorrectly. A TAS study of math errors on dependent TINs found that the IRS subsequently reversed at least part of these math errors on 55 percent of the returns with incorrect TINs.¹⁴ The study also found that the IRS could have resolved 56 percent of these errors using information already in its possession (*e.g.*, the TIN listed on a prior year return), rather than assessing tax using math error procedures and asking the taxpayer to explain the apparent discrepancy.¹⁵

Even when the taxpayer did not respond and the IRS did not reverse the math error, the TAS study found that the IRS should have reversed it in 41 percent of the cases based on information in its files, and thus, it deprived taxpayers of benefits to which they were entitled.¹⁶ The IRS’s failure to review information in its files before assessing tax using math error procedures is inconsistent with general direction from Congress that the IRS should use information in its possession to avoid using the summary assessment process, rather than resolving uncertainty against the taxpayer.¹⁷ In other words, in a large percentage of

11 The IRS also uses the DDb filters to detect potential identity theft. As of November 26, 2015, the DDb filters used by the IRS’s Taxpayer Protection Program (TPP) had a “false positive” rate of 38.2 percent during calendar year 2015. See IRS, Return Integrity & Compliance Services (RICS), *Update of the Taxpayer Protection Program (TPP)* 9 (Dec. 2, 2015). According to the IRM, the TTP “is responsible for handling potential Identity Theft (IDT) cases that are scored by a set of IDT models in the DDb or selected through a query in the Electronic Fraud Detection System (EFDS) or selected by Integrity & Verification Operation (IVO) tax examiners during the daily screening process.” IRM 25.25.6.1, *Taxpayer Protection Program* (May 26, 2015).

12 See generally IRM 4.19.14, *EITC/Revenue Protection Strategy* (Jan. 1, 2015).

13 IRC § 6213(g)(2)(H).

14 National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 114, 117 (Research Study: *Math Errors Committed on Individual Tax Returns – A Review of Math Errors Issued on Claimed Dependents*).

15 *Id.* at 119-20.

16 *Id.* at 120.

17 H.R. REP. No. 94-658, at 290 (1976) (“...care should be taken to be sure that what appears to be an error in addition or subtraction is not in reality an error in transcribing a number from a work sheet, with the final figure being correct even though an intermediate arithmetical step on the return appears to be wrong... It is expected that the Service will check such possible sources of arithmetical errors before instituting the summary assessment procedures.”). *Id.* at 291 (“[T]he taxpayer has the obligation of showing that he or she is entitled to the number of exemptions claimed. However, this summary assessment procedure is not to be used where the Service is merely resolving an uncertainty against the taxpayer.”). The 1976 committee report provided detailed direction from Congress about how it generally expected the IRS to apply the math error rules, however, the IRS was not expressly authorized to use the math error procedure to address the omission of a dependent’s TIN on a return until 1996. See Small Business Job Protection Act of 1996, Pub. L. No 104-188, § 1615, 110 Stat. 1853 (1996); H.R. REP. No. 104-737, at 319-20 (1996).

math error cases the IRS imposed a burden on taxpayers, generating phone calls and letters it could not timely handle, triggering interest charges and denying tax benefits to those entitled to them, rather than investing a few minutes of research at the front end. Under the correctable error proposal, the IRS could burden taxpayers and waste more resources in this way.

Example 4: It May Be Difficult to Determine What Documentation Is Attached

Congress authorized the IRS to use math error authority to deny the First-Time Homebuyer Credit (FTHBC) to taxpayers who did not attach a “settlement statement,” as required.¹⁸ Initially, the IRS accepted a settlement statement as sufficient only if it showed all parties’ names and signatures, the property address, sales price, and date of purchase, as provided on the Form HUD-1. After learning that not all states required a settlement statement to include a complete address or both parties’ signatures, the IRS reversed its position.¹⁹

The IRS’s continued use of math error authority in this circumstance would have been very costly and burdensome.²⁰ To make determinations about the sufficiency of a settlement statement, an IRS employee would have to read papers attached to the return and explain any problems to the taxpayer (or summarily assess the liability without providing a good explanation). Accordingly, the National Taxpayer Advocate recommended the IRS be permitted to use math error authority only when a return does not contain a document that purports to be a settlement statement (*i.e.*, a simple yes/no determination), and required to use normal deficiency procedures to address facts-and-circumstances determinations concerning the *sufficiency* of a settlement statement.²¹ Yet, under the correctable error proposal, after promulgating regulations, the IRS could summarily assess tax related to any return that did not attach sufficient documentation in similarly ambiguous circumstances.

18 See Worker, Homeownership, and Business Assistance Act of 2009, Pub. L. No. 111-92, § 11, 123 Stat. 2984, 2991-92 (2009), amending IRC § 36(d) and adding IRC § 6213(g)(2)(P).

19 The IRS’s handling of FTHBC issues in the 2011 filing season delayed processing of an estimated 128,000 returns and led to a sharp increase in related TAS cases (from 669 through April 30 of fiscal year (FY) 2010 to 4,299 for the same period in FY 2011). National Taxpayer Advocate FY 2012 Objectives Report to Congress 28-36. IRS SERP Alert 100290 (May 25, 2010); IRM 21.6.3.4.2.11.6(4) (May 7, 2012) (“The settlement statement may or may not contain the buyer(s) and seller(s) signatures.”). See also IRS SERP Alert 100066 (Feb. 12, 2010); IRS Instructions for Form 5405, *First-Time Homebuyer Credit and Repayment of the Credit 2* (Mar. 2011) (acknowledging that not all taxpayers will have a signed HUD-1).

20 It would also have been inconsistent with concerns expressed by Congress in 1976. See H.R. REP. No. 94-658, at 292 n.1 (1976) (“[D]isputes as to the adequacy of the schedule that the taxpayer submits are to be dealt with under normal administrative procedures and not by use of the extraordinary summary assessment procedure.”).

21 See, e.g., National Taxpayer Advocate 2011 Annual Report to Congress 524-30 (Legislative Recommendation: *Mandate That the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights*).

RECOMMENDATIONS

To ensure that the IRS's use of summary assessment authority does not impair taxpayers' rights and unnecessarily burden both the taxpayer and the IRS, the National Taxpayer Advocate recommends (and reiterates prior recommendations) that Congress authorize the IRS to summarily assess a deficiency only if:²²

1. There is a mismatch between the return and unquestionably reliable data (rather than the IRS's estimate about the mere probability of an error).
2. The IRS's math error notice clearly describes the discrepancy and how taxpayers may contest the proposed change.
3. The IRS has researched all of the information in its possession (*e.g.*, information provided on prior-year returns) that could reconcile the apparent discrepancy.
4. The IRS does not have to analyze facts and circumstances or weigh the adequacy of information submitted by the taxpayer (*e.g.*, whether *sufficient* documentation is attached) to determine if the return contains an error.
5. The abatement rate for a particular issue or type of inconsistency is below a specified threshold for those taxpayers who respond.²³
6. For any new data or criteria, the Department of Treasury, in conjunction with the National Taxpayer Advocate, has evaluated and publicly reported to Congress on the reliability of the data or criteria for purposes of assessing tax using math error procedures.²⁴ The report should analyze the burdens and benefits of the proposed use of math error authority, considering downstream costs to taxpayers (*e.g.*, time, paperwork, representation) and the IRS (*e.g.*, processing taxpayer calls and letters, requests for audit reconsideration, amended returns, appeals, and TAS intervention).

PRESENT LAW

Taxpayers Generally Have the Right to Judicial Review Before Paying an Assessment by the IRS

Before assessing a deficiency (*e.g.*, as a result of an audit), the IRS is legally required to send the taxpayer a Statutory Notice of Deficiency (SNOD), also known as a "90-day letter."²⁵ This letter explains the basis for the deficiency and gives the taxpayer 90 days to file a petition with the Tax Court.²⁶ A taxpayer who misses this deadline can only seek judicial review by paying the assessment and filing a claim for refund.²⁷

22 See, *e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 284 (Legislative Recommendation: *Taxpayer Rights: Codify Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections*); National Taxpayer Advocate 2011 Annual Report to Congress 524-530 (Legislative Recommendation: *Mandate that the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights*); National Taxpayer Advocate 2002 Annual Report to Congress 189 (Legislative Recommendation: *Math Error Authority*).

23 An issue should not be subject to math error simply because the population in question is relatively unresponsive, *e.g.*, because they do not understand the IRS's notices or are transient and do not receive them.

24 As noted above, in 2001 Congress requested a study of the FCR database by the Department of Treasury, in consultation with the National Taxpayer Advocate. H.R. CONF. REP. 107-84, at 147 (2001).

25 Prior to the issuance of the SNOD, the IRS will generally issue a 30-day letter giving the taxpayer the opportunity to file a protest with Appeals. IRS, Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund* 5 (Sept. 2013).

26 IRC § 6213. The 90-day period becomes 150 days if the notice is addressed to a person outside of the United States.

27 If the claim is denied or if no action is taken on the claim within six months, the taxpayer may file a refund suit in a federal district court or the Court of Federal Claims within the limitations period. IRC §§ 6511, 6532, 7422.

Low income taxpayers are less likely to be able to afford to pay the assessment before disputing it or to navigate these more complicated procedures.

Taxpayers Do Not Automatically Receive the Right to Judicial Review Before Paying a Math Error Assessment

IRC §§ 6213(b) and (g) authorize the IRS to use its math error authority to assess and collect tax after 60 days without first providing the taxpayer access to the Tax Court. To preserve the right to petition the Tax Court, the taxpayer must request an abatement within 60 days. If the taxpayer does so, the IRS will then work the case through normal deficiency procedures (described above). Although initially limited to situations involving mathematical errors (*e.g.*, $2+2=5$),²⁸ Congress first expanded the IRS's math error authority to address "clerical errors" (*e.g.*, inconsistent entries on the face of the return),²⁹ and then expanded it to address other circumstances such as where a taxpayer omits a required TIN or uses an SSN that does not match the one in the Social Security Administration's Numident database.³⁰

Congress Carefully Limited Summary Assessment Procedures

Congress was concerned about substituting summary assessment procedures for deficiency procedures.³¹ It generally reserved summary assessment procedures for simple situations where "not only is the error apparent from the face of the return, but the correct amount is determinable with a high degree of probability from the information that appears on the return."³² Noting that authorizing summary assessment procedures when the taxpayer omitted a required schedule may arguably depart from this general approach, a committee report explained that "disputes as to the *adequacy* of the schedule that the taxpayer submits are to be dealt with under normal administrative procedures and not by use of extraordinary summary assessment procedure."³³ The IRS was not to use summary assessment procedures "where it is not clear which of the inconsistent entries is the correct one" or for "resolving an uncertainty against the taxpayer."³⁴

If taxpayers do not understand the supposed error, they may have difficulty deciding whether to request an abatement (assuming they understand that requesting abatement is an option). They are also less likely to request abatement within the shorter 60-day period applicable to summary assessments. Accordingly,

28 H.R. REP. No. 691, at 10-11 (1926).

29 Pub. L. No. 94-455, § 1206(b), 90 Stat. 1520, 1704 (1976) (defining "mathematical or clerical error" to include (1) errors in addition, subtraction, multiplication, or division shown on any return, (2) an incorrect use of any table provided by the IRS with respect to any return if such incorrect use is apparent from the existence of other information on the return, (3) an entry on a return of an item that is inconsistent with another entry of the same or another item on the return, (4) an omission of information which is required to be supplied on the return to substantiate an entry on the return, and (5) an entry on a return of a deduction or credit in amount which exceeds certain types of statutory limits). The IRS had interpreted "math errors" broadly, but courts had limited its use to arithmetic errors; thus the 1976 legislation formally expanded it to encompass "clerical" errors, while also "restricting" its use by the IRS. H.R. REP. No. 94-658, at 289 (1976).

30 IRC § 6213(g)(2). A "mathematical or clerical error" currently includes 14 categories of errors (in subparagraphs A-N), including (a) an omission of a correct TIN required to be included on a tax return for certain tax credits, and (b) the inclusion of a TIN indicating that the individual's age disqualifies them from certain credits, as discussed above. *Id.*

31 See H.R. REP. No. 94-658, at 289 (1976); S. REP. No. 94-938(I), at 375 (1976); Joint Committee on Taxation (JCT), *General Explanation of the Tax Reform Act of 1976*, JCS 33-76, 372 (1976) (*Assessments in Case of Mathematical or Clerical Errors, Sec. 1206 of the Act and Sec. 6213 of the Code*). Although the IRS originally had the authority to assess EITC overpayments without providing taxpayers an opportunity for judicial review in a pre-payment forum (under former IRC § 6201(a)(4)), Congress specifically granted taxpayers this right in 1988. See Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. No. 100-647, § 1015(r), 102 Stat. 3342, 3572 (1988).

32 H.R. REP. No. 94-658, at 292 (1976).

33 *Id.* at n.1 (emphasis added).

34 *Id.* at 291.

Congress also enacted IRC § 6213(b)(1), requiring that “[e]ach notice under this paragraph shall set forth the error alleged and an explanation thereof,”³⁵ and should “include questions designed to show whether the taxpayer indeed is entitled” to what they claimed on the return.³⁶

REASONS FOR CHANGE

As the IRS Receives More Data and Fewer Resources, It May Be Tempted to Apply Summary Assessment Procedures to a Wider Range of Situations

As the IRS’s resources have decreased, it has proposed that Congress expand its summary assessment authority as a seemingly cost-effective way to assess deficiencies and protect revenue.³⁷ This temptation will increase as the IRS receives more data that may be or appear to be inconsistent with a person’s return. The IRS received about 2.1 billion information reporting documents in 2013 (including 47.5 million on paper), and projects a steady increase through 2022.³⁸ It will also begin receiving new types of information. Notably, the IRS will soon begin receiving information from health insurers and self-insured employers about people’s health coverage;³⁹ credit card issuers recently started reporting the aggregate amount of reportable payments they process for businesses;⁴⁰ and brokerage firms generally must now report the cost bases (as well as gross proceeds) of stock, bond, and mutual fund sales.⁴¹ It should make this data available to taxpayers during the filing season to help them in preparing accurate returns, and use it to inform them of seeming inconsistencies when they file or as soon afterward as possible. However, the increasing availability of tax-related data is likely to prompt the IRS to ask Congress to expand its authority to use math error procedures to assess additional tax when there appear to be inconsistencies between the data and a tax return.

Congress Should Consider Expanding the IRS’s Summary Assessment Authority Only in Limited Situations

It is appropriate to expand the IRS’s summary assessment authority to cover only one of the situations described in the Administration’s correctable error proposal — where there can be no doubt that the taxpayer has claimed amounts in excess of a lifetime limitation based on information shown on the return.

35 Pub. L. No. 94-455, § 1206(a), 90 Stat. 1520, 1703 (1976).

36 H.R. REP. No. 94-658, at 291 (1976).

37 See generally National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical As the IRS Develops a Real-Time Tax System*).

38 IRS Pub. 6961, *Calendar Year (CY) Projections of Information and Withholding Documents for the United States and IRS Campuses* (July 2014), Tables 2 and 3.

39 Notice 2013-45, 2013-31 I.R.B. 116; T.D. 9660, 2014-13 I.R.B. 842 (Mar. 10, 2014). Reporting entities are not subject to penalties for failure to comply with the IRC §§ 6055 and 6056 reporting requirements for coverage in 2014 (including the provisions requiring the furnishing of statements to covered individuals in 2015 with respect to 2014). *Id.* These information returns, which are submitted with new Form 1095-B, *Health Coverage*, are not reflected in the IRS’s information return projections. IRS Pub. 6961, *Calendar Year (CY) Projections of Information and Withholding Documents for the United States and IRS Campuses* (July 2014), Table 2. For a discussion of related problems, see Most Serious Problem: *Affordable Care Act - Individuals: The IRS Is Compromising Taxpayer Rights as it Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions*, *supra*, and Most Serious Problem: *Affordable Care Act (ACA) - Business: The IRS Faces Challenges in Implementing the Employer Provisions of the ACA While Protecting Taxpayer Rights and Minimizing Burden*, *supra*.

40 Pub. L. No. 110-289, Div. C, Title III, § 3091(a), 122 Stat. 2654, 2908 (2008) (codified at IRC § 6050W, applicable to returns for calendar years beginning after 2010). The IRS received about 10.3 million Forms 1099-K, *Merchant Card and Third Party Payments*, in 2013 and expects to receive about 11.6 million in CY 2022. IRS Pub. 6961, *Calendar Year (CY) Projections of Information and Withholding Documents for the United States and IRS Campuses* (July 2014), Table 2.

41 Energy Improvement and Extension Act of 2008, Pub. L. No. 110-343, Div. B, § 403(a)(1), 122 Stat. 3765, 3854 (2008) (codified at IRC § 6045(g) and phased in between 2011 and 2013).

For example, in cases where it is clear that a taxpayer has claimed an American Opportunity Tax Credit (AOTC) in excess of a statutory limit, then the summary assessment process may be appropriate. The AOTC is a partially refundable credit for qualified post-secondary education expenditures that is available only for the first four years of a student's post-secondary education.⁴² Because the number of years claimed for each student is shown on the face of the return, allowing the IRS to use math error procedures to stop the improper payment of capped claims may be appropriate and cost effective, although probably not as cost effective as alerting the taxpayer to the problem at or before filing.⁴³

Inappropriate Expansion of Summary Assessment Authority Could Unduly Burden Taxpayers While Eroding the Right to Judicial Review

Without adequate safeguards and congressional oversight, the other proposed expansions of summary assessment authority would erode the right to judicial review *before* paying an audit assessment, which is the cornerstone of due process in the U.S. tax system. The taxpayer bears the burden of asking for the right to petition the Tax Court within a 60-day period, rather than automatically receiving that right under normal IRS deficiency procedures.

It Can Be Difficult to Determine If a Particular Document Is Attached

The correctible error proposal could potentially allow the IRS to “correct” already-accurate returns that do not appear to include required documentation. However, it can be difficult to determine if a particular document is attached to a return, as illustrated by the FTHBC (discussed above).

Accurate Returns May Appear Inconsistent With Government Data

The correctible error proposal could potentially allow the IRS to “correct” already-accurate returns that do not match the information contained in government databases. There are a wide variety of reasons for why accurate returns may appear inconsistent with government data. As illustrated by the FCR database, third-party data may not be sufficiently accurate.

Moreover, applying data collected for nontax purposes to tax claims is akin to relying on the addresses shown in a telephone directory to deny the home mortgage interest deduction. Even if virtually all of the entries in a directory were accurate, they were compiled for a different purpose, do not disprove eligibility under the tax law, may not be current, and should not deprive a taxpayer of a due process right to present his or her own facts.

Of course, even data collected for tax purposes contains errors. By one estimate, 1.5 percent of information returns have invalid payee data.⁴⁴ If other information on these returns is inaccurate at the same rate, the IRS might burden about 31.5 million taxpayers with erroneous assessments (1.5 percent of the 2.1 billion information returns, noted above), if it could make a summary assessment based solely on

42 See IRC § 25A(i).

43 See *Improper Payments in the Administration of Refundable Tax Credits*, Hearing Before the H. Subcomm. on Oversight, Comm. on Ways and Means (May 25, 2011). Both the Government Accountability Office (GAO) and the Treasury Inspector General for Tax Administration (TIGTA) have recommended expanding math error authority to correct returns claiming the Hope Credit (now called the American Opportunity Tax Credit) in more years than allowed by law. See GAO, GAO-10-225, *IRS Met Many 2009 Goals, But Telephone Access Remained Low, and Taxpayer Service and Enforcement Could Be Improved* (Dec. 2009); TIGTA, Ref. No. 2009-30-141, *Improvements Are Needed in the Administration of Education Credits and Reporting Requirements for Educational Institutions* (Sept. 30, 2009).

44 TIGTA, Ref. No. 2011-30-019, *Targeted Compliance Efforts May Reduce the Number of Inaccurate Information Returns Submitted by Government Entities 3-4* (Feb. 15, 2011).

inconsistencies between returns and information returns. Even the government sent out 800,000 incorrect information reporting documents (Forms 1099-A) in the 2015 filing season.⁴⁵

Longstanding IRS matching programs further illustrate how third-party data are often unreliable when used as the sole basis to conclude that the taxpayer's return is wrong. The IRS's automated underreporter (AUR) process adjusts returns where there are mismatches between a tax return and data from third-party information returns, such as Forms W-2 and 1099. For tax years (TYs) 2009-2011, 24.9 percent of these mismatches did not result in an assessment.⁴⁶ Thirty-seven percent of the SNODs went unanswered, resulting in default assessments.⁴⁷ About 4.6 percent of all AUR assessments (and 16.3 percent of the dollars) were abated.⁴⁸ For taxpayers who specifically requested reconsideration of an AUR assessment in FY 2012, the IRS abated at least part of the assessment about 82.9 percent of the time (82.7 percent of the dollars).⁴⁹ Thus, even data from information returns is a weak basis on which to conclude that a taxpayer's return is wrong.⁵⁰

Because Congress and the judiciary have recognized that third-party information returns can be unreliable and difficult for a taxpayer to disprove, the IRS is not always entitled to rely on its general presumption of correctness in court when its determination is based on them.⁵¹ In the context of an exam, even the IRS recognizes the unreliability of third-party information and attempts to verify it with the taxpayer.⁵² However, the IRS could potentially replace its AUR program with summary assessment procedures under the correctable error proposal, eroding a taxpayer's right to have a court review the determination.⁵³

“Mismatches” Should Not Trigger an Adjustment If the IRS Can Explain Them

Not every return that contains a typo or similar error contains an understatement, as illustrated by the TAS study of math errors involving dependent TINs (described above). As that study showed, the IRS imposed a burden on taxpayers in a large percentage of math error cases, generating phone calls and letters it could not timely handle, rather than investing a few minutes of research at the front end. Further, for those who did not respond, the IRS improperly denied tax benefits even when it had the correct TINs in its files.

45 Notice 2015-30, 2015-17 I.R.B. 928; IRS, *Questions and Answers - Incorrect Forms 1095-A and the Premium Tax Credit* (July 6, 2015), available at <https://www.irs.gov/Affordable-Care-Act/Individuals-and-Families/Questions-and-Answers-Incorrect-Forms-1095A-and-the-Premium-Tax-Credit>; IRS SERP Alert 15A0147 (Apr. 6, 2015).

46 Individual Master File (June 11, 2015) (of the 16,242,759 TY 2009-2011 tax modules with mismatches that were assigned to AUR, 4,044,403 did not result in an assessment). In some cases this may have been because the taxpayer explained the reason for the mismatch before a deficiency was assessed, but in others it may have been because the IRS decided not to pursue the discrepancy.

47 IRS response to TAS information request (May 28, 2015). TYs 2009-2011 are the three most recent years for which the IRS has complete data. For these same years, 12 percent of the IRS's SNODs were returned to the IRS as undeliverable. *Id.*

48 IRS Compliance Data Warehouse (CDW), Enforcement Revenue Information System (ERIS) (Dec. 11, 2015) (AUR assessments in TYs 2009-2011).

49 IRS CDW, ERIS (Dec. 11, 2015) (reconsiderations in FY 2012).

50 According to TIGTA, more than two billion information returns were submitted to the IRS in TY 2007, of which almost 31.7 million had invalid payee data (1.5 percent). TIGTA, Ref. No. 2011-30-019, *Targeted Compliance Efforts May Reduce the Number of Inaccurate Information Returns Submitted by Government Entities* 3-4 (Feb. 15, 2011).

51 See, e.g., *Portillo v. Comm'r*, 932 F.2d 1128 (5th Cir. 1991); IRC § 6201(d).

52 See, e.g., IRM 4.10.3.2.1.4(2) (Mar. 1, 2003) (“Information about taxpayers collected from third parties will be verified to the extent practicable with the taxpayer before action is taken.”).

53 For further discussion of the problems with this approach, see, e.g., National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical As the IRS Develops a Real-Time Tax System*); Real-Time Tax System Initiative Comments of Keith T. Fogg, Director, Villanova Law School Federal Tax Clinic (Dec. 8, 2011), available at http://www.irs.gov/pub/irs-utl/t_keith_fogg_aba_tax_section_and_low_income_tax_clinic.pdf.

“Mismatches” Between a Return and a Database That Reflects the Probability of an Error Should Not Trigger an Adjustment

As described above, the DDb combines unreliable FCR data with other information, which the IRS uses to estimate the probability that a taxpayer has improperly claimed a dependent. It would be a slippery slope to authorize the IRS to assess a tax using summary assessment procedures based on its estimate of the probability that a return contains an error. Under the correctable error proposal, however, Treasury Regulations could essentially define such estimates as “mismatches” that would trigger summary assessment authority. When taxpayers do not understand math error notices or the procedure for disputing the assessment, the resulting delay may cost them the opportunity to contest it in a prepayment forum, or even the opportunity to obtain benefits to which they are entitled.

EXPLANATION OF RECOMMENDATIONS

The National Taxpayer Advocate presents six broad recommendations that would help ensure the IRS uses math error procedures only in appropriate circumstances. First, the IRS would be permitted to use math error procedures only after reviewing and revising all of its math error notices to ensure they clearly describe what the IRS changed and why, and how to contest the change. For situations that the IRS can or will not clearly describe on a math error notice, it could use normal deficiency procedures.

Second, the IRS would be permitted to use math error procedures only when there is a mismatch between the return and unquestionably reliable data. For example, because the DDb filters combine unreliable data from various sources to create a more reliable estimate of the probability that a taxpayer’s return is inaccurate, this proposal would not authorize the IRS to rely on such filters.

Third, the IRS would be permitted to use math error procedures only after it has researched all of the information in its possession that could help explain the apparent discrepancy so that it does not need to burden the taxpayer by requesting an explanation. For example, if a return contains an inaccurate dependent TIN, the IRS would review the taxpayer’s prior year returns to determine if the error was a typo. If so, it could inform the taxpayer that it had corrected the typo, rather than burdening the taxpayer with an inaccurate tax assessment.

Fourth, the IRS would be permitted to use math error procedures only in situations where it does not have to analyze facts and circumstances or weigh the adequacy of information submitted by the taxpayer to determine if the return contains an error. For example, while the math error process could require the IRS to determine if the taxpayer included an attachment (*i.e.*, a yes/no determination), the proposal would not authorize its use on the basis that the documentation was insufficient (*i.e.*, a facts and circumstances inquiry).

Fifth, the IRS would be permitted to use math error procedures only if the annual abatement rate for a particular issue or type of inconsistency is below a specified threshold for those taxpayers who respond. The IRS would compute and report the abatement rate on an annual basis so that it could respond to changes in the accuracy of its assessments. It would exclude taxpayers who do not respond so as to avoid a bias toward applying math error procedures to populations that are less responsive to IRS notices (*e.g.*, because they are transient or are less likely to understand IRS correspondence).

Finally, the IRS would be permitted to use math error procedures for any new data or criteria only if, the Department of Treasury, in conjunction with the National Taxpayer Advocate, has evaluated and publicly reported to Congress on the reliability of the data or criteria for purposes of assessing tax using math

error procedures. The report should analyze the burdens and benefits of the proposed use of math error authority, considering downstream costs to taxpayers (*e.g.*, time, paperwork, representation) and the IRS (*e.g.*, processing taxpayer calls and letters, requests for audit reconsideration, amended returns, appeals, and TAS intervention).

The GAO has proposed a similar study to evaluate third-party data reliability.⁵⁴ As noted above, Congress mandated a similar study before the effective date of the IRS's math error authority to address FCR data mismatches, a study that the IRS would not have undertaken without the mandate. These safeguards would help prevent the IRS from unnecessarily wasting resources and burdening taxpayers by making summary assessments based on conclusions that involve the exercise of judgment, information that is not sufficiently accurate, or estimates of the likelihood of an error. They would also be consistent with the taxpayers' *rights to quality service, to pay no more than the correct amount of tax, to privacy, to challenge the IRS's position and be heard, and to appeal an IRS decision in an independent forum.*

54 GAO, GAO-11-691T, *Enhanced Pre-Refund Compliance Checks Could Yield Significant Benefits* 9 (May 25, 2011) (“To ensure IRS continues to use MEA [math error authority] only in these limited circumstances [*i.e.*, where the error is “virtually certain”] if given broader authority, Congress could, for example, require IRS to submit a report to it or an entity it designates on a proposed new use of MEA. The report could include how such use would meet the standards or criteria outlined by Congress. The report could also describe IRS's or the National Taxpayer Advocate's assessment of any potential effect on taxpayer rights.”).

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#3

LEVIES ON RETIREMENT ACCOUNTS: Amend IRC § 6334 to Include a Definition of Flagrancy and Require Consideration of Basic Living Expenses at Retirement Before Levying on Retirement Accounts

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

PROBLEM

Taxpayers rely on Individual Retirement Accounts (IRAs) or defined contribution plans, such as 401(k) plans, or Thrift Savings Plans (TSP) for federal employees, to fund living and other expenses after retirement. Understanding the importance of U.S. taxpayers having sufficient retirement savings, Congress has encouraged retirement savings and formulated statutes to protect the rights of individuals to pensions.² Similarly, the IRS acknowledges the long-term importance of retirement assets to individuals' future welfare by regarding retirement levies as "special cases" that require additional scrutiny and managerial approval.³

Nevertheless, the IRS guidance that explains the steps required before a retirement account can be levied contains inadequate detail and is insufficient to protect taxpayer rights.⁴ For instance, the determination of whether "flagrant behavior" has occurred is an important prerequisite for levying on a retirement account.⁵ According to that guidance, if the IRS determines that a taxpayer has engaged in flagrant conduct, it may consider levying on a retirement account. The guidance also provides that if a taxpayer has not engaged in flagrant conduct, then the levy should not occur. Thus, the determination of flagrant behavior is critical in determining whether to levy on a retirement account.

However, there is no on-point definition of what constitutes "flagrant behavior" in the Internal Revenue Code (IRC), accompanying regulations, or the Internal Revenue Manual (IRM). As a result, the determination of flagrancy is left to subjective judgment by individual IRS employees. Furthermore, the IRS is not required to consider the taxpayer's ability to pay basic living expenses at the time of retirement. This could lead to inconsistent treatment of similarly situated taxpayers, which could erode taxpayers' confidence in a fair tax system and decrease voluntary compliance. More importantly, the IRS's approach undermines Congress' goal to have people able to afford basic living expenses while in retirement.

1 See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 For example, the Employee Retirement Income Security Act of 1974 (ERISA) was enacted to provide protection for participants in pension and health plans in private industry. See Pub. L. No. 93-406, 88 Stat. 829 (1974).

3 IRM 5.11.6.2(3) (Sept. 26, 2014).

4 See IRM 5.11.6.2(4)-(7) (Sept. 26, 2014). For a more detailed discussion, see Most Serious Problem: *Levies on Assets in Retirement Accounts: Current IRS Guidance Regarding the Levy of Retirement Accounts Does Not Adequately Protect Taxpayer Rights and Conflicts with Retirement Security Public Policy*, *supra*.

5 IRM 5.11.6.2(5) (Sept. 26, 2014).

EXAMPLE

A taxpayer is 57 years old and has worked at her current job for over ten years. For much of that time she has had five percent of her wages automatically contributed to her retirement account, which has been matched with an equal contribution by the employer. Prior to working at her current job, the taxpayer was self-employed. The taxpayer fell behind on her tax liabilities while she was self-employed and now owes over \$50,000. As part of the routine collection process, a revenue officer (RO) assigned to her case has identified the retirement account as the taxpayer's only asset that can fully pay the liability. Using the current internal guidance, the RO determined that the taxpayer's continued retirement account contributions, while she has an outstanding tax liability, constitutes flagrant conduct. The RO also determined that, despite the taxpayer being 57 years old, she still has adequate time to save for retirement. In making that determination, the RO did not consider the taxpayer's basic living expenses at retirement, nor did he consider the taxpayer's life expectancy or the actual amount she would realistically be able to save from age 57 to retirement. As a result, the IRS levies the entire amount of the taxpayer's retirement account to fully satisfy her tax liability. The taxpayer is left without retirement savings less than a decade before she will retire.

RECOMMENDATION

To protect taxpayer rights and to further retirement security public policy, the National Taxpayer Advocate recommends that Congress:

Amend IRC § 6334 to define flagrant conduct as willful action (or failure to act) which is voluntarily, consciously, and knowingly committed in violation of any provision of chapters 1, 61, 62, 65, 68, 70, or 75, and which appears to a reasonable person to be a gross violation of any such provision; and to require the IRS to issue regulations describing a full financial analysis of the taxpayer's projected basic living expenses at retirement prior to allowing a determination to levy on a retirement account.⁶

PRESENT LAW

IRC § 6331 authorizes the IRS to levy on a taxpayer's property and rights to property. This power allows the IRS to levy on funds held in retirement accounts.⁷ Generally, the levy on a retirement account will only reach the assets over which the taxpayer has a present withdrawal right (*i.e.*, a levy will not attach until the taxpayer has a present right to withdraw funds from the plan).⁸ IRM guidance explains a "current levy can reach a taxpayer's vested present rights under a plan, but a levy does not accelerate payment and

6 A bill has been introduced in the House and Senate that recommends a stricter standard for defining flagrant conduct. The proposed definition includes: "(A) the filing of a fraudulent return by the taxpayer, or (B) that the taxpayer acted with the intent to evade or defeat any tax imposed by this title or the collection or payment thereof." Taxpayer Rights Act of 2015, S. 2333, 114th Cong. § 307 (2015); Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. § 307 (2015). The proposed language also provides a statutory change by making retirement plans (including TSP accounts) exempt from levy unless "(A) the amount of tax (excluding interest and penalties) owed by the taxpayer exceeds \$10,000, (B) the Secretary determines that the taxpayer has committed a flagrant act, and (C) the Secretary determines that such levy will not create an economic hardship due to the financial condition of the taxpayer (as described in [IRC] section 6343(a)(1)(D))." Taxpayer Rights Act of 2015, S. 2333, 114th Cong. § 307 (2015); Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. §307 (2015). For more information on the bill, see Senator Ben Cardin, *Cardin and Becerra Introduce Plan to Protect Taxpayers' Rights*, available at <http://www.cardin.senate.gov/newsroom/press/release/cardin-and-becerra-introduce-plan-to-protect-taxpayers-rights>. The National Taxpayer Advocate believes this is another way to address the concerns involving retirement account levies.

7 For information on what constitutes a retirement plan, see IRC § 4974(c).

8 IRM 5.11.6.2(8) (Sept. 26, 2014).

is only enforceable when the taxpayer is eligible to receive benefits.”⁹ If a taxpayer has a defined benefit plan and has no present right to withdraw the account balance, the IRS will have no corpus (the main part of the retirement plan) to levy upon at the present time. Rather; the IRS can only levy the monthly distributions or the corpus of the account once a taxpayer reaches retirement age, subject to allowances for reasonable basic living expenses, which are calculated based on circumstances at that time. However, recent changes in the TSP regulations allow a levy on a TSP account to reach up to the entire vested account balance.¹⁰

The IRS has established three steps that must be taken before it can issue a notice of levy on a taxpayer’s retirement account:

- Determine what property (retirement assets and non-retirement assets) is available to collect the liability;
- Determine whether the taxpayer’s conduct has been flagrant; and
- Determine whether the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.¹¹

REASONS FOR CHANGE

It is important to make sure that the determination to levy on a retirement account is correct.¹² Once removed, funds levied from a retirement account cannot be returned to that retirement account, even in the event of a wrongful levy.¹³ Second, when a distribution occurs as the result of levy action, the taxpayer will experience tax consequences. Pursuant to IRC § 408(d), generally, the entire amount paid from a retirement account or any distribution, is considered gross income and is subject to taxation. In the instance of a levy on a retirement account, the payor would be required to withhold ten percent.¹⁴ However, this amount of withholding is not guaranteed to be sufficient to cover the federal tax liability created by the distribution, and the taxpayer may be liable for a state income tax as well.

Even with the gravity of a retirement levy and the need for a correct decision, current internal guidance does not ensure that a taxpayer’s unique facts and circumstances will be considered prior to levy of his or her retirement account. For instance, there is no on-point definition of flagrancy, which is a prerequisite

9 IRM 5.11.6.2(8) (Sept. 26, 2014). For instance, a taxpayer is fully vested in his retirement plan account balance of \$10,000, but he is not yet entitled to a withdrawal. In this instance, a levy may attach to the taxpayer’s present right to the \$10,000, but no money can be collected until the taxpayer has a right to withdraw those funds. Assuming the balance has grown to \$30,000 by the time the taxpayer is eligible to withdraw the funds, the IRS will only be able to collect \$10,000 because this was the taxpayer’s present right at the time of the levy.

10 5 U.S.C. § 8437(e)(3), 5 C.F.R. § 1653.35, and IRM 5.11.6.2.1, *Thrift Savings Plan* (July 17, 2015).

11 IRM 5.11.6.2(4)-(7) (Sept. 26, 2014).

12 See Most Serious Problem: *Levies on Assets in Retirement Accounts: Current IRS Guidance Regarding the Levy of Retirement Accounts Does Not Adequately Protect Taxpayer Rights and Conflicts with Retirement Security Public Policy*, *supra*.

13 The National Taxpayer Advocate recommended legislative changes to IRC § 401 (for Qualified Pension, Profit Sharing, Keogh, and Stock Bonus Plans), IRC § 408 (for IRAs and SEP-IRAs), and IRC § 408A (for Roth IRAs) to authorize the reinstatement of funds to retirement accounts and other pension plans where the IRS levied upon the plans in error or in flagrant disregard of established IRS rules, procedures, or regulations and the funds were returned under IRC § 6343(d). National Taxpayer Advocate 2001 Annual Report to Congress 202-9. 5 C.F.R. § 1653.36(g) states that distributions made to satisfy an IRS levy may not be returned to a participant’s TSP account.

14 IRC § 3405(b)(1). The payor generally is responsible for making this withholding, but the plan administrator may be liable in the case of certain plans. IRC § 3405(d)(1).

to making the levy determination. Instead, IRS employees receive their guidance in this area through various examples. Two particularly troublesome examples include:

- Taxpayers who continue to make voluntary contributions to retirement accounts while asserting an inability to pay an amount that is owed; or
- Taxpayers who voluntarily contributed to retirement accounts during the time period the taxpayer knew unpaid taxes were accruing.¹⁵

The examples described above are overly broad in terms of discouraging retirement savings for *any* taxpayer with an outstanding liability. The guidance also goes against strong public policy that encourages saving for retirement.¹⁶ By statute, federal employees, without their consent, are automatically enrolled to have a certain percentage (typically three percent) of their salary contributed to the TSP.¹⁷ This is done to encourage saving for retirement and to take advantage of employer matching; federal employees must take an affirmative step to stop these automatic contributions.¹⁸ Other employer plans adopt a similar “opt-out” approach to automatically enroll employees.¹⁹

Another example of flagrant conduct includes taxpayers who have demonstrated a “pattern of uncooperative or unresponsive behavior,” which includes, “failing to meet established deadlines, failing to attend scheduled appointments, failing to respond to revenue officer attempts to contact.”²⁰ This guidance relies on a subjective determination by an IRS employee. For instance, one employee may determine that if a taxpayer is 30 days late in submitting documentation, then the taxpayer has been uncooperative, whereas another employee may consider a taxpayer uncooperative after 60 days. Without clear guidance, the IRS employee’s determination is subjective and susceptible to personal judgment.

The IRS could adopt a definition of “flagrant” similar to the definition found in Treasury regulation § 1.507-1(c)(2) related to excise taxes on exempt organizations, which reads:

a willful and flagrant act (or failure to act) is one which is voluntarily, consciously, and knowingly committed in violation of any provision of chapter 42 (other than sections 4940 or 4948(a)) and which appears to a reasonable man to be a gross violation of any such provision.

This definition contains the necessary elements of willful and voluntary conduct as well as gross violation. This definition balances the government’s interest in the efficient collection action with the government’s interest in retirement security for individuals and protection of taxpayer rights.

Additionally, while the IRM does mention extenuating circumstances may exist to mitigate a taxpayer’s behavior, it does not contain any examples of such extenuating circumstances.²¹ Nor does the IRM require the IRS employee to identify mitigating circumstances, which could include IRS delays, IRS failures

15 IRM 5.11.6.2(6) (Sept. 26, 2014).

16 Congress has focused its efforts on improving retirement savings for Americans. Senator Orrin Hatch recalled in 2014 that, “[t]he retirement policies we have pursued have always been about helping Americans help themselves save more of their hard-earned money, not less.” *Retirement Savings 2.0: Updating Savings Policy for the Modern Economy, Hearing Before the Committee on Finance*, 113th Cong. (2014) (statement of Orrin Hatch, ranking member, Committee on Finance).

17 5 U.S.C. § 8432(b)(2)(A). See also Thrift Savings Plan, *Summary of the Thrift Saving Plan 2*, available at <https://www.tsp.gov/PDF/formspubs/tspb08.pdf> (last visited June 30, 2015).

18 *Id.*

19 Automatic enrollment in 401(k) and similar plans was one of the most highly touted changes in the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006).

20 IRM 5.11.6.2(6) (Sept. 26, 2014).

21 IRM 5.11.6.2(5) (Sept. 26, 2014).

to meet appointments or take promised actions, or IRS failures to follow its own published procedures.²² Again, this internal guidance is susceptible to subjective interpretation by an individual IRS employee.

Without an on-point definition for flagrancy and an inquiry into whether the taxpayer voluntarily committed a gross violation, the IRS employee could find flagrancy where there was an unconscious and involuntary, or unknowing violation. This means the IRS could be reducing a taxpayer to poverty in retirement because of an unconscious or unknowing act.

The last step in determining if a levy on a retirement account is appropriate is to decide if the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.²³ To conduct this analysis, employees are instructed to use the standards in IRM 5.15, *Financial Analysis*, to establish necessary living expenses and the life expectancy tables in Publication 590-A, *Individual Retirement Arrangements* (IRAs), to estimate how much can be withdrawn annually to deplete the retirement account in the taxpayer's remaining life.²⁴

While the guidance refers the employee to IRM 5.15 to determine necessary living expenses, there is no requirement to calculate the taxpayer's projected retirement income when he or she retires. Additionally, there is no requirement to document the actual calculations, making it impossible to verify that a consistent method is used in all retirement levy cases. The financial analysis handbook does not take into account cost of living increases or adjustments for increased expenses due to advanced age either, such as rising health care or hospice costs. Finally, the guidance lacks a safeguard that, if the IRS determines a 50-year-old taxpayer does not currently rely on the retirement account (and will not rely on it in the near future), the taxpayer has sufficient opportunity to rebuild the retirement account back up to a level that provides for a stable retirement.²⁵

EXPLANATION OF RECOMMENDATION

This legislative change will balance the need to efficiently collect taxes with the strong and longstanding public policy supporting financially secure retirements. A taxpayer cannot adequately challenge the decision to levy without being provided a detailed analysis of the basis for levy, a situation which impacts the taxpayer's *right to challenge the IRS's position and be heard*. Similarly, without clear guidance, taxpayers do not know what they need to do to comply with tax laws, so they can avoid a determination of "flagrant behavior," which diminishes the *right to be informed*.

22 When an IRS employee has not followed published administrative guidance (including the IRM), the National Taxpayer Advocate may construe the factors in a light most favorable to the taxpayer when deciding to issue a Taxpayer Assistance Order. IRC § 7811(a)(3).

23 IRM 5.11.6.2(7) (Sept. 26, 2014). Employees are instructed not to levy on the retirement account if it is determined that the taxpayer depends on the money in the retirement account (or will in the near future).

24 *Id.* When conducting this financial analysis, employees are reminded to consider special circumstances that may be present on a case-by-case review.

25 There are tools publicly available to help taxpayers estimate their retirement earnings. The IRS could use such tools to compute an estimate of benefits. For instance, the Social Security Administration (SSA) provides an online tool to estimate Social Security retirement benefits. See SSA, *Retirement Estimator*, available at <https://www.ssa.gov/retire/estimator.html>. The TSP website offers an online calculator to figure out how a TSP contribution will affect account savings over time. See TSP, *Paycheck Estimator*, available at <https://www.tsp.gov/PlanningTools/Calculators/paycheckEstimator.html>.

The proposed legislative change would provide a clear definition of flagrancy which would be consistent with the interpretation provided by the Tax Court and the current IRS regulations in exempt organizations' context.²⁶

Finally, the proposed legislative change would require the IRS to issue formal guidance regarding a full financial analysis of the taxpayer's projected income and basic living expenses at retirement, prior to allowing a levy on a retirement account based on the taxpayer's ability to meet necessary living expenses upon retirement.

Another acceptable approach to address the deficiencies associated with retirement account levies is presented in the recently proposed Taxpayer Rights Act of 2015. This bill proposes that retirement plans (including TSP accounts) should be exempt from levy unless "(A) the amount of tax (excluding interest and penalties) owed by the taxpayer exceeds \$10,000, (B) the Secretary determines that the taxpayer has committed a flagrant act, and (C) the Secretary determines that such levy will not create an economic hardship due to the financial condition of the taxpayer (as described in [IRC] section 6343(a)(1)(D))."²⁷ The bill also proposes a definition for flagrant act that includes, "(A) the filing of a fraudulent return by the taxpayer, or (B) that the taxpayer acted with the intent to evade or defeat any tax imposed by this title or the collection or payment thereof."²⁸

26 See Treas. Reg. § 1.507-1(c)(2); *Thorne v. Comm'r*, 99 T.C. 67, 108-109 (1992). In particular, the court found that the trustee engaged in "willful conduct" by knowing that certain procedures should be followed but not requiring them to be followed. Also, the court found that the trustee did not act reasonably by relying on oral assurances of his tax advisor after he received a notice of deficiency. Furthermore, making grants to himself and trustees' family members for their own travel to conferences was seen as a gross violation.

27 Taxpayer Rights Act of 2015, S. 2333, 114th Cong. § 307 (2015); Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. § 307 (2015).

28 *Id.*

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#4**CHAPTER 3 AND CHAPTER 4 CREDITS AND REFUNDS: Protect Taxpayer Rights by Aligning the Rules Governing Credits and Refunds for Domestic and International Withholding****TAXPAYER RIGHTS IMPACTED¹**

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

PROBLEM

Under Internal Revenue Code (IRC) §§ 1441-1443 (Chapter 3), the IRS imposes withholding on payments made to non-resident aliens and foreign corporations and allows credits and refunds of the amounts to which these taxpayers are entitled.² For many years, the operation of this regime closely paralleled the approach taken by the IRS with respect to domestic withholding under IRC § 31 in that there were no restrictions limiting credits or refunds to the amount of withheld tax actually paid over to the IRS.³ With the advent of the additional reporting and withholding requirements established by the Foreign Account Tax Compliance Act (FATCA), which passed IRC §§ 1471-1474 (Chapter 4), the IRS has become increasingly concerned about fraudulent activity on the part of taxpayers and withholding agents.⁴ Such is the case, even though approximately 85 percent of Chapter 3 and Chapter 4 withholding agents are domestic and therefore can be reached by the IRS for tax enforcement purposes.⁵

While IRS fears may have some foundation, the nature and extent of the potential fraudulent activities have not been established by the IRS through any comprehensive, statistically valid evidence.⁶ Nevertheless, the IRS has taken the drastic step of freezing Chapter 3 and Chapter 4 refunds for up to one year or longer, while attempting to match the documentation provided by taxpayers with the documentation provided by withholding agents. This action is not only costly for taxpayers, but for the IRS which estimates that an extension of the freezes through early 2016 will result in an interest expense of approximately \$4.4 million.⁷ As of August 31, 2015, over 50,000 refund claims aggregating to well in

1 See Taxpayer Bill of Rights available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 See Treas. Reg. §§ 1.1462-1 and §1.1464-1.

3 For a discussion of prior IRS practice in the processing of Chapter 3 refund claims, see Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2010-40-121, *Improvements Are Needed to Verify Refunds to Non-resident Aliens Before the Refunds Are Sent Out of the United States*, 6 (Sept. 2010).

4 Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat 71 (2010); Notice 2015-10, 2015-20 I.R.B. 965.

5 Large Business and International before (LB&I) response to TAS information request (Sept. 9, 2015). This percentage is developed from data provided by the IRS with respect to fiscal year ending (FYE) 2012 and FYE 2013, which are the only years for which it furnished this information.

6 LB&I response to TAS information request (Sept. 9, 2015). After analyzing the issue with respect to the 2008 tax year (TY), TIGTA found no statistically significant indicia of fraud relating to IRS processing of refund claims by non-resident aliens. A judgmental sample of TY 2007 and TY 2008 returns, however, revealed significant control weaknesses in the processing of refunds claimed on Forms 1040NR that could be exploited and therefore should be remedied. TIGTA, Ref. No. 2010-40-121, *Improvements Are Needed to Verify Refunds to Non-resident Aliens Before the Refunds Are Sent Out of the United States* 2 (Sept. 2010).

7 IRS presentation: *Foreign Account Tax Compliance Act, Large Business & International (LB&I) Withholding & Refunds (W&R) Discussion*, slide 4 (Oct. 2015).

excess of \$100,000,000 have been frozen by the IRS.⁸ The vast majority of these taxpayers filing refund claims actually appear to be substantially more compliant than a comparable portion of the overall U.S. taxpayer population.⁹ However, the IRS has indefinitely retained amounts owing to this substantial group of taxpayers while it proves the compliant majority innocent in order to protect the tax system from potential exploitation by the noncompliant few.¹⁰ Moreover, the IRS has proposed issuing Chapter 3 and Chapter 4 regulations providing that, in general, even taxpayers who were subjected to proper withholding and who possess complete documentation of that withholding will nevertheless be fully or partially denied a refund of the withheld amounts unless the withholding agent has correctly remitted to the IRS the full amount of withholding for all taxpayers.¹¹ With that step, the IRS would largely complete the transformation of its prior administrative practice of treating domestic and international credit and refund claims similarly, to a new international enforcement regime under which the burdens and risks are disproportionately shifted to largely compliant taxpayers.

EXAMPLE

Taxpayer is a retired non-resident alien individual whose only U.S. source income during the year is dividend income from U.S. stocks. The dividend income is subject to U.S. tax, but in an amount less than what was withheld by the withholding agent. The withheld amount is remitted by the withholding agent to the IRS and is properly reported on the Form 1042-S issued to Taxpayer. Although Taxpayer files an early Form 1040NR seeking a refund of the overwithholding, several months elapse with no response from the IRS. Taxpayer, who relies on the overwithheld dividends as retirement income, contacts the IRS regarding the status of the refund and is forced to incur toll charges while waiting on hold for a lengthy period. When the call is finally answered, the IRS customer service representative says only that the IRS will need additional time to process the return and that Taxpayer should allow up to one year from the date the Form 1040NR was due.¹² The IRS states, “We apologize for the inconvenience,” as Taxpayer wonders how to pay for short-term living expenses.¹³ Where the refund is concerned, Taxpayer’s only options are to hope that the review will occur more quickly than predicted, to contact the Taxpayer Advocate Service for assistance in expediting processing of the Form 1040NR, or, eventually, to file suit in a federal district court.

8 IRS, Compliance Data Warehouse, IRTF Entity and IMF Trans History tables (Oct. 28, 2015); IRS presentation: *Foreign Account Tax Compliance Act, Large Business & International (LB&I) Withholding & Refunds (W&R) Discussion*, slide 9 (Oct. 2015).

9 TAS makes this assertion because our analysis found that individual taxpayers filing Form 1040NR refund claims have a lower percentage of high-scoring Discriminant Index Function (DIF) returns in comparison to filers overall. Data drawn Nov. 10, 2015 for TY 2014 from IRS Compliance Data Warehouse, IRTF Entity table, and IMF Transaction History tables. See particularly Total Positive Income (TPI) Class 72, which encompassed most taxpayers in this group. High-scoring DIF returns were defined as those with a DIF value that exceeded 80 percent of DIF scores in the general population for a particular TPI class. We calculated a cutoff point for DIF scores at the 80th percentile for each TPI class for TY 2014, and calculated the percentage of Form 1040NR refund filers in each TPI class that exceeded the DIF cutoff point. Overall, only approximately two percent of Form 1040NR refund filers exceeded their respective DIF cutoff points, compared to 20 percent for individual filers in the general population (especially TPI Class 72). Accordingly, Form 1040NR refund filers showed a lower percentage of “high-scoring” DIF returns, and thus more compliant behavior, than the overall population. We did, however, identify certain small groups of taxpayers within the overall group who appear to have considerable compliance issues (see TPI Classes 80 and 81). LB&I notes that the above-discussed “[s]coring methodologies and the filters used are not conclusive in determining if 1040NR filers are more compliant than the overall taxpayer population.” LB&I response to TAS informal fact check (Dec. 11, 2015). This methodology, however, is the approach TAS typically employs to evaluate the relative reporting accuracy of two distinct groups.

10 See IRC § 6611(e)(4), under which the IRS may hold a claim without paying interest for up to 180 days from the later of the due date of the return or when the return is filed. The IRS may issue regulations providing some exceptions that could narrow the scope and impact of these freezes. Notice 2015-10, 2015-20 I.R.B. 965.

11 Notice 2015-10, 2015-20 I.R.B. 965.

12 IRS, SERP Alert 15A0416, *Form 1040NR Frozen Refund Extension* (Sept. 11, 2015).

13 *Id.*

Although Taxpayer's situation is unfortunate and unjustifiable, it actually could be worse. If the requisite Form 1042-S was not properly issued by the withholding agent, Taxpayer's right to receive the refund could be lost.¹⁴ Likewise, even though amounts were correctly withheld from payments made to Taxpayer, if the withholding agent did not remit any deposits to the IRS with respect to those amounts, Taxpayer, although not at fault, would not be entitled to a refund.¹⁵

RECOMMENDATION

To protect taxpayer rights, the National Taxpayer Advocate recommends that Congress amend IRC §§ 33 and 6401(b)(2) to provide that unless the IRS identifies some affirmative indicia of fraud, taxpayers will be entitled to a full credit or refund if they can demonstrate that withholding occurred at source.

PRESENT LAW

Chapter 3 generally requires withholding agents to collect the substantive tax liability of non-resident aliens imposed under IRC §§ 871(a), 881(a), and 4948 by withholding on certain payments of U.S. source fixed or determinable annual or periodical income.¹⁶ Likewise, Chapter 4 directs withholding agents to withhold tax on certain payments to foreign financial institutions (FFIs) that are covered nonparticipating FFIs and nonfinancial foreign entities that do not provide information regarding their substantial U.S. owners.¹⁷ Chapter 4 also generally requires participating FFIs to withhold tax on certain payments to accounts of recalcitrant account holders and payees that are nonparticipating FFIs.¹⁸

Amounts withheld by withholding agents under Chapter 3 and Chapter 4 must be deposited with the IRS.¹⁹ If, for any calendar year, the withholding agent fails to remit the proper amount of withheld taxes, it must pay the shortfall out of its own funds and is also subject to the payment of penalties and interest.²⁰ For each calendar year, withholding agents must file a Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*, with the IRS showing the aggregate amount of income they withheld under Chapter 3 and Chapter 4 and the aggregate withholdings they remitted to the government.²¹ Additionally, withholding agents issue Forms 1042-S to each taxpayer from which amounts have been withheld and file the Forms 1042-S with the IRS.²² In order to claim a credit or refund of the amounts withheld, taxpayers must attach the Form 1042-S to their annual tax return.²³

IRC § 33 allows non-resident aliens to claim a credit or refund of taxes withheld at source under Chapter 3. In turn, Chapter 4 provides that FATCA-related credits or refunds will be made available under the rules governing Chapter 3.²⁴ Specifically, the beneficial owner of the income may claim a credit of

14 Treas. Reg. § 301.6402-3T(e); IRM 21.8.1.11.14.1, *Claims for Tax Withheld at Source* (Oct. 1, 2015).

15 IRM 21.8.1.11.14.1, *Claims for Tax Withheld at Source* (Oct. 1, 2015).

16 IRC § 1441.

17 IRC §§ 1471(a), 1473(1). IRC § 1471(d)(1)(B) excepts from the reporting and withholding requirements those accounts that are held by individuals at the same FFI and have an aggregate value of \$50,000 or less.

18 IRC § 1471(b)(1)(D).

19 IRC § 6302; Treas. Regs. §§ 1.1461-1(a), 1.1474-1(b), and 1.6302-2.

20 Treas. Reg. § 1.1461-1. See also IRC §§ 6601, 6651(a)(2), and 6656.

21 Treas. Reg. § 1.1461-1T(b)(1).

22 Treas. Reg. § 1.1461-1T(c).

23 Treas. Reg. § 301.6402-3T(e).

24 IRC § 1474(b)(1).

the amount of tax actually withheld under Chapter 3 or Chapter 4 against the total income tax computed on the beneficial owner's return.²⁵

For cases of overwithholding, the Chapter 3 and Chapter 4 regulations can be read as generally providing a credit or refund of an overpayment of tax that has actually been withheld at source.²⁶ According to the IRS, however, "Under a special rule in section 6401(b)(2), the credit under section 33 is treated as a refundable credit only in the case of a beneficial owner who is a non-resident alien and who has made an election to be treated as a U.S. resident under section 6013(g) or (h)."²⁷ Barring such an election, the IRS's position now is that, even if withholding at source actually takes place, the overpayment required to support a refund only occurs if the withheld amounts are remitted by the withholding agent to the IRS.²⁸

Based on this analysis, the IRS has initiated the practice of matching taxpayer requests for Chapter 3 or Chapter 4 credits or refunds with the information filed by withholding agents before allowing the requested claims.²⁹ To the extent that the claim for refund, which must be evidenced by a Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, cannot be matched with at least some deposit from the withholding agent, no credit or refund will be allowed.³⁰ Nevertheless, the IRS has not yet developed the technology necessary for automatic matching, a shortcoming warned against by the National Taxpayer Advocate in the 2013 Annual Report to Congress.³¹

As a result of this technological deficiency, the IRS originally imposed an across the board 168-day freeze on most Chapter 3 and Chapter 4 refund claims to allow for manual review.³² The freeze has now been extended for up to one year from the date that any unreviewed and unverified returns were due or filed, whichever is later.³³ This one-year freeze period could be further expanded by the IRS as it attempts to implement automated matching systems for 2014, 2015, and beyond.

By contrast, the IRS has adopted the opposite approach with respect to credits and refunds of withheld employment taxes under IRC § 31, which is worded similarly to IRC § 33.³⁴ In the case of this domestic withholding, the IRS allows a credit or refund to taxpayers, even if the employer fails to make the actual deposit with the IRS. The regulations under IRC § 31 expressly provide, "if the tax has actually been withheld at the source, credit or refund shall be made to the recipient of the income even though such tax has not been paid over to the Government by the employer."³⁵

Where Chapter 3 and Chapter 4 are concerned, however, the IRS has announced its intention to propose regulations that would allow full credits or refunds only after a taxpayer files the requisite Form 1042-S

25 IRC §§ 1462 and 1474(b)(1); Treas. Reg. §§ 1.1462-1(a) and 1.1474-3(a).

26 Treas. Reg. §§ 1.1464-1(a) and 1.1474-5(a)(1).

27 Notice 2015-10, 3, 2015-20 I.R.B. 965.

28 *Id.*

29 IRM 21.8.1.11.14.1, *Claims for Tax Withheld at Source* (Oct. 1, 2015).

30 *Id.*

31 National Taxpayer Advocate 2013 Annual Report to Congress 244.

32 IRM 21.8.1.11.14.2, *FATCA - Programming Beginning January 2015 Affecting Certain Forms 1040NR* (TC 810-3 -E Freeze) (May 1, 2015); IRS, SERP Alert 15A0188, *FATCA-Programming Beginning in January 2015 Affecting Certain Forms 1040NR* (TC 810-3 -E Freeze) (Mar. 23, 2015).

33 IRS, SERP Alert 15A0416, *Form 1040NR Frozen Refund Extension* (Sept. 11, 2015); IRS, SERP Alert 15A0417, *Form 1120-F Frozen Refund Extension* (Sept. 11, 2015).

34 See IRC § 31.

35 Treas. Reg. §1.31-1(a).

if the IRS can confirm that the withholding agent remitted the full amount of the aggregate liabilities for which the withholding agent is responsible.³⁶ In the event that a withholding agent has only partially satisfied its deposit requirements with the IRS, the regulations will also provide for a *pro rata* allocation of the amount deposited among taxpayers seeking to claim credits or refunds for the withholding in question.³⁷ Some exceptions may be developed for certain scenarios, such as in cases where the under deposit of tax is *de minimis*, or in cases where the withholding agent in question has a demonstrated history of compliance with its deposit requirements.³⁸ None of these proposed exceptions, however, addresses circumstances where proper amounts were actually withheld from a specific taxpayer's account.

REASONS FOR CHANGE

The IRS has transformed Chapter 3 and Chapter 4 tax administration into a system that assumes non-compliance and is dedicated disproportionately to denying unwarranted benefits to the malfeasant few at the cost of the compliant majority who deserve their credits and refunds. Although the IRS may be reacting to control weaknesses in its non-resident alien refund process identified by TIGTA, the IRS has neither demonstrated that this category of taxpayers is comparatively noncompliant, nor that widespread fraud is actually occurring.³⁹ Nevertheless, most taxpayers seeking refunds of amounts withheld under Chapter 3 or Chapter 4 will have their refunds frozen for up to one year, if not longer, while the IRS attempts to match applicable documentation and satisfy itself that fraud has not occurred.⁴⁰ Moreover, no guarantee exists that this one-year period will not be further extended by the IRS as it attempts to implement automated matching systems for 2014, 2015, and beyond. Thus thousands of compliant taxpayers will experience indeterminate delays in receiving their legitimately claimed refunds, while the IRS tries to marshal its internal resources and detect a relatively few bad actors.

At the same time, the IRS is considering regulations that would allow taxpayers full refunds only to the extent that their withholding agent has fully remitted to the IRS all withholding liabilities for all taxpayers. As a result, a taxpayer could conceivably end up waiting a year or more only to find out that even though the taxpayer's withholding was properly collected and remitted to the IRS by the withholding agent, such was not the case with all other funds collected by the withholding agent, and therefore the taxpayer is only entitled to a proportional amount of the long-delayed refund. By contrast, the IRS currently accepts creditor-risk in the case of domestic withholding, such as on employment taxes, and taxpayers need only show that the withholding actually occurred to be entitled to a credit or refund from the IRS.⁴¹

The IRS argues that the shift in enforcement burden now proposed with respect to international withholding is necessary as a means of preventing fraud. Nevertheless, it has not produced any systematic and rigorous analysis documenting the nature and scope of this risk. No comprehensive statistically valid

36 Notice 2015-10, III.A., 2015-20, I.R.B. 965.

37 *Id.*

38 *Id.*

39 TIGTA, Ref. No. 2010-40-121, *Improvements Are Needed to Verify Refunds to Non-resident Aliens Before the Refunds Are Sent Out of the United States*, 6 (Sept. 2010); LB&I response to TAS information request (Sept. 9, 2015).

40 IRM 21.8.1.11.14.2, *FATCA - Programming Beginning January 2015 Affecting Certain Forms 1040NR (TC 810-3 -E Freeze)* (May 1, 2015). See also IRS, SERP Alert 15A0416, *Form 1040NR Frozen Refund Extension* (Sept. 11, 2015); IRS, SERP Alert 15A0417, *Form 1120-F Frozen Refund Extension* (Sept. 11, 2015). The IRS informed taxpayers that those who requested a refund of tax withheld on a Form 1042-S by filing a Form 1040NR will have to wait up to six months from the original due date of the 1040NR return or the date the 1040NR is filed, whichever is later, to receive any refund due. IRS, *What to Expect for Refunds in 2015*, available at <http://www.irs.gov/Refunds/What-to-Expect-for-Refunds-This-Year> (last visited on Apr. 1, 2015).

41 IRC § 31(a); Treas. Reg. § 1.31-1(a).

evidence has yet been produced to support IRS assertions that significant tax noncompliance is occurring, or may begin occurring, in the context of international withholding. The vast majority of taxpayers filing Forms 1040NR, *U.S. Non-resident Alien Income Tax Return*, seeking refund claims actually appear to be substantially more compliant than a comparable portion of the overall U.S. taxpayer population.⁴² Although concerns regarding potential fraud should be taken seriously, open-ended retention of taxpayer funds, reallocation of creditor burdens to taxpayers, and fundamental shifts in tax policy should not be based on unsubstantiated conjecture. Where evidence of fraud exists, the IRS should develop procedures that are narrowly tailored to address the risk of fraud, and not impose undue burden on taxpayers who are complying with the law.

The IRS has asserted that once improperly refunded amounts have left U.S. jurisdiction and gone abroad, they are virtually impossible for the IRS to recover. While this statement may be true, the IRS does not generally face this risk in the context of potential wrongdoing by Chapter 3 and Chapter 4 withholding agents. Indeed, according to the IRS, approximately 85 percent of these withholding agents are domestic and, therefore, can be reached by the IRS for tax enforcement purposes.⁴³

Thus, withholding agents, even those active in the international context, are primarily domestic and, to the extent they engage in noncompliant behavior, can be compelled by the IRS to remit the withholding payments they have collected, even where non-resident taxpayers are involved.⁴⁴ The IRS has far more effective tools and comprehensive resources at its disposal for this type of enforcement than the individual taxpayers to whom the IRS would now allocate this burden.

Further, according to the Information Reporting Program Advisory Committee (IRPAC), there are many non-fraudulent reasons for a deposit shortfall and most withholding agents have a proven track record in making accurate and timely deposits.⁴⁵ For example, the IRS might have unilaterally debited a withholding agent's Chapter 3 tax deposit account in order to settle a tax liability associated with another account of that agent.⁴⁶ Likewise, the withholding agent might have made a coding mistake when making its deposit with the IRS.⁴⁷ IRPAC concluded that the *pro rata* approach contemplated by the IRS confuses the legitimate problem of fraudulent refund claims with collection of shortfalls in withholding deposits.⁴⁸

IRS concerns regarding the possibility of fraud may well be legitimate. Nevertheless, the sweeping solutions implemented by the IRS do not properly balance the operations of the anti-fraud regime with the taxpayer's need for a process no more intrusive than necessary, part of a taxpayer's *right to privacy*. In so doing, the IRS unnecessarily burdens taxpayers and unintentionally may well be discouraging investment in the United States and harming global commerce.

Accordingly, taxpayers should retain the right to receive their Chapter 3 or Chapter 4 credits or refunds in a timely fashion, if they can demonstrate, to the satisfaction of the IRS, that the withholding actually occurred. These rights should parallel those existing with respect to domestic withholding. In order to be entitled to a Chapter 3 or Chapter 4 credit or refund, a taxpayer should be required to provide only

42 See discussion regarding DIF scores of Form 1040NR refund filers, *supra*.

43 LB&I response to TAS information request (Sept. 9, 2015). This percentage is developed from data provided by the IRS with respect to FYE 2012 and FYE 2013, which are the only years for which it furnished this information.

44 Treas. Reg. § 1.1461-1T(c). See also IRC §§ 6601, 6651(a)(2), and 6656.

45 IRPAC Public Report, International Reporting and Withholding Subgroup Report 65, 69 (Oct. 28, 2015).

46 *Id.*

47 *Id.*

48 *Id.*

a matching Form 1042-S from a withholding agent, or other persuasive evidence that withholding has taken place, unless the IRS has detected some affirmative indicia of fraudulent activity. Further, the burden of pursuing noncompliant withholding agents should not be borne by taxpayers with legitimate refund claims. Rather, as in the case of domestic withholding, the IRS should mobilize its widespread enforcement powers and seek to collect what is properly due and owing from these malfeasant withholding agents.

EXPLANATION OF RECOMMENDATION

The IRS has treated the implementation of FATCA as an opportunity to alter the assumptions and rules governing Chapter 3 and Chapter 4 withholding. With only minimal explanation and without any comprehensive statistically valid evidence to support its actions, the IRS has shifted from a compliance-based to an enforcement-based model of tax administration in the international withholding context. Taxpayers subject to Chapter 3 and Chapter 4 withholding are assumed to be either intentionally or unwittingly participating in fraudulent conduct and must wait up to one year or longer while the IRS proves the taxpayer's innocence before withheld amounts are released. Moreover, the IRS is considering shifting creditor risk with respect to withholding agents, over which taxpayers generally have no control whatsoever, away from the IRS and onto the shoulders of these same taxpayers.

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#5

FOREIGN ACCOUNT REPORTING: Eliminate Duplicative Reporting of Certain Foreign Financial Assets and Adopt a Same-Country Exception for Reporting Financial Assets Held in the Country in Which a U.S. Taxpayer Is a *Bona Fide* Resident

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

PROBLEM

As a response to IRS and congressional concerns that U.S. taxpayers were not fully disclosing the extent of financial assets held abroad, Congress passed the Foreign Account Tax Compliance Act (FATCA) in 2010.² Many U.S. taxpayers, particularly those living abroad, have incurred increased compliance burdens and costs as a result of FATCA reporting obligations on Form 8938, *Statement of Specified Foreign Financial Assets*, that significantly overlap with the Financial Crimes Enforcement Network (FinCEN) Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR), filing requirements.³ These burdens include additional tax preparation fees and the unwillingness of some foreign financial institutions (FFIs) to do business with U.S. expatriates because of significant costs and regulatory risks associated with preparing and maintaining a business for ongoing FATCA compliance.⁴

Congress has given the IRS broad authority to issue regulations and guidance for the purpose of eliminating duplicative reporting requirements.⁵ The IRS has exercised the regulatory authority to eliminate duplicative reporting of assets on the Form 8938 if the asset is reported or reflected on certain other timely-filed international information returns, and provided an exception from reporting financial accounts held in U.S. territories for *bona fide* residents of such territories.⁶ However, it repeatedly declined to adopt the National Taxpayer Advocate's recommendations⁷ to forego duplicative FATCA reporting

1 See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010) (adding Internal Revenue Code (IRC) §§ 1471-1474; 6038D). See also *Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the "Hiring Incentives To Restore Employment Act," Under Consideration by the Senate*, Staff of the Joint Committee on Taxation, JCX-4-10 (Feb. 23, 2010).

3 See IRS Form 8938, *Statement of Specified Foreign Financial Assets* (2015) and FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (Oct. 2013). See also IRS, *Comparison of Form 8938 and FBAR Requirements*, available at <https://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements>; National Taxpayer Advocate 2013 Annual Report to Congress 235.

4 See, e.g., National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 48-52; National Taxpayer Advocate 2013 Annual Report to Congress 238-48. Under FATCA, to avoid being withheld upon a 30 percent withholding tax on certain U.S.-source payments made to them, FFIs may register with the IRS and agree to report certain information about their U.S. accounts, including accounts of certain foreign entities with substantial U.S. owners. IRC §§ 1471-1474.

5 See, e.g., IRC §§ 6038D(h)(1); 1471(d)(1)(C)(ii).

6 See Treas. Reg. § 1.6038D-7(a) and (c). For examples of information returns, see, e.g., Forms 3520, 3520A, 5471, 8621, 8865, or 8891.

7 See National Taxpayer Advocate 2014 Annual Report to Congress 343-45; National Taxpayer Advocate 2013 Annual Report to Congress 228-37; National Taxpayer Advocate 2013 Annual Report to Congress 238-48; National Taxpayer Advocate 2012 Annual Report to Congress 134-53; TAS Recommendations for Published Guidance under IRC §§ 6038D and 1471 (Apr. 15, 2015) and (Apr. 24, 2014). See also *National Taxpayer Advocate Seeks End to Duplicative FATCA Reporting*, 2015 TNT 71-16 (Apr. 14, 2015).

where assets have already been reported on an FBAR, and to allow a same-country exception for reporting financial accounts held in the country in which a U.S. taxpayer is a *bona fide* resident despite support by other stakeholders.⁸

EXAMPLE

Madeleine and Jacque Legrand are citizens and *bona fide* residents of France. Madeleine is also an “accidental” U.S. citizen. She was born in New York City where her parents worked as foreign researchers at a U.S. university on a J-1 visa. Madeleine left the United States for France with her parents at the age of three. As an adult, she visited the United States for brief periods on several occasions prior to 2006, but has never worked in the United States. Over 20 years of employment, Madeleine and her husband have saved about 800,000 Euros for retirement that are invested in mutual funds and certificates of deposit. In 2014, when visiting the United States again, Madeleine learned of the requirement to report worldwide income and the information reporting requirements associated with certain foreign financial assets and accounts, and realized that her retirement savings met the reporting thresholds.⁹ When she returned to France, Madeleine attempted to comply but could not find free tax assistance. She became anxious about the potential FBAR and FATCA penalties that could negatively affect her retirement savings. As a result, she had to pay for tax preparation, plus an additional fee to discuss any FBAR and FATCA reporting questions with her advisor.¹⁰ In addition, upon learning that Madeleine is a dual U.S.-French citizen, the small local bank where the couple had held joint accounts for over a decade suggested that the Legrands either close the accounts or remove Madeleine from them, so that the bank can avoid costs and risks associated with reporting and withholding obligations under FATCA.

RECOMMENDATIONS

To reduce the burdens of FATCA compliance, the National Taxpayer Advocate recommends that Congress:

- Amend IRC § 6038D:
 - To eliminate duplicative reporting of assets on Form 8938, *Statement of Specified Foreign Financial Assets*, if the asset is or has been reported or reflected on an FBAR; and
 - To exclude from the specified foreign financial assets required to be reported on the Form 8938 financial accounts maintained by a financial institution organized under the laws of the country of which the U.S. person is a *bona fide* resident.
- Amend IRC § 1471 to specifically exclude from the definition of financial account subject to reporting by FFI financial accounts maintained by a financial institution organized under the laws of the country of which the U.S. person is a *bona fide* resident.

8 See, e.g., National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 93-4, 99; *Reporting of Specified Foreign Financial Assets*, Preamble to Final Regulations under IRC § 6038D, Summary of Comments and Explanation of Revisions, sec. V (G), 79 FR 73817-01 (Dec. 12, 2014); Email from the Special Counsel to the Deputy Chief Counsel (Technical) to TAS Supervisory Attorney Advisor, *Recommendations for Published Guidance under Sections 6038D and 1471* (Oct. 13, 2015). See also Government Accountability Office (GAO), GAO-12-403, *Reporting Foreign Accounts to IRS: Extent of Duplication Not Currently Known, but Requirements Can Be Clarified*, App. 2 (Feb. 2012); TAS meetings with representatives of the Association of Americans Resident Overseas and the Federation of American Women’s Clubs Overseas (Mar. 24, 2014 and Feb. 24, 2015); TAS meetings with Democrats Abroad Task Force on FATCA (Mar. 4, 2014 and Feb. 24, 2015).

9 For filing thresholds, see generally 31 U.S.C. § 5314(a); 31 C.F.R. § 1010.350; Electronic Filing Requirements for Report of Foreign Bank and Financial Accounts, FinCEN Form 114 (2014) (\$10,000 threshold). See also Treas. Reg. § 1.6038D-2(a).

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

PRESENT LAW

The law requires U.S. taxpayers to file a number of information returns and imposes severe civil penalties for failing to file, many of which are not based on the amount of the underpayment of tax.¹¹ Among the most publicized are the penalties for failure to disclose foreign financial accounts (FBAR) and foreign financial assets (FATCA). The Currency and Foreign Transaction Reporting Act of 1970 (commonly known as The Bank Secrecy Act) requires U.S. citizens and residents to report foreign accounts with an aggregate value of \$10,000 or more at any time during the calendar year on the FBAR.¹² FATCA requires U.S. citizens, resident aliens, and certain non-resident aliens to file a Form 8938 with their individual returns reporting foreign assets exceeding specified thresholds.¹³

A taxpayer may be subject to a civil FBAR penalty of up to \$10,000 per violation for failing to file an FBAR even if the failure was not “willful.”¹⁴ If the government establishes the failure was willful, the maximum penalty is the greater of \$100,000 or 50 percent of the balance of the undisclosed account annually.¹⁵ The taxpayer may also face criminal penalties of up to \$500,000 and ten years in prison.¹⁶ For taxable years beginning after March 18, 2010, pursuant to FATCA, an additional penalty of \$10,000 (and of up to \$50,000 for continued failure after IRS notification) is imposed on U.S. taxpayers holding financial assets outside the United States who fail to report those assets on Form 8938.¹⁷ Underpayments of tax attributable to non-disclosed foreign financial assets are subject to an additional substantial understatement penalty of 40 percent.¹⁸ Additionally, the statute of limitations is extended to six years if there is an omission of gross income in excess of \$5,000 and the omitted gross income is attributable to a foreign financial asset.¹⁹

IRC § 1471(d)(1) defines the term “United States account” and provides for the elimination of duplicative reporting requirements.²⁰ The term “United States account” excludes financial accounts in FFIs if the holder of such account is otherwise subject to information reporting requirements

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- 11 These penalties include but are not limited to penalties under IRC §§ 6038, 6038A, 6038B, 6038C, 6039F, 6046, 6046A. See also IRC §§ 6038D, 6662(b)(7); 31 U.S.C. § 5321(a)(5).
- 12 See 31 C.F.R. § 1010.306(c); Electronic Filing Requirements for Report of Foreign Bank and Financial Accounts, FinCEN Form 114 (2014).
- 13 Treas. Reg. § 1.6038D-2(a). An unmarried taxpayer living in the U.S. must file a Form 8938 if the total value of the taxpayer’s specified foreign financial assets is more than \$50,000 on the last day of the tax year or more than \$75,000 at any time during the tax year. This threshold is doubled in the case of specified individuals who are married filing jointly. A qualifying unmarried taxpayer living abroad must file a Form 8938 if the total value of the taxpayer’s specified foreign financial assets is more than \$200,000 on the last day of the tax year or more than \$300,000 at any time during the tax year. This threshold is doubled as well in the case of qualified individuals living abroad who are married filing jointly. *Id.*
- 14 See 31 U.S.C. § 5321(a)(5)(B). Prior to October 22, 2004, there was no penalty for a non-willful failure to file and the maximum civil penalty for willful violations was \$100,000. The American Jobs Creation Act of 2004, Pub. L. No. 108-357, Title VIII, § 821(a), 118 Stat. 1418, 1586 (Oct. 22, 2004) established a penalty for non-willful violations and increased the penalty for willful violations.
- 15 31 U.S.C. § 5321(a)(5)(C). The penalty can reach 300 percent of the account balance if the willful failures continue over a six-year period. A six-year statute of limitations applies to the civil FBAR penalty. See 31 U.S.C. § 5321(b)(1).
- 16 31 U.S.C. § 5322; 31 C.F.R. § 1010.840(b). To establish willfulness for either civil or criminal penalties, the IRS generally has to establish that the taxpayer had knowledge of the FBAR filing requirement.
- 17 IRC § 6038D.
- 18 See IRC § 6662(b)(7).
- 19 IRC § 6501(e).
- 20 IRC § 1471(d)(1)(C).

which the IRS determines would make the reporting with respect to these accounts duplicative.²¹ IRC § 1471(d)(1)(C)(ii) states:

(C) Elimination of duplicative reporting requirements.--Such term shall not include any financial account in a foreign financial institution if —

(ii) the holder of such account is *otherwise subject to information reporting* requirements which the Secretary determines would make the reporting required by this section with respect to United States accounts *duplicative* (emphasis added).

Treasury Regulation § 1.1471-5(b)(2) provides specific exceptions to the definition of financial accounts subject to reporting by FFIs. Currently, the regulation does not provide an exception for financial accounts maintained by a financial institution organized under the laws of the country of which the U.S. person is a *bona fide* resident.

Similarly, IRC § 6038D specifically authorizes the IRS to issue regulations or other guidance to provide appropriate exceptions from FATCA reporting when such reporting would be duplicative of other disclosures. IRC § 6038D(h)(1) provides that:

The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section, including *regulations or other guidance which provide appropriate exceptions* from the application of this section in the case of —

(1) classes of assets identified by the Secretary, including any assets with respect to which the Secretary determines that disclosure under this section would be duplicative of other disclosures... (emphasis added).

Treasury Regulations under IRC § 6038D eliminate duplicative reporting of assets on the Form 8938 if the asset is reported or reflected on certain other timely-filed international information returns (*e.g.*, Forms 3520, 3520A, 5471, 8621, 8865, or 8891) provided the Form 8938 indicates the filing of the form on which the asset is reported.²² However, FinCEN Report 114 (FBAR) is not included on the list of those information returns.

Similarly, Treasury Regulation § 1.6038D-7(c)(1) provides that a *bona fide* resident of a U.S. possession who is required to file Form 8938 is *not required* to report financial accounts maintained by a financial institution organized under the laws of the U.S. possession of which the specified individual is a *bona fide* resident. The regulation currently does not have a similar exception for U.S. individuals who are *bona fide* residents of foreign countries.

²¹ IRC § 1471(d)(1)(C)(ii).

²² See Treas. Reg. § 1.6038D-7(a).

REASONS FOR CHANGE

Eliminate Duplicative Reporting

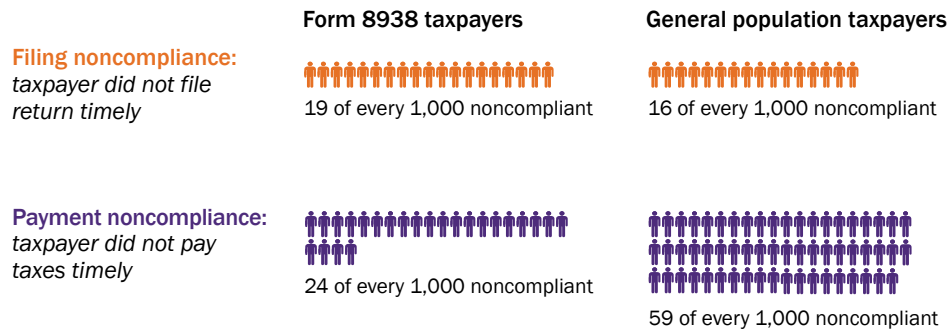
For several years, the National Taxpayer Advocate and other stakeholders have expressed concerns about the overlap of FBAR and the Form 8938, which must be filed with annual federal income tax returns.²³ The FinCEN Report 114 and the Form 8938 are significantly duplicative, increasing confusion and adding to the compliance burden for taxpayers.²⁴ Reporting and withholding obligations have resulted in additional costs and risks of substantial penalties for taxpayers and withholding agents, and might have prompted some FFIs to close accounts of U.S. taxpayers abroad.²⁵

FATCA was passed in response to IRS and congressional concerns that U.S. taxpayers were not fully disclosing the extent of financial assets held abroad.²⁶ However, the IRS's approach to FATCA apparently is based on the unsubstantiated assumption that most taxpayers are "bad actors" and that a widespread, burdensome enforcement regime is necessary. Such has been the case even though the vast majority of taxpayers have been, and likely will continue to be, fully compliant. In her 2013 report, the National Taxpayer Advocate observed that based on analysis of the data then available "... to this point, the IRS is imposing additional reporting burdens and increased potential penalties primarily on a category of taxpayers that, under principles of quality tax administration, should be encouraged, rather than penalized."²⁷ Further review of updated and expanded data from fiscal year 2010 through the present continues to demonstrate tax evaders are not feeling the weight of FATCA; instead, the burden of FATCA falls on U.S. taxpayers who likely would be compliant regardless. U.S. taxpayers under the FATCA umbrella who must file Form 8938 are generally as compliant as the overall U.S. taxpayer population as shown on Figure 2.5.1.²⁸

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- 23 National Taxpayer Advocate 2013 Annual Report to Congress 238-48; National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 23; National Taxpayer Advocate 2012 Annual Report to Congress 134, 141; National Taxpayer Advocate 2011 Annual Report to Congress 129-272; TAX ANALYSTS, *Texas CPAs Recommend Simplifying Foreign Financial Reporting*, 2015 TNT 167-13; GAO, GAO-12-403, *Reporting Foreign Accounts to IRS: Extent of Duplication Not Currently Known, but Requirements Can Be Clarified*, App. 2 (Feb. 2012).
- 24 IRS, *Comparison of Form 8938 and FBAR Requirements*, available at <http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements>.
- 25 Under FATCA, to avoid being withheld upon a 30 percent withholding tax on certain U.S.-source payments made to them, FFIs should register with the IRS and agree to report certain information about their U.S. accounts, including accounts of certain foreign entities with substantial U.S. owners. IRC §§ 1471-1474.
- 26 See *Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the "Hiring Incentives To Restore Employment Act," Under Consideration by the Senate*, Staff of the Joint Committee on Taxation, JCX-4-10 (Feb. 23, 2010).
- 27 National Taxpayer Advocate 2013 Annual Report to Congress 241.
- 28 National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 48-52 (Area of Focus: *The IRS's Implementation of FATCA Has in Some Cases Imposed Unnecessary Burdens and Failed to Protect the Rights of Affected Taxpayers*).

FIGURE 2.5.1²⁹

Noncompliance Rates for Form 8938 Filers vs. General Population Taxpayers



The National Taxpayer Advocate previously has observed taxpayers' willingness to meet their reporting and filing obligations is driven more by considerations of personal integrity and perceptions of systemic fairness than by economic deterrence and enforcement measures.³⁰

As of December 2015, approximately 300,000 taxpayers had filed Forms 8938 for tax year (TY) 2013, while about 283,000 had filed for TY 2014.³¹ Of the taxpayers filing Forms 8938 in TY 2013, approximately 38 percent also filed FBAR forms.³² Roughly 24 percent of Form 8938 returns were submitted to the IRS from a foreign address based on TY 2013 data.³³

29 Data drawn from IRS Compliance Data Warehouse (CDW), IRTF Entity and IMF Status History tables (Mar. 26, 2015). This table uses status code 03 data (Tax Delinquency Investigation) to measure filing compliance and status code 22, 24, and 26 data (Tax Delinquent Account) to measure payment compliance. The analysis covers five tax years from 2009 forward. In addition, FATCA filers appear to have a lower level of reporting noncompliance than the general population because FATCA filers have a lower percentage of high-scoring DIF returns in comparison to filers overall. Data drawn April 13, 2015 from CDW, IRTF Entity table, Processing Year 2013. High-scoring DIF returns were defined as those with a DIF value that exceeded 80 percent of DIF scores in the general population for a particular TPI class. We calculated a cutoff point for DIF scores at the 80th percentile for each TPI class for Processing Year 2013 and calculated the percentage of FATCA filers in each TPI class that exceeded the DIF cutoff point. Only 16.5 percent of FATCA filers exceeded their respective DIF cutoff points, compared to, of course, 20 percent for individual filers in the general population. Thus, FATCA filers showed a lower percentage of "high-scoring" DIF returns than the overall population.

30 National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 134.

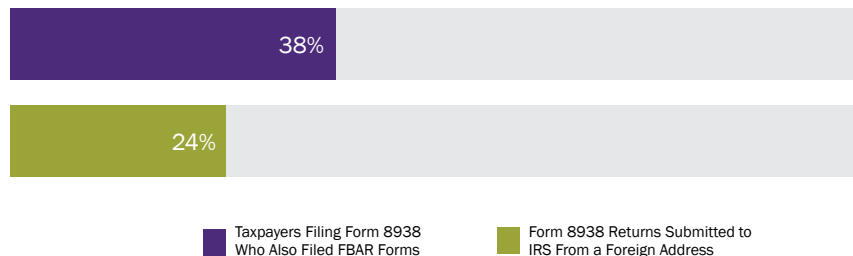
31 TAS Research, CDW, IRTF Entity and IRTF F1040 tables, data drawn Nov. 16, 2015. These numbers may change as more TY 2013 and 2014 returns are filed with the IRS.

32 TAS Research, CDW, IRTF Entity and IRMF_F90_22 tables, data drawn Nov. 16, 2015.

33 IRS LB&I Division, Planning, Analysis, Inventory, and Research (PAIR) analysis, CDW, IMF_Entity table, data drawn Dec. 18, 2015.

FIGURE 2.5.2³⁴

Taxpayers Filing Forms 8938 in Tax Year 2013



As noted above, the IRS has regulatory authority under FATCA to eliminate duplicative reporting on FATCA Form 8938 and FBAR. However, it repeatedly has declined to do so, citing the Joint Committee on Taxation (JCT) Technical Explanation accompanying the HIRE Act.³⁵ The Technical Explanation states that “[n]othing in this provision [section 511 of the HIRE Act enacting new section 6038D] is intended as a substitute for compliance with the FBAR reporting requirements, which are unchanged by this provision.”³⁶ At the same time, as described above, the *statutory* language (as opposed to a JCT explanation) specifically authorizes elimination of duplicative reporting requirements.³⁷

While the IRS may feel constrained in its regulatory authority to change the FBAR filing requirements, it is specifically granted the freedom to adjust FATCA filing requirements. The National Taxpayer Advocate is therefore baffled by the IRS’s inexplicable unwillingness to address this unnecessary duplication of reporting requirements. It appears that congressional action specifically *requiring* the IRS to eliminate duplicative reporting under FATCA and FBAR is necessary to alleviate significant burdens being experienced by affected taxpayers and to protect the taxpayers’ rights to *privacy* and to a *fair and just tax system*.

Same-Country Exception

As stated above, U.S. taxpayers residing abroad are subject to overlapping reporting requirements under FBAR and FATCA, which increase preparation expenses and the chance of error.

Additionally, organizations representing U.S. taxpayers abroad have voiced concerns about unintended consequences of new FATCA rules for FFIs that make it harder for U.S. taxpayers living abroad to open

34 TAS Research, CDW, IRFT Entity and IRMF_F90_22 tables, data drawn Nov. 16, 2015. IRS LB&I Division, PAIR analysis, CDW, IMF_Entity table, data drawn Dec. 18, 2015. These numbers will change as more TY 2013 returns are filed with the IRS.

35 *Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the “Hiring Incentives To Restore Employment Act,” Under Consideration by the Senate*, Staff of the Joint Committee on Taxation, JCX-4-10 (Feb. 23, 2010). See also *Reporting of Specified Foreign Financial Assets*, Preamble to Final Regulations under IRC § 6038D, Summary of Comments and Explanation of Revisions, sec. V (G), 79 FR 73817-01 (Dec. 12, 2014); Email from the Special Counsel to the Deputy Chief Counsel (Technical) to TAS Supervisory Attorney Advisor, *Recommendations for Published Guidance under Sections 6038D and 1471* (Oct. 13, 2015); National Taxpayer Advocate 2015 Objectives Report to Congress 93-94, 99.

36 *Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the “Hiring Incentives To Restore Employment Act,” Under Consideration by the Senate*, Staff of the Joint Committee on Taxation, JCX-4-10 (Feb. 23, 2010) at 60.

37 IRC §§ 1471(d)(1)(C)(ii) and 6038D(h)(1).

and maintain legitimate bank accounts overseas.³⁸ Some FFIs, such as DeutscheBank, HSBC, and ING, have reportedly closed out foreign accounts of U.S. citizens in response to FATCA to avoid significant costs and regulatory risks associated with preparing for and maintaining an ongoing FATCA compliance.³⁹ Other FFIs have severely restricted the services they offer to these customers.⁴⁰

During recent meetings with TAS, organizations of U.S. citizens abroad reiterated their concerns about the difficulty of opening bank accounts in their countries of residency.⁴¹ The National Taxpayer Advocate has personally received multiple reports from taxpayers, taxpayer representatives, and tax professionals residing in a range of countries including Austria, Hungary, and Sweden and from some foreign tax officials themselves.⁴² Because FATCA creates burdens for FFIs, some foreign banks are unwilling to open accounts for U.S. citizens abroad, especially for those individuals residing in small communities where the global banks do not have branches.

Similarly, substantial day-to-day compliance burdens and costs of implementing FATCA are placed on financial institutions.⁴³ For example, unless an FFI agrees to provide comprehensive information regarding accounts of U.S. taxpayers, a broad range of U.S.-source payments to that FFI are subject to a 30 percent withholding tax.⁴⁴ FATCA further charges withholding agents with the responsibility of determining whether they are obliged to undertake FATCA withholding and implementing that withholding when it is required.⁴⁵

As a recommendation to help minimize the burden of FATCA compliance for both individual U.S. taxpayers residing abroad and FFIs, the National Taxpayer Advocate proposed that the IRS and Treasury adopt a “same-country exception.”⁴⁶ Accounts opened by U.S. citizens in a foreign country of *bona fide* residence are not “offshore” accounts designed for tax avoidance. These *bona fide* residents have a legitimate need for local banking services in their countries of residence. Thus, it is more logical and in keep-

38 IRC §§ 1471-1474. See, e.g., ACA Comments on the Proposed Treasury Regulations Concerning FATCA Dated February 8, 2012 (Apr. 4, 2012), available at <https://www.americansabroad.org/files/6813/4192/6083/acastatementapril2012s.pdf> (last visited Nov. 23, 2015); April Carvelli, *Taxes Pushing U.S. Citizens to Renounce*, Imperfect Parent (Apr. 17, 2012) (quoting Francisca N. Mordi, Vice President and Senior Tax Counsel at the American Bankers Association, who stated she received a number of calls from Americans in Europe complaining about banks closing their accounts. “They’re going to drop Americans like hot potatoes,” Mordi says. “The foreign banks are upset enough about the regulations that they’re saying they just won’t keep American customers, and it’s giving (Americans living abroad) a lot of sleepless nights.”), available at <http://www.imperfectparent.com/topics/2012/04/17/taxes-pushing-u-s-citizens-to-renoance/>; James Fellows, *The FATCA Chronicles: Tales From China, Canada, and Estonia*, THE ATLANTIC (Jan. 3, 2012), available at <http://www.theatlantic.com/international/archive/2012/01/the-fatca-chronicles-ales-from-china-canada-and-estonia/250771/>; Judi Lembke, *Americans in Sweden Suffer U.S. Tax Crackdown*, THE LOCAL (Sweden’s News in English) (Mar. 6, 2012), available at <http://www.thelocal.se/39522/20120306/>.

39 See National Taxpayer Advocate 2013 Annual Report to Congress 238.

40 *Id.*

41 TAS meetings with representatives of the Association of Americans Resident Overseas and the Federation of American Women’s Clubs Overseas (Mar. 24, 2014 and Feb. 24, 2015); TAS meeting with Democrats Abroad Task Force on FATCA (Mar. 4, 2014 and Mar. 4, 2015).

42 National Taxpayer Advocate’s meetings at the University of Vienna, Austria, Harvard Club of Hungary, Budapest, Hungary, and Swedish Tax Agency, Stockholm, Sweden.

43 Presentation of the National Taxpayer Advocate to the Securities Industry and Financial Markets Association (Oct. 7, 2014). See also Lee Sheppard, *News Analysis: The Reformation of FATCA*, 2015 TNT 92-1 (May 13, 2015).

44 IRC §§ 1471(a) and 1473(1). IRC § 1471(d)(1)(B) exempts from the reporting and withholding requirements those accounts that are held by individuals at the same FFI and have an aggregate value of \$50,000 or less. Note that an FFI can provide information either as a participating FFI or pursuant to an intergovernmental agreement negotiated between the U.S. and the FFI’s home country.

45 IRC §§ 1471-1474; Notice 2013-43, 2013-31 I.R.B. 113.

46 TAS Recommendations for Published Guidance under IRC §§ 6038D and 1471 (Apr. 15, 2015) and (Apr. 24, 2014). See also *National Taxpayer Advocate Seeks End to Duplicative FATCA Reporting*, 2015 TNT 71-16 (Apr. 14, 2015).

ing with the spirit of FATCA to require information reporting on financial assets and accounts opened in a country other than one's country of residence.

The IRS could have significantly alleviated reporting burdens for U.S. persons who are *bona fide* residents in foreign countries by revising regulations under IRC §§ 6038D and 1471 to eliminate the requirement to report specified foreign financial assets on the Form 8938 if such persons have reported the assets on the FBAR. The IRS could also facilitate these taxpayers' legitimate need for local banking services in their countries of residence by excluding financial accounts maintained by a financial institution organized under the laws of the country of which the U.S. persons are *bona fide* residents from FATCA reporting.⁴⁷ To this point, the IRS has not been willing to pursue these recommendations proposed by the National Taxpayer Advocate and supported by other stakeholders.⁴⁸ In response to the National Taxpayer Advocate's request that this proposal be included in the U.S. Department of the Treasury Office of Tax Policy and the IRS Priority Guidance Plan, the IRS Office of Chief Counsel maintained:

Under longstanding U.S. tax policy, U.S. citizens are taxed on their worldwide income irrespective of where they reside. Section 6038D was enacted to provide the IRS with an effective means to ensure compliance by all U.S. taxpayers owning foreign financial assets, including those residing outside of the United States. Thus, it was decided that the regulations under section 1471 and 6038D should not provide a broad carve out (from either the FFI reporting rules or the taxpayer self-reporting requirements, respectively) for U.S. citizens residing abroad as proposed in [TAS Recommendations for Published Guidance under Sections 6038D and 1471]. However, please note that the section 6038D regulations provide very substantial reporting relief for most U.S. citizens who are *bona fide* residents of another country. The regulations do so by providing aggregate foreign financial asset reporting thresholds for U.S. citizens residing abroad that are very generous and substantially higher than those applicable to other U.S. taxpayers. As a result, only those U.S. taxpayers residing abroad who have very substantial foreign financial asset holdings are required to file a Form 8938.⁴⁹

For "accidental" Americans who have lived abroad for most of their lives, as described in the example above, the increased thresholds may not achieve the intended result as their savings may exceed even the higher thresholds.⁵⁰ This is particularly true where the accounts subject to reporting contain retirement savings. As a result, these taxpayers will bear the cost of tax preparation expenses for duplicate reporting under FBAR and FATCA. Others excepted from FATCA reporting under the higher thresholds will bear

47 To qualify for foreign earned income exclusion and foreign housing exclusion or deduction, a U.S. citizen or resident alien (for tax purposes) must have a tax home in a foreign country, and either be a *bona fide* resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year (*bona fide* residence test), or be present in a foreign country or countries during at least 330 full days in any period of 12 consecutive months (physical presence test). IRC § 911(d)(2).

48 Email from the Special Counsel to the Deputy Chief Counsel (Technical) to TAS Supervisory Attorney Advisor, *Recommendations for Published Guidance under Sections 6038D and 1471* (Oct. 13, 2015); TAS meetings with the Special Counsel to the Deputy Chief Counsel (Technical) (May 23, 2014 and June 17, 2015).

49 Email from the Special Counsel to the Deputy Chief Counsel (Technical) to TAS Supervisory Attorney Advisor, *Recommendations for Published Guidance under IRC Sections 6038D and 1471* (Oct. 13, 2015).

50 A qualifying unmarried taxpayer living abroad must file a Form 8938 if the total value of the taxpayer's specified foreign financial assets is more than \$200,000 on the last day of the tax year or more than \$300,000 at any time during the tax year. This threshold is doubled as well in the case of qualified individuals living abroad who are married filing jointly. Treas. Reg. § 1.6038D-2(a).

the risk of IRS audits due to potential FFI errors because FFIs are still required to report their accounts to the IRS on Forms 8966, *FATCA Report*.⁵¹

Both groups will face the increased risk of errors as the IRS has shut itself off from a two-way dialogue with taxpayers abroad by closing all IRS tax attaché posts and eliminating the Electronic Tax Law Assistance Program, which was the only free method for taxpayers abroad to ask and receive answers to their specific tax law questions without paying toll phone or fax charges.⁵² Similarly, both groups will continue experiencing difficulties with opening or maintaining bank accounts unless the definition of financial accounts subject to reporting by FFIs under IRC § 1471(d) excludes accounts maintained by a financial institution organized under the laws of the country of which the U.S. person is a *bona fide* resident.

EXPLANATION OF RECOMMENDATIONS

Treasury Regulations under IRC § 6038D eliminate duplicative reporting of assets on the Form 8938 if the asset is reported or reflected on certain other timely-filed international information returns (*e.g.*, Forms 3520, 3520A, 5471, 8621, 8865, or 8891) provided the Form 8938 indicates the filing of the form on which the asset is reported.⁵³ The proposed legislation will achieve similar results by eliminating duplicative information reporting under FBAR. The proposed legislative change will not jeopardize the IRS's access to foreign financial account information reported on FBARs. The IRS has access to the FinCEN Query System, which allows IRS employees direct electronic access to FBAR data.

This legislative proposal would also exclude from FATCA coverage foreign financial assets held in the country in which a U.S. taxpayer is a *bona fide* resident. It would mitigate concerns about the collateral consequences of FATCA raised by U.S. non-residents, reduce reporting burdens faced by FFIs, and allow the IRS to focus its enforcement efforts on identifying and addressing willful attempts at tax evasion through foreign accounts.⁵⁴ From a technical perspective this exception is substantially similar to the regulatory exception provided to *bona fide* residents of U.S. territories.⁵⁵

Information reporting can be very useful and can influence taxpayer behavior and future compliance, provided it is narrowly tailored to accomplish a reasonable result. The proposed legislative recommendations enhance taxpayer *rights to privacy* and *to a fair and just tax system* without inhibiting the IRS's ability to obtain information about financial accounts maintained by FFIs outside the U.S. person's country of *bona fide* residency.

51 Reaching the IRS to address inadvertent errors would be especially problematic given the decline in phone service over the recent year. In FY 2013, the average wait time on the international phone line was 10.5 minutes, compared to 19.9 minutes in FY 2015, a 90 percent increase. Furthermore, the average level of service on the international phone line in FY 2015 was only 55 percent. See Most Serious Problem: *International Taxpayer Service: The IRS's Service on Demand Strategy Fails to Compensate for the Closure of International Tax Attaché Offices and Does Not Sufficiently Address the Unique Needs of International Taxpayers, supra*.

52 *Id.*

53 See Treas. Reg. § 1.6038D-7(a).

54 A workable same-country exception would require the development of detailed guidance from the IRS, ideally arrived in consultation with FFIs and other stakeholders. One potential starting point would be to allow an FFI to accept the self-reporting of its accountholders to the extent that this reliance is reasonable under the facts and circumstances known to the FFI.

55 See Treas. Reg. § 1.6038D-7(c).

LR
#6**INDIAN TRIBAL GOVERNMENTS (ITGs): Treat ITGs As States for Social Security Tax Purposes****TAXPAYER RIGHTS IMPACTED¹**

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

PROBLEM

Indian Tribal Governments (ITGs) have a unique status for federal tax purposes.² In 1983, Congress enacted Internal Revenue Code (IRC) § 7871 which provides that ITGs are treated as States for certain tax purposes,³ acknowledging that, in many respects, ITGs function like States and should therefore be treated as such.⁴ More recently, in 2000, Congress decided that ITGs should be treated identically to States with regard to Federal Unemployment Tax Act (FUTA) taxes, allowing ITGs, like State governments, to elect to pay FUTA taxes only when a former employee claims unemployment benefits.⁵ However, ITGs are not treated as States for the purpose of Social Security taxes. Thus, unlike State employees, ITG employees who are covered by a State retirement plan are not excepted from Social Security taxes.⁶ This inconsistency creates compliance burdens for ITGs and their employees.

In addition, as the law currently stands, ITGs may not be able to recruit and retain tribal police officers by offering participation in favorable State pension plans. Because ITGs are not treated as States for Social Security taxes under IRC § 7871 or any other IRC provision, ITGs and tribal police officers who participate in a State pension plan are still responsible for their respective employer and employee portions of Social Security tax. This creates an inequity that can impede the ITG's ability to recruit and retain police officers, places an economic burden on the ITG attempting to address crime on tribal lands, and thereby frustrates congressional intent to deal with this issue.⁷ It also undermines ITG taxpayers' *right to a fair and just tax system*.

1 See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 For a discussion of the various federal tax provisions applicable to ITGs, see Joint Committee on Taxation, *Overview of Federal Tax Provision and Analysis of Selected Issues Relating to Native American Tribes and Their Members*, JCX-40-12 (May 14, 2012).

3 See IRC § 7871(a). These include the ability to receive tax deductible charitable contributions for income, estate, and gift tax purposes, the special treatment afforded to States for certain excise taxes, the ability to deduct taxes paid to an ITG, and the issuance of tax-exempt government bonds. ITGs are also treated as States for other purposes that are set forth in IRC § 7871(a).

4 This section was originally enacted by the Indian Tribal Governmental Tax Status Act of 1982, Pub. L. No. 97-473, § 202(a), 96 Stat. 2605, 2608-11 (1983). It has been amended several times since the initial enactment.

5 See Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, § 166, 114 Stat. 2763, 2763A-627 (2000). This legislation amended FUTA provisions contained in IRC §§ 3306 and 3309 to provide that ITGs are to be treated like State and local governments for FUTA purposes. See IRC §§ 3306(c), 3306(u), and 3309. See also Announcement 2001-16, 2001-1 C.B. 715 (providing guidance to ITGs on FUTA obligations).

6 IRC § 3121(b)(7)(F).

7 See Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 202, 124 Stat. 2261, 2262 (2010) (noting that domestic and sexual violence against American Indian and Alaska Native women has reached epidemic proportions and that Indian tribes have experienced significant increases in domestic violence, burglary, assault, and child abuse on Indian reservations). See also Timothy Williams, *Higher Crime, Fewer Charges on Indian Land*, N.Y. TIMES, Feb. 20, 2012, available at http://www.nytimes.com/2012/02/21/us/on-indian-reservations-higher-crime-and-fewer-prosecutions.html?_r=0 (citing Department of Justice (DOJ) data that the country's 310 Indian reservations have violent crime rates that are more than two and a half times higher than the national average).

EXAMPLE

An ITG is facing an increase in crime on its land. To deal with this increase, the tribe seeks to recruit additional police officers and is also concerned about the retention of its current police officers. The tribe is located within a State that, to incentivize the recruitment and retention of qualified police officers, offers a retirement plan with excellent benefits to State police officers. Under IRC § 3121(b)(7)(F), State police officers who are covered by this retirement plan are excepted from paying Social Security taxes.

To facilitate recruitment and retention of police officers, the tribe has entered into an agreement with the State that permits police officers employed by the tribe to participate in the State's retirement plan. However, because tribal police officers are technically employees of the tribe and not the State, they are not excepted from Social Security taxes. Therefore, if they wish to participate in the State retirement plan, the tribal police officers and the ITG must pay into both Social Security and the State retirement system. This inconsistent treatment between State and tribal police officers has an adverse effect on the tribe's ability to recruit and retain tribal police officers and places an economic burden on the tribe, which is attempting to address the increase in crime on tribal lands.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 7871(a) to include IRC § 3121(b)(7)(F) in the list of IRC sections for which ITGs are treated as a "State."

PRESENT LAW

The Federal Insurance Contributions Act (FICA) provisions in the IRC provide for Social Security taxes (also referred to as old age, survivors, and disability insurance, or OASDI) on both employers and employees.⁸ IRC § 3101(a) imposes on the income of every individual a 6.2 percent Social Security tax on the wages (as defined in IRC § 3121(a)) received with respect to employment (as defined in IRC § 3121(b)). IRC § 3111(a) imposes on every employer, with respect to having individuals in its employ, a 6.2 percent Social Security excise tax on wages (as defined in IRC § 3121(b)).

IRC § 3121(b)(7)(F) provides an exception to the term "employment" for Social Security tax purposes and states that services performed in the employ of a State, or any political subdivision thereof, or any instrumentality, are not subject to Social Security taxes. However, this exception does not apply unless the employee is covered by a retirement plan of the State, political subdivision, or instrumentality.

IRC § 7871(a) provides that ITGs shall be treated as States for certain purposes enumerated in this section. However, this section does not provide that ITGs should be treated as States for the purpose of Social Security taxes.

REASONS FOR CHANGE

In previous Annual Reports to Congress, the National Taxpayer Advocate has written about the unique needs of ITG taxpayers as well as made a legislative recommendation to treat ITGs as States for the

⁸ The FICA provisions are contained in Subtitle C, Chapter 21 of the IRC. FICA taxes also include Medicare taxes (also called hospital insurance, or HI) and the Additional Medicare tax, but these are not at issue here.

purpose of the adoption credit in IRC § 23.⁹ ITGs have a unique status for federal tax purposes.¹⁰ IRC § 7871 provides that ITGs are treated as States for certain tax purposes set forth in that section.¹¹ These include the ability to receive tax deductible charitable contributions for income, estate, and gift tax purposes,¹² the special treatment afforded to States for certain excise taxes,¹³ the ability to deduct taxes paid to an ITG,¹⁴ and the issuance of tax-exempt government bonds.¹⁵ In the legislative history of IRC § 7871, a report of the Senate Committee on Finance provides the reason that Congress chose to treat ITGs as States for certain purposes. It states:

Many Indian tribal governments exercise sovereign powers; often this fact has been recognized by the United States by treaty. With the power to tax, the power of eminent domain, and police powers, many Indian tribal governments have responsibilities and needs quite similar to those of State and local governments. Increasingly, Indian Tribal governments have sought funds with which they could assist their people by stimulating their tribal economies and by providing governmental services. The committee has concluded that, in order to facilitate these efforts of the Indian tribal governments that exercise such sovereign powers, it is appropriate to provide these governments with a status under the Internal Revenue Code similar to what is now provided for the governments of the States of the United States.¹⁶

Thus, in enacting IRC § 7871, Congress acknowledged that, in many respects, ITGs function like States and should therefore be treated like them for certain federal tax purposes.

More recently, in 2000, Congress decided that ITGs should be treated as States with regard to FUTA taxes.¹⁷ Under FUTA, employers must pay a six percent tax on total wages paid with respect to covered employment.¹⁸ The change in law allowed ITGs, like State governments, to elect to pay FUTA taxes only when a former employee claims unemployment benefits.¹⁹ Therefore, for FUTA tax purposes, ITGs are treated identically to States.

Regarding Social Security taxes under FICA, in 1990, Congress was concerned about State and local government employees who were neither covered by a State retirement system or through the federal Social

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- 9 See National Taxpayer Advocate 2013 Annual Report to Congress 116 (Most Serious Problem: *Indian Tribal Taxpayers: Inadequate Consideration of Their Unique Needs Causes Burdens*); National Taxpayer Advocate 2012 Annual Report to Congress 521 (Legislative Recommendation: *Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes*).
- 10 For a discussion of the various federal tax provisions applicable to ITGs, see Joint Committee on Taxation, *Overview of Federal Tax Provision and Analysis of Selected Issues Relating to Native American Tribes and Their Members*, JCX-40-12 (May 14, 2012).
- 11 This section was originally enacted by the Indian Tribal Governmental Tax Status Act of 1982, Pub. L. No. 97-473, § 202(a), 96 Stat. 2605, 2608-11 (1983). It has been amended a few times since the initial enactment.
- 12 IRC § 7871(a)(1).
- 13 IRC § 7871(a)(2).
- 14 IRC § 7871(a)(3).
- 15 IRC § 7871(a)(4). ITGs are also treated as States for other purposes that are set forth in IRC § 7871(a).
- 16 S. REP. No. 97-646, at 11 (1982).
- 17 See Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, § 166, 114 Stat. 2763, 2763A-627 (2000). This legislation amended FUTA provisions contained in IRC §§ 3306 and 3309 to provide that ITGs are to be treated like State and local governments for FUTA purposes. See IRC §§ 3306(c), 3306(u), and 3309. See also Announcement 2001-16, 2001-1 C.B. 715 (providing guidance to tribes on FUTA obligations).
- 18 The FUTA provisions are contained in IRC §§ 3301-3311.
- 19 IRC § 3309(d).

Security program.²⁰ It therefore enacted legislation to require Social Security coverage for State or local government employees who were not covered by a retirement system in conjunction with their employment.²¹ However, Congress provided a Social Security tax coverage exception for State employees who are actually covered (*i.e.*, not simply eligible to participate) by a State retirement plan.²²

When enacting IRC § 7871 in 1983, Congress recognized the unique attributes of ITGs and how they have similar needs and characteristics as States and should therefore be treated as States for many tax purposes. Similarly, in 2000, Congress decided to treat ITGs as States for FUTA tax purposes.

ITGs face high levels of crime, particularly violent crime, on tribal lands.²³ In response, Congress enacted the Tribal Law and Order Act of 2010 to encourage the hiring of more law enforcement officers for Indian tribal lands and provide additional tools to address critical public safety needs.²⁴ Specifically, one of the purposes of this legislation was “to empower tribal governments with the authority, resources, and information necessary to safely and effectively provide public safety in Indian country.”²⁵ This law also, among other things, expands efforts to recruit, train, and retain tribal police officers.²⁶

An ITG grappling with a surge in crime will naturally seek to recruit additional tribal police officers and do its best to retain its current ones. To facilitate recruitment and retention, an ITG will likely attempt to put forth attractive compensation packages for tribal police officers, including offering favorable retirement benefits. Due to complex jurisdictional issues on Indian tribal lands, an ITG will often enter into agreements with State (and federal) authorities to coordinate law enforcement efforts.²⁷ An ITG may also enter into an agreement with a State in which it is located to allow tribal police officers to participate in the State’s retirement plan.

However, if tribal police officers choose to participate in a State retirement plan, they and the ITG must still pay Social Security taxes in addition to any contributions they make to the retirement plan. Yet, as State employees, their State police officer counterparts are excepted under the IRC from Social Security taxes if they participate in a State retirement plan.²⁸ This places an unfair economic burden on ITGs and is a disincentive for tribal police officers to work on Indian tribal lands. As a result, ITGs may not be able to recruit and retain tribal police officers by offering participation in favorable pension plans.

20 See Staff of H. Comm. of Ways and Means, 101st Cong., Legislative History of Ways and Means Democratic Alternative, Ways and Means Comm. Print No. 101-37, at 86-87 (1990).

21 See Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, Title XI, § 11332(b), 104 Stat. 1388, 1388-469 (1990).

22 See IRC § 3121(b)(7)(F).

23 See Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 202, 124 Stat. 2261, 2262 (2010) (noting that domestic and sexual violence against American Indian and Alaska Native women has reached epidemic proportions and that Indian tribes have experienced significant increases in domestic violence, burglary, assault, and child abuse on Indian reservations); see also, *e.g.*, Timothy Williams, *Higher Crime, Fewer Charges on Indian Land*, N.Y. TIMES, Feb. 20, 2012, available at http://www.nytimes.com/2012/02/21/us/on-indian-reservations-higher-crime-and-fewer-prosecutions.html?_r=0 (citing DOJ data that the country’s 310 Indian reservations have violent crime rates that are more than two and a half times higher than the national average).

24 See Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 201, 124 Stat. 2261 (2010). See also DOJ, *Tribal Law and Order Act*, available at <http://www.justice.gov/tribal/tribal-law-and-order-act>.

25 See Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 202(b)(3), 124 Stat. 2261, 2263 (2010).

26 See DOJ, *Tribal Law and Order Act*, available at <http://www.justice.gov/tribal/tribal-law-and-order-act>.

27 See Tribal Law and Order Act of 2010, Pub. L. No. 111-211, § 202(a)(4)(C), 124 Stat. 2261, 2262 (2010) (noting that the complicated jurisdictional scheme in Indian country requires a high degree of commitment and cooperation among tribal, federal, and State law enforcement officials).

28 See IRC § 3121(b)(7)(F).

More importantly, the inconsistency in tax treatment of ITGs and tribal police officers for Social Security tax purposes as compared to their counterparts employed by States appears to run contrary to congressional intent in reducing crime, particularly violent crime, on Indian lands.

To address this inequity and the compliance burdens placed on ITGs and tribal officers (and other ITG employees), to provide uniform treatment of ITGs as States for all employment tax purposes, and to comport with congressional intent in addressing crime on ITG lands, Congress should amend IRC § 7871(a) to include IRC § 3121(b)(7)(F) in the list of IRC sections for which ITGs are treated as a State. This would mean that ITG police officers who participate in a State retirement plan, as well as the ITG, would not be responsible for Social Security taxes. In making this legislative change, Congress can align both tax and non-tax legislation impacting ITGs.

EXPLANATION OF RECOMMENDATION

The proposal to amend IRC § 7871(a) to include IRC § 3121(b)(7)(F) in the list of IRC sections for which ITGs are treated as States would allow ITGs to better recruit and retain tribal police officers to address crime on Indian tribal lands, which has been a goal of Congress in non-tax legislation.²⁹ This proposal would provide parity between ITG and State law enforcement officers and would also be in line with prior congressional action treating ITGs as States for IRC § 7871 and FUTA purposes. This change would also protect the fundamental taxpayer *right to a fair and just tax system*.

²⁹ Technically speaking, this proposal would amend IRC § 7871(a) to include a provision similar to IRC § 3121(b)(7)(F) in the list of IRC sections for which ITGs are treated as States. Simply treating ITGs as a State under IRC § 3121(b)(7)(F) would not achieve the desired result because the tribal police officer or other ITG employee would not be participating in an ITG retirement plan but rather a State retirement plan. However, the goal of this proposal is to extend the benefits of IRC § 3121(b)(7)(F) to ITG employees, particularly ITG tribal police officers, who participate in a State retirement plan.

LR
#7**TAXPAYER RIGHTS: Toll the Time Period for Financially Disabled Taxpayers to Request Return of Levy Proceeds to Better Protect Their Right to a Fair and Just Tax System****TAXPAYER RIGHTS IMPACTED¹**

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Appeal the IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

PROBLEM

Under Internal Revenue Code (IRC) § 6331, the IRS is authorized to collect outstanding tax by levying against a taxpayer's nonexempt property and rights to property. If the IRS wrongfully levies the property of a third person (*i.e.*, property in which the taxpayer has no rights and that is not otherwise subject to the federal tax lien), it is lawful for it to return such property to that person within certain time periods. The IRS also may return levied property to the taxpayer if certain conditions are met, and it must return levied property to a taxpayer, however, only if the levy was in violation of the law.² Under IRC § 6343(b), the IRS may only return money levied upon or money received from sale of property nine months from the date of levy.³ A person other than a taxpayer (*i.e.* a third party) may file a civil suit against the United States for a wrongful levy under IRC § 7426, but under IRC § 6532(c), the civil suit must be brought by the third party within nine months from the date of the levy that gave rise to the action.⁴ However, a taxpayer who is requesting the return of levied property generally may not bring suit if the IRS denies the taxpayer's request to return the property.⁵ Therefore, if a third party or taxpayer files a request with the IRS, or if a third party files a civil suit under IRC § 7426 for return of levied proceeds without first filing a request for return of the property under IRC § 6343(b) after the nine-month period has expired, neither the IRS nor the court has authority to consider the claim.

1 See Taxpayer Bill of Rights, available at <http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights>.

2 See IRC §§ 6343(b) and (d); Treas. Reg. § 301.6343-3(d). The IRS is required to return the levied upon property if the levy was wrongful, premature, or in violation of the law. The IRS has discretion to return levied upon property if "(A) the levy was not in accordance with administrative procedures of the Secretary, (B) the taxpayer has entered into an agreement under section 6159 to satisfy the tax liability for which the levy was imposed by means of installment payments, unless such agreement provides otherwise, (C) the return of such property will facilitate the collection of the tax liability, or (D) with the consent of the taxpayer or the National Taxpayer Advocate, the return of such property would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States."

3 IRC § 6343(b); Treas. Reg. § 301.6343-3.

4 IRC § 6532(c); Treas. Reg. § 301.6532-3. This nine-month period can be extended if the taxpayer files a claim for return of levy proceeds with the IRS within nine months of the date of the levy. It will be extended to the shorter of 12 months from the date of filing by a third party of a written request for the return of the property wrongfully levied upon, or six months from the date of mailing a notice of disallowance. A request which does not meet the requirements under Treas. Reg. § 301.6343-2(b)(3) is not considered adequate and will not extend the nine-month period.

5 A taxpayer may file suit for certain unauthorized collection actions that violated the law or a regulation under IRC § 7433, but the suit must be filed within two years of the date that the right of action accrues.

Unlike IRC § 6511(h), which suspends the running of the period for filing a claim for refund when a taxpayer can show that he or she was financially disabled,⁶ neither IRC § 6343, the relevant Treasury Regulations (Treas. Reg.), or IRC § 6532(c) provides for any such suspension.⁷ The absence of a suspension of the nine-month time period when a taxpayer or an individual who is a third party, that is financially disabled fails to protect the *rights to pay no more than the correct amount of tax, to appeal an IRS decision in an independent forum, to privacy, and to a fair and just tax system*, and for financially disabled taxpayers or individuals who are third parties who lack the capacity to file a claim during that short time period. Even if Congress extends the nine-month period to two years, as recommended previously by the National Taxpayer Advocate and as proposed in several bills,⁸ the running of the two-year period should be suspended for the person's disability, because the same arguments apply — and especially because IRC § 6511 has the same two-year timeframe.

EXAMPLES

Example One: A Levy Wrongfully Served on a Third-Party's Bank Account

Fred and Mary Jones reside in a non-community property state. Fred Jones owes delinquent tax for taxable year (TY) 2007, when his filing status was single. In addition, Fred and Mary Jones owe delinquent tax for returns they filed jointly for TYs 2008 and 2009. In 2010, the IRS mistakenly levies Mary's bank for all three taxable years. This results in money from Mary's bank account being used to pay liabilities for all taxable years, including Fred's separate TY 2007 liability. In the beginning of 2010, Fred and Mary separated due to financial stress. As a result of the separation and financial stress, Mary was suffering from severe clinical depression, which impaired her ability to complete day-to-day tasks and manage her financial affairs. Mary's illness prevented her from submitting a request for return of levy proceeds until 18 months from the time the levy attached to the bank account. The IRS rejected Mary's late-filed request for the return of the wrongly levied property because it was not submitted within the nine-month time period. Mary is barred from filing a civil suit for return of the wrongfully levied proceeds because IRC § 6532(c)(1) prohibits a suit once the nine-month period has expired if there was not a timely-filed claim.

Example Two: A Levy Was Filed Prematurely

John Doe suffers from Post-Traumatic Stress Disorder (PTSD) following his active combat duty. John Doe had tax liabilities for TYs 2008 and 2009. On January 1, 2010, the IRS filed a levy against his bank account. However, the IRS had not issued Mr. Doe a notice of intent to levy and his right to a collection due process hearing prior to filing the levy under IRC § 6330. During 2010, John Doe continued to suffer from severe PTSD, which crippled his ability to hold down a job, manage his financial affairs, and maintain personal relationships. In January 2011, with the assistance of a close family member, John Doe

6 Congress was concerned about similar unfair outcomes and has acted with legislation to address inequities associated with taxpayers' inability to manage financial affairs, and to strike a better balance between the tax system's need for finality and taxpayer's *right to a fair and just tax system*. Pub. L. No. 105-206 (July 1998) amended IRC § 6511, adding subsection (h), which provides that a person is financially disabled when he or she is "unable to manage his financial affairs by reason of a medically determinable physical or mental impairment of the individual which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months."

7 National Taxpayer Advocate 2013 Annual Report to Congress 302-10 (Legislative Recommendation: *Broaden Relief from Timeframes for Filing a Claim for Refund for Taxpayers with Physical or Mental Impairments*).

8 National Taxpayer Advocate 2001 Annual Report to Congress 202. A bill was recently introduced in the United States Senate that included the National Taxpayer Advocate's recommendation and would extend the nine-month period in IRC § 6532(c) to two years. Taxpayer Bill of Rights Enhancement Act of 2015, S.1578, 114th Cong. (2015). Senator Cornyn and Representative Thornberry introduced companion bills that would extend the nine-month period in IRC § 6532(c) to three years. S. 949, 114th Cong. (2015) and H.R. 1828, 114th Cong. (2015).

was able to file a request for return of levy proceeds. Because the request was filed more than nine months from the date of levy, the IRS would be barred from considering his claim.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that Congress:

- Amend IRC § 6343(b) to suspend the period in which the IRS has to return levy proceeds during any period in which a taxpayer or a third party who is an individual is financially disabled. A taxpayer or a third party who is an individual will not be considered to be financially disabled unless proof of the existence of a physical or mental disability is furnished in such a form and manner as the Secretary may require.
- Amend IRC § 6532(c) to suspend the period in which a third party who is an individual can file a civil suit for return of wrongfully levied proceeds during any period within that time in which that individual is financially disabled. An individual will not be considered to be financially disabled unless proof of the existence of a physical or mental disability is furnished in such form and manner as the Secretary may require.
- Adopt the National Taxpayer Advocate's definition of financial disability:⁹
 - Replace the existing requirement that the individual impairment be medically determinable with a provision that it be determined by a qualified medical or mental health professional. For this purpose, Congress should specify that a qualified medical or mental health professional is an individual who is licensed by the state in which he or she practices to provide direct medical or mental health treatment to another individual.
 - Replace the existing requirement that the impairment leave the individual unable to manage his financial affairs with the requirement that the impairment materially limit the management of those affairs.

The National Taxpayer Advocate reiterates her recommendation that the nine-month period for requesting return of levied property under IRC § 6343(b) should be extended to two years.¹⁰

PRESENT LAW

Under IRC § 6331, the IRS is authorized to collect outstanding tax by levying against the taxpayer's nonexempt property and rights to property. In certain situations, however, under IRC § 6343 and the regulations, levies must be released, and levied property may, or in some situations must, be returned to its owner. The IRS is authorized to return levy proceeds to either a taxpayer when the levy was erroneous (*i.e.*, in violation of law or IRS administrative procedures) or a third party whose property has been wrongfully levied (*i.e.*, property in which the taxpayer has no rights and that is not otherwise subject to the Federal tax lien).

Return of Wrongfully Levied Amounts to Third Parties Under IRC § 6343(b)

Under this provision, the IRS may return levied property or money when the levy incorrectly attaches to property belonging to a third party in which the taxpayer has no property rights and that is not otherwise

⁹ National Taxpayer Advocate 2013 Annual Report to Congress 302.

¹⁰ National Taxpayer Advocate 2006 Annual Report to Congress 547.

subject to the federal tax lien.¹¹ This is commonly known as a “wrongful levy.” An individual can bring a civil suit against the IRS for return of the levied proceeds under IRC § 7426. Under IRC § 6532, this suit is barred from beginning no later than nine months from the date of the levy if no timely administrative request is first made by the third party.¹²

Return of Taxpayer’s Erroneously Levied Proceeds Under IRC § 6343(d)

Under this provision, the IRS may return levied property or money in the following situations:

- A levy that is premature or not in accordance with administrative procedures;
- An installment agreement is made for a liability included on the levy, unless the agreement provides otherwise;
- Returning levy proceeds facilitates collection; and
- With the consent of the taxpayer or the National Taxpayer Advocate, returning the levy proceeds is in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States.¹³

Return of Taxpayer’s Erroneously Levied Property or Money Under Treasury Regulation § 301.6343-3(d)

Under Treas. Reg. § 301.6343-3(d), the IRS must return property or money that was levied in violation of law.¹⁴ For example, under this regulation, the IRS must return property or money that is levied:

- Without giving the requisite 30-day notice of the right to a Collection Due Process hearing if required;¹⁵
- During the pendency of a proceeding for refund of divisible tax;¹⁶
- Before investigation of the status of levied upon property;¹⁷ and
- During the pendency of an offer in compromise.¹⁸

Time Period Under IRC § 6343(b) in Which the IRS Can Return Levied Property or Money to Taxpayer or Third Party

In all the situations above, levied upon property other than money can be returned to a taxpayer or third party at any time.¹⁹ However, the Treasury Regulations require a written request (described below) for return of levied money or money received from a sale of property within nine months from the date of the levy.²⁰

11 IRC §§ 6343(b) and 6331(a).

12 National Taxpayer Advocate 2001 Annual Report to Congress 202. Several bills were recently introduced in the United States Congress that included the National Taxpayer Advocate’s recommendation and would extend the nine-month period in IRC § 6532(c) to two or three years. See S.1578, 114th Cong. (2015), S. 949, 114th Cong. (2015), and H.R. 1828, 114th Cong. (2015).

13 IRC § 6343(d).

14 Treas. Reg. § 301.6343-3(d).

15 See IRC § 6330(a)(1).

16 IRC § 6331(i).

17 IRC § 6331(j).

18 IRC § 6331(k)(1).

19 IRC § 6343(b)(1); Treas. Reg. § 301.6343-3(e).

20 Treas. Reg. §§ 301.6343-2 and 301.6343-3.

Time Period in Which a Third Party Who Has Had Property Wrongfully Seized and/or Sold by the IRS Can File Suit Under IRC § 7426

Under IRC § 7426, a third party may file suit against the United States in the Federal District Court to enjoin the IRS from proceeding with enforcement of the levy, to return the specific property, or to grant a judgment.²¹ For a suit under IRC § 7426 to be timely, IRC § 6532 requires that it must be commenced from within nine months from the date of the levy if no request was made for the return of the levied property.²² However, if a written request for return of wrongfully levied property or money is submitted to the IRS within nine months from the date of the levy, the nine-month period will be extended 12 months from the date of filing the written request for the return of property wrongfully levied upon, or six months from the date of mailing the notice of disallowance, whichever is shorter.²³ A request which does not meet the requirements under Treas. Reg. § 301.6343-2(b)(3) is not considered adequate and will not extend the nine-month period.

The Doctrine of Equitable Tolling

The doctrine of equitable tolling prevents a statute of limitations from barring a claim if the claimant, despite diligent efforts, did not discover the injury until after the expiration of the limitations period or under the circumstances, could not reasonably be expected to file the claim within the designated time period.²⁴ In *Irwin v. Dept. of Veterans Affairs*,²⁵ the Court held that when Congress has waived the government's sovereign immunity, thereby subjecting it to lawsuits, equitable tolling should be made applicable in the same way that it is applicable to private suits.

Applying the holding in the *Irwin* decision, the 9th Circuit recently reaffirmed its prior interpretation that equitable tolling applies to the time limitation for filing a wrongful levy suit under IRC § 6532(c).²⁶ In *Volpicelli v. U.S.*, the plaintiff had filed a wrongful levy suit under IRC § 7426(a)(1) about eight years after the nine-month period for bringing a suit under IRC § 6532(c) had expired.²⁷ The plaintiff alleged when he was ten years old, the IRS had levied on checks that represented gifts from his great-grandmother to be used for his college attendance. The IRS applied the funds instead to the plaintiff's father's unrelated tax bill. Nearly a year after the plaintiff turned 18 (the age of majority), he brought the wrongful levy suit in Nevada district court. That court threw out the suit, holding that the nine-month period was not subject to equitable tolling.²⁸ The 9th Circuit reversed the district court, contrary to other courts including the 3rd Circuit,²⁹ holding that the nine-month period in IRC § 6532(c) is not jurisdictional

21 IRC § 7426(b). The court can grant an amount of money levied upon or judgment in an amount not to exceed what the IRS received for the sale of the property.

22 IRC § 7426(i) cross references IRC § 6532(c) for period of limitations for filing a suit.

23 IRC § 6532(c).

24 Black's Law Dictionary (10th ed. 2014).

25 498 U.S. 1075 (1991).

26 Prior to *Volpicelli v. U.S.*, 777 F.3d 1042 (9th Cir. 2015), the 9th Circuit in *Supermail Cargo, Inc. v. U.S.*, 68 F.3d 1204, 1206-07 (9th Cir. 1995) and *Capital Tracing, Inc. v. U.S.* 63 F.3d 859, 861-62 (9th Cir. 1995) applied the then-recent Supreme Court opinion in *Irwin v. Dept. of Veterans Affairs*, 498 U.S. 89 (1990), which held that the same rebuttable presumption in suits among private litigants that statutory periods of limitations could be subject to equitable tolling applied in analogous suits involving the United States. The 9th Circuit made two separate holdings: first, IRC § 6532(c) is not "jurisdictional", such as the 90-day period, or 150 days if the statutory notice of deficiency was sent outside the United States, for petitioning the United States Tax Court. Second, IRC § 6532(c) was a common statutory period of limitation, and there was nothing to rebut the *Irwin* presumption in favor of tolling.

27 *Volpicelli v. U.S.*, 777 F.3d 1042 (9th Cir. 2015).

28 *Volpicelli v. U.S.*, 108 A.F.T.R.2d 2011-7409.

29 *Becton Dickinson and Co. v. Wolckenhauer*, 215 F.3d 340 (3d Cir. 2000).

and is subject to equitable tolling.³⁰ The 9th Circuit remanded the case to the district court to decide, in the first instance, whether tolling was justified.

Equitable tolling has been found not applicable to other statutory time periods in tax administration. The Supreme Court in *U.S. v. Brockamp* and the 4th Circuit in *Webb v. U.S.* declined to toll IRC § 6511.³¹ In *Brockamp*, the taxpayer, who was 93 years old and demonstrating early signs of dementia, mailed a check to the IRS for \$7,000 instead of \$700, along with an application for an automatic extension of time to file his 1983 tax return. The taxpayer never sent in the 1983 return. The taxpayer died intestate more than two years after this payment. His daughter, administrator of the estate, discovered the \$7,000 overpayment and requested in a letter to the IRS that the overpayment be refunded. In the letter she characterized her father as “senile” and stated that he had mistakenly sent the check for \$7,000 rather than \$700. The claim for refund was denied by the IRS on the basis that the statutory period of limitations under IRC § 6511 expired.³²

In *Webb*, the taxpayer was physically and mentally abused and drugged by trusted caretakers (*i.e.*, her personal physician and an attorney hired by the physician) who coerced the taxpayer into granting them power of attorney over her finances.³³ The caretakers ultimately stole money from the taxpayer and filed gift tax returns reporting the stolen money as a gift to the caretakers from the taxpayer. With the assistance of a friend, the taxpayer eventually broke free of the abusive caretakers and filed a refund claim seeking a return of the paid gift taxes. The IRS denied claims for amounts beyond three years of the filing of the gift tax return because the statutory period of limitations under IRC § 6511 had expired.

Despite these taxpayers’ inability to comply with the statutory limitations period due to impairments, both the Supreme Court and the 4th Circuit held that equitable tolling did not apply because the requirements of IRC § 6511 were already set out with specificity. It was in response to these cases that Congress enacted IRC § 6511(h).³⁴

The amendment in IRC § 6511(h) suspended the running of the three- or two-year time period in IRC § 6511(a) during any period in which a taxpayer is financially disabled. The amendment states that a person is financially disabled:

[I]f such individual is unable to manage his financial affairs by reason of a medically determinable physical or mental impairment of the individual which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.

REASONS FOR CHANGE

The law, as currently written, prevents the IRS and the courts from returning levied property in situations where the taxpayer or a third party who is an individual, due to a physical or mental impairment, does not file a request for return of levied money or petition the court until after the nine-month period. As mentioned above, Congress has already expressed concerns about similar outcomes in other provisions

30 *Volpicelli v. U.S.*, 777 F.3d 1042 (9th Cir. 2015).

31 *U.S. v. Brockamp*, 519 U.S. 347 (1997), and *Webb v. U.S.*, 66 F.3d 691 (4th Cir. 1995).

32 *U.S. v. Brockamp*, 519 U.S. 347 (1997).

33 *Webb v. U.S.*, 66 F.3d 691 (4th Cir. 1995).

34 After the *Webb* and *Brockamp* cases, both Congress and the White House realized a legislative fix was needed. See Office of the White House Secretary, Press Release, Jan. 31, 1996; S. Rep. No. 105-174, at 60 (1998); H.R. Rep. No. 105-364, at 62 (1997). Both the House and the Senate reports show the Committees believed “that in cases of severe disability, equitable tolling should be considered in the application of the statutory limitations on the filing of tax refund claims.”

relating to statutory periods of limitation. Specifically, under IRC § 6511(h), the running of the three- or two-year time period for filing a claim for refund is suspended during any period in which a taxpayer is financially disabled. By passing IRC § 6511(h), Congress ensured that taxpayers who were impaired from filing a timely claim for refund would not lose the opportunity to file such a claim altogether.

The current nine-month time period in IRC §§ 6343(b) and 6532(c) creates the same potential for harm that was experienced by the taxpayers in the *Webb* and *Brockamp* cases. As with IRC § 6511(h), to ensure that an impaired third party or who is an individual or a taxpayer is able to have his or her request for return of levy proceeds considered by either the IRS or the courts, the nine-month period should be tolled if the third party who is an individual or taxpayer can show that he or she was financially disabled during such period. Without this change, a taxpayer or other third party who is an individual who is impaired, and therefore prevented from requesting the return of a levied amount, will lose that amount, even though the levy may have been wrongful, violated the law, or damaged the taxpayer's ability to pay the debt. Tolling the period for filing a claim during the period in which a taxpayer or third party who is an individual is financially disabled would strike a better balance between finality for the IRS and the taxpayer's *right to a fair and just tax system*. This would also better protect a taxpayer's *rights to privacy, to pay no more than the correct amount of tax, and to appeal an IRS decision in an independent forum*.

Although IRC § 6511(h) provided relief for financially disabled taxpayers and is a helpful guide for amending IRC §§ 6343(b) and 6532(c) its narrow definition of financial disability leaves unprotected a number of third parties who are individuals and taxpayers who lack the capacity to manage financial affairs.³⁵

To ensure the provision protects all taxpayers and third parties who are individuals who lack the capacity to manage their financial affairs, Congress should adopt the definition of financial disability recommended by the National Taxpayer Advocate in her 2013 Annual Report to Congress when amending IRC §§ 6343(b) and 6532(c).³⁶

This definition of financial disability would provide relief to those who can complete certain tasks but are prevented by their disability from completing others. More specifically, in many cases a disability can materially limit particular aspects of an individual's conduct, which may cause the taxpayer or third party who is an individual to fail to file the request within the nine-month period. For instance, for an individual suffering from clinical depression, a simple, routine task may pose little anxiety, while a more difficult and complex task (*e.g.*, filing a refund claim) may trigger severe anxiety and be avoided entirely.³⁷

35 National Taxpayer Advocate 2013 Annual Report to Congress 302.

36 *Id.*

37 Andrew M. Busch, Jonathan W. Kanter, Sara J. Landes, and Cristal E. Weeks, *The Nature of Clinical Depression: Symptoms, Syndromes, and Behavior Analysis*, *Behav. Anal.* 31(1): 1-21 (2008), available at <http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2395346/> (stating that "[d]epression is characterized as much by increased escape and avoidance repertoires as by reduced positive repertoires"). As the fields of psychiatry and mental health have advanced, we have learned that some mental illnesses, such as PTSD, may bring about neurochemical changes in the brain which may have biological, psychological, and behavioral effects on an individual's health. See U.S. Department of Veterans Affairs, National Center for PTSD, available at <http://www.ptsd.va.gov/professional/co-occurring/ptsd-physical-health.asp>. See also Jonathan E. Sherin, MD, PhD and Charles B. Nemeroff, MD, PhD, *Post-Traumatic Stress Disorder: The Neurobiological Impact of Psychological Trauma*, *Dialogues Clin. Neurosci.* 2011 Sep; 13(3): 263-78.

EXPLANATION OF RECOMMENDATION

Add a Provision to IRC §§ 6343 and 6532(c) Requiring Tolling for Claims of Financially Disabled Taxpayers

The nine-month period in IRC §§ 6343(b) and 6532(c) has no tolling period for financially disabled taxpayers or third parties who are individuals.³⁸ Suspending the nine-month period in which a taxpayer or a third party who is an individual can request the IRS to return levy proceeds or to bring a civil action in courts would expand protections available to those taxpayers or third party individuals who are financially disabled, and make these protections consistent with the suspension of the statutory period of limitations in a refund context under IRC § 6511(h). The concerns that led Congress to enact IRC § 6511(h) are equally applicable to the requests for return of levy proceeds.³⁹

Expand the Protections Available to Financially Disabled Individuals

As discussed in the National Taxpayer Advocate's 2013 Annual Report to Congress, taxpayers with disabilities often experience difficulty proving financial disability under IRC § 6511(h), due to its narrow definition of financial disability and medical professionals' ability to designate a taxpayer as financially disabled.⁴⁰ In brief, the IRS interpretation and guidance for what documentation the IRS can consider in evaluating a "qualified impairment" is unduly restrictive and may lead the IRS to dismiss otherwise compelling evidence, thereby resulting in the denial of relief to taxpayers who lacked the capacity to file a refund claim.⁴¹ A better articulated exception with more breadth than the current definition will more readily protect individuals suffering from clinical depression, anxiety, PTSD, and other mental afflictions.⁴² Therefore, Congress should adopt the National Taxpayer Advocate's 2013 recommendation to broaden the definition of financial disability under IRC § 6511(h) when defining financial disability for the purpose of tolling the statutory time period for filing under IRC §§ 6343 and 6532.

The National Taxpayer Advocate has previously submitted legislative recommendations to broaden relief from timeframes for filing a refund claim⁴³ and to extend the refund statute expiration date under IRC § 6511.⁴⁴ Even if Congress adopts the two years, the issue of tolling still exists, as it does with the three-year/two-year statutory limitations period for refund claims.⁴⁵ The National Taxpayer Advocate reaffirms these proposals and now recommends the nine-month period in which the IRS is authorized to return levy proceeds, or the court can hear a suit for return of levy proceeds, be suspended when the taxpayer is financially disabled.

38 See 26 U.S.C. § 6343.

39 S. REP. No. 105-174, at 60 (1998); H.R. REP. No. 105-364, at 62 (1997).

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

41 National Taxpayer Advocate 2013 Annual Report to Congress 303. In *Kurko v. Commissioner*, Docket No. 24040-13L, a Collection Due Process hearing, the taxpayer argued that an amended return claiming an overpayment was timely because the time period for filing a claim was tolled under IRC § 6511(h). The taxpayer presented the Settlement Officer with a letter from a licensed psychologist stating that the taxpayer had a mental health disability that made her financially disabled for purposes of IRC § 6511(h)'s provision tolling the credit or refund claim period under (a). The Settlement Officer did not accept the letter from the licensed psychologist because Rev. Proc. 99-21, 1999-1 C.B. 960, required the letter to come from a doctor of medicine or osteopathy as defined in IRC § 1395x(r)(1). The taxpayer petitioned the United States Tax Court and in an order issued on March 20, 2015, Judge Gustafson instructed the parties to brief the issue of the validity of Rev. Proc. 99-21, 1999-1 C.B. 960. After reading Judge Gustafson's questions in his March 20 order, the IRS decided to sign a stipulated decision providing that the overpayment was timely claimed, notwithstanding that the letter was not from a "physician" – thereby settling the case and rendering the issue moot for purposes of the *Kurko* case.

42 See Rev. Proc. 99-21; T. Keith Fogg & Rachel E. Zuraw, *Financial Disability for All*, 62 Cath. U. L. Rev. 965, 994-1004 (2013).

43 National Taxpayer Advocate 2013 Annual Report to Congress 302.

44 National Taxpayer Advocate 2001 Annual Report to Congress 202.

45 *Id.* A bill was recently introduced in the United States Senate that included the National Taxpayer Advocate's recommendation and would extend the nine-month period in IRC § 6532(c) to two or three years. See S.1578, 114th Cong. (2015), S. 949, 114th Cong. (2015); H.R. 1828, 114th Cong. (2015).

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#8

THE FRIVOLOUS RETURN PENALTY: Protect Good Faith Taxpayers by Expanding the Availability of Penalty Reductions, Establishing Specific Penalty Abatement Procedures, and Providing Appeal Rights

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

PROBLEM

By the early 1980's, Congress became concerned with the rapid growth of deliberate defiance of the tax laws by "tax protestors."² As a result, Congress passed Internal Revenue Code (IRC) § 6702, which, as currently formulated, generally imposes an immediately assessable \$5,000 penalty on tax returns adopting a position which the IRS has identified as frivolous or reflecting a desire to delay or impede the administration of federal tax laws.³ This penalty, however, was primarily intended to address "protest" returns and was not aimed at taxpayers making good faith mistakes on their returns, such as innocent mathematical or clerical errors.⁴

In order to mitigate the harshness of the frivolous return penalty, Congress also allowed for a reduction of the penalty, which now can be decreased from \$5,000 to \$500, if the IRS determines that such reduction would promote compliance with and administration of the federal tax laws.⁵ Nevertheless, when adopting procedures implementing this provision, the IRS denied potential penalty reduction to any taxpayers to the extent they have already paid the penalty, including by means of an automatic or involuntary refund offset.⁶ This broad exclusion is particularly problematic because no clearly defined procedures exist allowing an abatement of the penalty for reasonable cause and good faith.⁷ Further, the IRS Office of Appeals (Appeals) refuses to consider any appeals of frivolous return penalties even if those appeals are contending that the penalties were incorrectly applied in the first instance or are in some other way substantively

1 See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 S. REP. No. 97-494(I), at 277 (1982). Subsequently, Congress enacted the IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, Title III, Subtitle H, § 3707(a) (July 22, 1998), which prohibited the IRS from labeling taxpayers as Illegal Tax Protesters or adopting similar terminology based on fear of stigmatization. In RRA 98 § 3707(b), Congress, however, did allow IRS personnel to designate appropriate taxpayers as "nonfilers."

3 IRC § 6702(a)(2). The frivolous return penalty can also be imposed by the IRS in response to the filing of a specified frivolous submission. IRC § 6702(b). These IRC § 6702 penalties are sometimes also referred to as "postassessment penalties" because they can be assessed in the absence of deficiency procedures and because they do not provide prepayment review rights in the U.S. Tax Court. Internal Revenue Manual (IRM) 8.11.1.1.2(1) (Nov. 12, 2013).

4 S. REP. No. 97-494(I), at 277 (1982).

5 IRC § 6702(d); Rev. Proc. 2012-43, 2012-49 I.R.B. 643. Taxpayers can also avoid assertion of the penalty if they withdraw a frivolous return within 30 days of receiving notice by the IRS. This right is statutory in the case of IRC § 6702(b), *Specified Frivolous Submissions*, and a matter of IRS policy in the case of IRC § 6702(a), *Frivolous Tax Returns*. See IRC § 6702(b)(3); IRM 4.10.12.1(10) (Sept. 5, 2014).

6 Rev. Proc. 2012-43, § 3, 2012-49 I.R.B. 643.

7 An abatement can be obtained if the IRS has asserted the penalty in error. IRM 25.25.10.8.4, *Post Penalty Assessment Processing* (Aug. 13, 2015).

erroneous.⁸ Appeals may well be concerned with having to rehear arguments that gave rise to application of the frivolous return penalty in the first instance. However, mechanisms already exist that could be used and expanded to properly balance taxpayers' need for post-assessment, prepayment or post-payment appeal reviews with Appeals' legitimate need to address the proliferation of baseless claims.⁹

As options for relief have been narrowed by the IRS, opportunities for inappropriate application of the frivolous return penalty have been simultaneously increased. The number of frivolous positions specifically identified by the IRS has grown to over 50, some of which are sufficiently broad as to encompass unintentional tax reporting errors.¹⁰ Further, as the IRS enlarges its reliance on automated systems for application of the frivolous return penalty, the likelihood of incorrect penalty application correspondingly will expand. Thus, an increasingly broad swath of taxpayers are exposed to application of the frivolous return penalty and are left with no meaningful administrative recourse.¹¹ The approach of the IRS, to shoot first and then not even ask or answer questions later, all too often results in application of the frivolous return penalty in a way that jeopardizes a range of fundamental taxpayer rights including *the right to challenge the IRS's position and be heard*, *the right to a fair and just tax system*, and *the right to appeal an IRS decision in an independent forum*.

EXAMPLE

Taxpayer earned \$9,000 of adjusted gross income during the year and qualified for an Earned Income Tax Credit (EITC) of \$3,600. When Taxpayer completed the tax return, however, Taxpayer made a clerical error, overreporting amounts withheld and claiming a refund of \$9,000, rather than the \$5,000 refund that was properly payable. The IRS issued a letter threatening Taxpayer with a frivolous return penalty if Taxpayer did not correct the return within 30 days. This letter frightened Taxpayer who decided to seek the assistance of a tax preparer. By the time a preparer could be located, however, and the return amended, the 30-day period had been exceeded by ten days, and the IRS moved forward with assessment of the \$5,000 frivolous return penalty. This occurred despite Taxpayer's good faith effort to correct the clerical error.

Taxpayer was somewhat heartened when the tax preparer explained the penalty could be reduced from \$5,000 to \$500. This hope did not last long, however, as the IRS collected the full \$5,000 penalty as an offset against the \$5,000 refund to which Taxpayer was properly entitled. As a result, the IRS was unwilling to consider the request for a penalty reduction.¹² Taxpayer had been planning to use much of the claimed refund for essential living expenses, but after offset of the full frivolous return penalty, Taxpayer was left with nothing.

With the assistance of the tax preparer, Taxpayer filed an abatement request arguing that the error was made in good faith, which was summarily denied based on the cryptic explanation that the IRS would only look at the face of the return in determining application of the frivolous return penalty. Not

8 Appeals previously undertook such reviews but has recently modified its policy in this regard. Compare IRM 8.11.8.2(1) (Oct. 28, 2013) with obsolete IRM 8.11.1.7(3) (Feb. 26, 1999).

9 See, e.g., IRM 8.22.5.5.3.1, *Processing Frivolous, Desire to Delay or Impede Requests* (Nov. 8, 2013).

10 These positions identified by the IRS as frivolous are set forth in Notice 2010-33, 2010-17 I.R.B. 609, as supplemented by IRM 4.10.12.1.1, *Frivolous Arguments* (Sept. 5, 2014).

11 Taxpayers theoretically can pay the penalty and file a refund claim in Federal District Court, but such a remedy generally would cost taxpayers more than the underlying penalty and would be particularly burdensome for low income and unsophisticated taxpayers.

12 See Rev. Proc. 2012-43, 2012-49 I.R.B. 643.

believing this answer could be correct, Taxpayer sought to have the matter reviewed by Appeals. Taxpayer, however, was informed Appeals no longer heard any challenges to the frivolous return penalty. Taxpayer was told about the possibility of filing a refund claim in federal court, but Taxpayer no longer had either the funds or energy to pursue the matter further.

RECOMMENDATIONS

In order to protect good faith taxpayers and enable the frivolous return penalty to be imposed more fairly and effectively, the National Taxpayer Advocate recommends that Congress:

1. Amend IRC § 6702(b)(3) to expand the notice period allowing taxpayers to correct their returns and avoid application of the frivolous return penalty from 30 days to 60 days and establish the same mechanism for correcting returns under IRC § 6702(a).
2. Amend IRC § 6702(d) to clarify taxpayers will be eligible for reduction of the frivolous return penalty regardless of whether they have already satisfied the penalty.
3. Amend IRC § 6702 to establish the availability of a full penalty abatement for good faith and reasonable cause.
4. Amend IRC § 6702 to provide that taxpayers will be entitled to obtain either a post-assessment, prepayment or post-assessment, post-payment review of frivolous return penalties within Appeals.

PRESENT LAW

IRC § 6702 generally imposes an immediately assessable \$5,000 penalty on tax returns adopting a position that the IRS has identified as frivolous or reflecting a desire to delay or impede the administration of federal tax laws.¹³ Further requirements for application of the frivolous return penalty are that a taxpayer has filed what purports to be a tax return that does not contain information on which the substantial correctness of the self-assessment may be judged or that contains information that on its face indicates the self-assessment is substantially incorrect.¹⁴ The frivolous return penalty can also be imposed by the IRS in response to the filing of specified frivolous submissions, which include collection due process (CDP) appeals, requests for installment agreements, proposed offers in compromise, and taxpayer assistance orders.¹⁵

The IRS first identified frivolous positions subject to the IRC § 6702 penalty in Notice 2007-30.¹⁶ This list was augmented in 2008, and then again in 2010 when the group was expanded to cover over 50 positions and any others that were the same as or similar to those positions.¹⁷

This list of frivolous positions was provided at the express direction of Congress.¹⁸ Nevertheless, Congress also envisioned certain parameters limiting application of the frivolous return penalty. Congress wanted a regime that discouraged “protest” returns, but not one that adopted punitive measures with respect to potentially good faith taxpayers. As a result, Congress also required the IRS to provide taxpayers individual notice that a position they adopted constitutes a specified frivolous submission and furnish the

13 IRC § 6702(a)(2).

14 IRC § 6702(a)(1).

15 IRC § 6702(b).

16 Notice 2007-30, 2007-14 I.R.B. 883.

17 Notice 2008-14, 2008-4 I.R.B. 310; Notice 2010-33, 2010-17 I.R.B. 609.

18 IRC § 6702(c).

opportunity to avoid application of the penalty if the position is withdrawn within 30 days.¹⁹ The IRS now issues these 30-day letters in the case of potential IRC § 6702(a) penalties as well as those arising under IRC § 6702(b).²⁰

As Congress originally explained,

The committee believes that an immediately assessable penalty on the filing of protest returns will help deter the filing of such returns, and will demonstrate the determination of the congress to maintain the integrity of the income tax system The penalty will be imposed, therefore, only on purported returns that are patently improper and not in cases involving valid disputes with the Secretary. This penalty will not be imposed, of course, in the case of innocent or inadvertent mathematical or clerical errors (as defined in § 6213(G)(2)(A) or (B)), including certain incorrect uses of tax tables, etc.²¹

Congress also provided the statutory authority for the IRS to reduce the IRC § 6702 penalty “... if the Secretary determines that such reduction would promote compliance with and administration of the Federal tax laws.”²² When establishing the procedures for this reduction in Rev. Proc. 2012-43, however, the IRS imposed some significant limitations. Among other things, the IRS determined that it would only reduce a frivolous return penalty from \$5,000 to \$500.²³ Further, this reduction would only be available to the extent that the penalty had not already been satisfied by the taxpayer.²⁴

A taxpayer has no appeal rights if the IRS rejects a reduction request.²⁵ Further, Appeals does not currently consider any challenges with respect to application of the IRC § 6702 penalty.²⁶

REASONS FOR CHANGE

The National Taxpayer Advocate applauds both Congress and the IRS, respectively, for allowing taxpayers to avoid application of the frivolous return penalty if they withdraw and correct their frivolous position within 30 days of receiving notice from the IRS.²⁷ This approach allows taxpayers to self-correct unintentional errors without experiencing the stigma and the burden of the frivolous return penalty. It has the additional benefit of using IRC § 6702 as an opportunity to educate taxpayers and encourage their future compliance.²⁸

TAS is aware of a number of circumstances, however, in which taxpayers, despite diligent and good faith efforts, have simply been unable to withdraw and correct their erroneous returns within the 30-day notice period. This challenge is particularly acute for unsophisticated taxpayers who may require the assistance of a tax preparer to amend their tax return or even to understand the contents of the notice letter itself.²⁹

19 IRC § 6702(b)(3).

20 IRM 4.10.12.1(10) (Sept. 5, 2014).

21 S. REP. No. 97-494(I), at 277 (1982).

22 IRC § 6702(d).

23 Rev. Proc. 2012-43, § 4.01(2), 2012-49 I.R.B. 643.

24 Rev. Proc. 2012-43, § 3, 2012-49 IRB (Dec. 3, 2012).

25 See Rev. Proc. 2012-43, § 5.03, 2012-49 IRB (Dec. 3, 2012).

26 See IRM 8.11.8.2(1) (Oct. 28, 2013).

27 This 30-day window is statutory in the case of IRC § 6702(b) and a matter of IRS policy in the case of IRC § 6702(a). See IRC § 6702(b)(3); IRM 4.10.12.1(10) (Sept. 5, 2014).

28 IRM 20.1.1.2.1(8) (Nov. 25, 2011).

29 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 163 and 172.

The notice's effectiveness should not be limited by application of a response window that is simply too short for many taxpayers, especially some unsophisticated taxpayers. As a result, the National Taxpayer Advocate recommends that Congress consider statutorily expanding the notice period allowing taxpayers to correct their returns and avoid application of the frivolous return penalty from 30 days to a reasonable but more manageable 60 days, which is in line with the amount of time available to taxpayers to correct summary assessments under IRC § 6213(b)(2), *Abatement of assessment of mathematical or clerical errors*.

Further, the previous addition by Congress of IRC § 6702(d) allowing for a reduction of the frivolous return penalty, is laudable. Nevertheless, the IRS is currently applying that reduction in a way that does not comport with Congress' intent and sometimes appears to be arbitrary and capricious.

TAS has received requests for assistance from taxpayers in a number of cases in which a group of taxpayers has been taken in by an unscrupulous tax preparer and all adopted the identical frivolous return position. Nevertheless, some of those taxpayers are eligible for the IRC § 6702(d) reduction while others are not. This distinction is often based solely on whether or not the taxpayers have already satisfied, either through direct payment or refund offset, the \$5,000 penalty initially asserted by the IRS.³⁰

Those taxpayers who have satisfied the \$5,000 penalty are essentially double-penalized for their willingness to pay, or for their overpayment status, by losing eligibility for the reduction to \$500. This practice by the IRS not only violates most taxpayers' notions of fairness, but is particularly hard on taxpayers who rely on certain refundable credits, such as the EITC. When these anticipated refunds fail to arrive, such taxpayers often find themselves in desperate circumstances without the money they had counted on for basic living expenses.

There is no persuasive reason to differentiate between taxpayers based on the payment status of the original penalty, and a very good reason to make application of the reduction more equitable. Voluntary compliance tends to correlate with taxpayers' perceptions that the IRS and the tax laws are fair and may decline if taxpayers feel that the IRS is overreaching or applying arbitrary rules.³¹ Thus, Congress should consider taking steps to require that the IRS abandon the distinction that it currently draws between those who have and have not satisfied the penalty when considering eligibility for the IRC § 6702(d) penalty reduction.

Further, the IRS applies the IRC § 6702 penalty in a highly mechanical fashion, and this process is being increasingly automated. Thus, it is quite possible for taxpayers to be erroneously assessed the penalty in the first instance or for good faith taxpayers to file a return that is technically frivolous without ever intending to do so.

For example, Notice 2010-33 identifies as a frivolous position the assertion of the Fifth Amendment right against self-incrimination as the basis for withholding "all financial information from the Service."³² When a taxpayer asserted this right with respect to the omission of certain information from the interest and dividend schedule on his tax return, the IRS assessed the IRC § 6702 penalty, and, after relief was denied in a CDP appeal, the matter came before the U.S. Tax Court in the form of cross-motions for summary judgment.³³ Judge Holmes granted the taxpayer's motion for summary judgment on the grounds that because the withheld information related to the duty to file a *Report of Foreign Bank and Financial*

30 Note: these refund offsets generally are automatic and involuntary.

31 National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 134.

32 Notice 2010-33, § III.(9)(f), 2010-17 I.R.B. 609.

33 *Youssefzadeh v. Comm'r*, No. 14868-14 L. (Nov. 6, 2015).

Accounts (FBAR), and because the willful failure to file an FBAR is a crime, the Fifth Amendment had been properly invoked, and the assessed IRC § 6702 penalty was therefore invalid. The frivolous return penalty should not be used by the IRS as a means of doing an end run around Constitutional protections or other legitimately exercised rights.

Some taxpayers have been successful in persuading the IRS to abate the IRC § 6702 penalty where it was incorrectly applied or where it resulted from a position that the taxpayers did not know to be improper.³⁴ Nevertheless, TAS is also aware of other occasions in which similarly situated taxpayers have been treated differently and subjected to the penalty. The IRS is not always consistent in its standards for acknowledging and utilizing its discretion to abate the frivolous return penalty under IRC §§ 7803 and 6404.³⁵

The IRS frequently assumes that anyone caught up in the ever-expanding definition of a frivolous return must, by default, be a bad actor. However, this category now includes many taxpayers who had no desire to delay or impede the administration of federal tax laws. As the IRS itself recognizes in *The Penalty Handbook*, “Voluntary compliance is achieved when a taxpayer makes a good faith effort to meet the tax obligations defined by the Internal Revenue Code.”³⁶ Penalties should be objectively proportioned to the offense, and be used as an opportunity to educate taxpayers and encourage their future compliance.³⁷ Penalties should relate to the standards of behavior they encourage.³⁸ IRS employees are responsible for administering the penalty statutes and regulations in an even-handed manner that is fair and impartial to both the government and the taxpayer.³⁹

Such balance, however, is absent where provision of frivolous return abatements is concerned. Additional clarity and uniformity in this area would benefit both taxpayers and the government. Several IRC provisions expressly allow a penalty abatement for reasonable cause and good faith.⁴⁰ Congress should consider amending IRC § 6702 to clarify the specific availability of such an abatement in appropriate cases where application of the frivolous return penalty is concerned. Congress has already demonstrated its support for this approach in the legislative history quoted above. This step would help eliminate confusion within the IRS and on the part of taxpayers regarding abatement discretion and would perpetuate fairness and consistency in application of the frivolous return penalty.

The problems inherent in overly broad application of the penalty are exacerbated by Appeals’ current unwillingness to review IRC § 6702 determinations.⁴¹ Appeals has the authority to review such cases, but has made the “business decision” to terminate the provision of such oversight.⁴² This policy effectively eliminates any higher level administrative review of the actions taken by the IRS’s Frivolous Return

34 See IRM 25.25.10.8.4, *Post Penalty Assessment Processing* (Aug. 13, 2015).

35 IRC § 7803 abatements are premised on the IRS Commissioner’s general authority to administer the IRC. See also IRC § 6404; IRM 25.6.1.10.1.1(2) (Nov. 18, 2011). This general abatement authority can result in a refund to the extent that the refund statute of limitations under IRC § 6511 remains open with respect to any previously paid assessments that are the subject of the abatement. IRM 25.6.1.10.1.1(6) (Nov. 18, 2011).

36 IRM 20.1.1.2.1(6) (Nov. 25, 2011).

37 IRM 20.1.1.2.1(8) (Nov. 25, 2011).

38 IRM 20.1.1.2.1(10) (Nov. 25, 2011).

39 IRM 20.1.1.2.2(c) (Nov. 25, 2011).

40 See, e.g., IRC §§ 6662(c), 6651(a), and 6038D.

41 The importance of appeal rights and other issues currently relating to Appeals are further developed in the National Taxpayer Advocate 2015 Annual Report to Congress, Most Serious Problem: *Appeals: The Appeals Judicial Approach and Culture Project is Reducing the Quality and Extent of Substantive Administrative Appeals Available to Taxpayers*, *supra*.

42 IRS Office of Chief Counsel Memorandum, *Appeals Rights with Respect to a Request to Abate a Section 6702 Penalty*, PMTA 2013-28 (Dec. 20, 2013).

Program (FRP).⁴³ It is also inconsistent with the IRS's adoption of the Taxpayer Bill of Rights, particularly *the right to appeal an IRS decision in an independent forum* and *the right to challenge the IRS's position and be heard*.

Taxpayers are granted the option of paying the assessed penalty and seeking a refund in Federal District Court. Realistically, however, very few taxpayers, particularly lower income taxpayers, will possess the financial resources or the remaining energy to continue fighting a \$500 penalty, or even a \$5,000 penalty, in federal court. Further, in most cases, the legal expenses and other related costs required to contest the penalty would exceed the amount of the penalty itself. The deprivation of appeal rights in the case of IRC § 6702 frivolous return penalties is a punitive and unnecessary denial of fundamental taxpayer rights that Congress should consider taking steps to rectify by allowing for an independent Appeals review regardless of whether the immediately assessable penalty has yet been paid by taxpayers.

Appeals may well be concerned with having to rehear arguments that gave rise to application of the frivolous return penalty in the first instance. Nevertheless, Appeals already has procedures directing Appeals personnel to ignore frivolous arguments raised as part of various proceedings, such as CDP appeals.⁴⁴ Such an approach applied to all appeals of frivolous return penalties presumably would discourage repetition of these arguments and should address case proliferation concerns. Moreover, such potential administrative burdens should not serve as the basis for denying taxpayers basic access to Appeals.

TAS has held ongoing discussions with the IRS operating divisions regarding many of these issues for years. Nevertheless, no significant administrative progress has been made toward implementing these recommendations for protecting taxpayer rights and thereby increasing the effective and equitable application of IRC § 6702.

EXPLANATION OF RECOMMENDATION

Over time, the reach of the IRC § 6702 frivolous return penalty has extended beyond the bad actors for whom it was originally designed. Additionally, the IRS's approach to applying the penalty and the related reduction has confused and harmed many good faith taxpayers. The recommendations, which seek to balance the concern for administrative efficiency with the need for taxpayer protections, would allow taxpayers a broader window for correcting returns and submissions identified as frivolous, would achieve greater uniformity in application of the IRC § 6702(d) reduction, would allow for a reasonable cause abatement of the full amount of the penalty in the case of good faith taxpayers, and would ensure that taxpayers are entitled to obtain review of frivolous return penalty abatement requests by Appeals.

⁴³ The FRP currently resides within the Wage & Investment Division of the IRS.

⁴⁴ IRM 8.22.5.5.3.1, *Processing Frivolous, Desire to Delay or Impede Requests* (Nov. 8, 2013).

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AFFORDABLE CARE ACT INFORMATION REPORTING: Allow Taxpayer Identification Number Matching for Filers of Information Returns Under IRC §§ 6055 and 6056

TAXPAYER RIGHTS IMPACTED¹

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

PROBLEM

The IRS relies on new information returns to verify data relevant to a number of provisions in the Patient Protection and Affordable Care Act of 2010 (ACA). Although the tax code requires health insurance providers and applicable large employers (ALEs)² to file information returns with the IRS reflecting specific information regarding health insurance coverage,³ the law does not permit these companies to verify taxpayer identification numbers (TINs) with the IRS prior to filing.⁴ Unlike other information return filers who can perfect TINs prior to issuing any information reporting forms if the IRS advises them of any errors, health insurance providers and ALEs must rely on input from their customers and employees while still facing penalties for errors. The IRS expects to receive over 120 million information returns from health insurance providers and ALEs during the 2016 filing season.⁵ If these entities were able to verify name/TIN accuracy prior to filing these information reports, they would avoid unnecessary penalties and the IRS would minimize the resources spent on avoidable penalty abatement requests.

EXAMPLE

ABC Health is a health insurance provider that insures 800,000 individuals in the state of Maryland. As part of the insurance enrollment process, ABC Health obtains TINs from insured individuals that it uses to prepare approximately 600,000 Forms 1095-B (and the associated transmittal Form 1094-C).⁶ ABC Health timely files the forms with the IRS and provides copies to the insured. Upon filing, the IRS finds that 10,000 of the TINs do not match the insureds' names, whether due to transposition errors, name changes, or otherwise. As a result, ABC Health faces \$2.5 million in penalties. If ABC Health also includes the incorrect TINs on statements it furnishes to the insured, it could potentially be liable for

1 See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Internal Revenue Code (IRC) § 4980H(a)(1) provides that an ALE must offer minimum essential coverage (MEC) to its full-time employees. In general, an employer is considered an ALE if it employs 50 or more full-time workers (or full-time equivalents (FTEs)), or a combination of full-time and part-time employees that equals at least 50 FTEs. IRC § 4980H(c)(2).

3 IRC §§ 6055 and 6056.

4 In the case of an individual taxpayer, a TIN generally is the Social Security number (SSN). See IRC § 6109(d). The IRS may also issue an adoption taxpayer identification number (ATIN). For an alien individual not eligible for an SSN who has a federal tax reporting requirement, the IRS assigns an individual taxpayer identification number (ITIN). See Treas. Reg. § 1.6109-1(a) and (d).

5 IRS response to TAS information request (Oct. 22, 2015).

6 A health insurer needs to provide a Form 1095-B to each responsible person (the individual who is the primary insured) that will include the information for all other individuals covered under that responsible person. IRC § 6055. The total number of Forms 1095-B will be less than the total number of covered individuals when taking into account self plus one and family plans.

an additional \$2.5 million in penalties. If the errors were due to intentional disregard of the filing and furnishing requirements, the potential penalties would be much greater.

RECOMMENDATION

Amend IRC §§ 6055 and 6056 to allow entities required to file information returns under these sections to verify TINs with the IRS prior to filing annual information returns.

PRESENT LAW

IRC § 6055 requires annual information reporting by health insurance issuers, self-insuring employers, government agencies, and other providers of health coverage. IRC § 6056 requires annual information reporting by ALEs relating to the health insurance that the employer offers (or does not offer) to its full-time employees. Below is a list of information returns the IRS created to meet these reporting requirements:

- Form 1095-B, *Health Coverage* (used by health insurance issuers and carriers to report information about individuals who are covered by MEC);⁷
- Form 1094-B, *Transmittal of Health Coverage* (used by health insurance issuers and carriers to submit Form 1095-B);
- Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage Insurance* (used by ALEs to report information about offers of health coverage and actual coverage of full-time employees);⁸ and
- Form 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns* (used by ALEs to submit Form 1095-C).

Form 1095-B was developed to verify compliance with the requirement to have MEC under IRC § 5000A. The form reports the names and TINs of all individuals covered under a health insurance plan and the months of coverage.⁹ If the IRS cannot verify that a taxpayer had MEC, the taxpayer will be assessed an Individual Shared Responsibility Payment (ISRP).¹⁰

⁷ The forms are due by February 28 (or March 31 if filing electronically). IRS, *Instructions for Forms 1094-B and 1095-B* (2015), available at www.irs.gov/pub/irs-pdf/i109495b.pdf.

⁸ The forms are due by February 28 (or March 31 if filing electronically). IRS, *Instructions for Forms 1094-C and 1095-C* (2015), available at www.irs.gov/pub/irs-pdf/i109495c.pdf.

⁹ If an insurer is unable to obtain a TIN for an individual after making a reasonable effort, the regulations allow it to provide the individual's date of birth instead of the TIN.

¹⁰ IRC § 5000A. Taxpayers filing tax year 2014 federal income tax returns were required to report they have MEC or were exempt from the responsibility to have the required coverage. If the taxpayer did not have coverage and was not exempt, he or she was required to make an ISRP when filing a return. For a detailed discussion of the ISRP, see *Affordable Care Act - Individuals: The IRS Is Compromising Taxpayer Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions*, *supra*.

Form 1095-C was developed to determine whether an ALE will be subject to an Employer Shared Responsibility Payment (ESRP) for failure to offer affordable MEC to its full-time employees.¹¹ The form reports the names and TINs of all full-time employees, as well as information about their coverage under the employer-provided plan, their offer of coverage, and share of the insurance premium. This information will also be used to verify a taxpayer's eligibility for the Premium Tax Credit (PTC) if he or she claimed one on his or her tax return.¹²

FIGURE 2.9.1, Projected Volume of Information Returns for ACA Exchange Provisions, Tax Years 2015–2017¹³

	Tax Year 2015	Tax Year 2016	Tax Year 2017
Forms 1095-B	46 million	45 million	47 million
Forms 1095-C	77 million	77 million	78 million
Total	123 million	122 million	125 million

As noted above, the IRS expects to receive over 120 million information returns from health insurance providers and ALEs during the 2016 filing season. These information returns facilitate the administration of the ESRP, establish health insurance coverage — or lack thereof — for the ISRP, and impact eligibility for the PTC and Small Business Health Care Tax Credit (SBHCTC).¹⁴

The penalty for failure to file a correct information return is generally \$250, and the penalty for failure to furnish a correct payee statement is also generally \$250.¹⁵ Each penalty is capped at \$3 million for each calendar year. If the failure is due to intentional disregard of the filing or furnishing requirements, the penalty for each return or statement would be at least \$500, with no maximum. IRC § 6724 provides that the IRS will not impose the penalty if the filer shows the failure was due to reasonable cause and

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- 11 IRC § 4980H provides that an ALE will be subject to an ESRP if (1) it fails to offer its full-time employees the opportunity to enroll in MEC under an eligible employer-sponsored plan, and (2) a PTC was paid to at least one full-time employee. The amount of the ESRP under IRC § 4980H(a) is \$2,000 per full-time employee per year (determined on a monthly basis). IRC § 4980H(c)(1). The ESRP provisions provide an inflation adjustment mechanism beginning in years after 2014. IRC § 4980H(c)(5). IRC § 4980H(b) requires ALEs to offer affordable MEC that provide minimum value. If an ALE offers MEC but it is not considered affordable, the ALE will be assessed an ESRP of \$3,000 for each employee (pro-rated on a monthly basis) who purchases health insurance from the exchange and is granted a tax credit and/or subsidy for health insurance. IRS § 4980H(b)(1). While an employer may be subject to ESRP under both IRC § 4980H(a) and (b), the liability is limited to the amount under IRC § 4980H(a). Treas. Reg. § 54-4890H, 79 Fed. Reg. 8543 (Feb. 12, 2014), available at www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage.
- 12 PTC is a refundable tax credit paid either in advance or at return filing to help taxpayers with low to moderate income purchase health insurance through the exchange. IRC § 36B. The amount of the credit paid in advance is based on projected household income (HHI) and family size for the year of coverage, while the amount a taxpayer is actually eligible for is based on actual HHI and family size for the year reflected on the tax return. Many taxpayers were required to reconcile the credit amount they received in advance with the PTC to which they were actually entitled. For a detailed discussion of the PTC, see Most Serious Problem: *Affordable Care Act - Individuals: The IRS Is Compromising Taxpayer Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions*, *supra*.
- 13 IRS response to TAS information request (Oct. 22, 2015).
- 14 Under IRC § 45R, eligible small employers can claim the SBHCTC for 2010 through 2013 and for two additional years beginning in 2014. A small employer is eligible for the credit if (a) it has fewer than 25 FTE employees, (b) the average annual wages of its employees are less than \$50,000 (adjusted for inflation beginning in 2014), and (c) it pays a uniform percentage for all employees that is equal to at least 50 percent of the premium cost of employee-only insurance coverage. For a detailed discussion of the SBHCTC, see *Affordable Care Act (ACA) - Business: The IRS Faces Challenges in Implementing the Employer Provisions of the Affordable Care Act While Protecting Taxpayer Rights and Minimizing Burden*, *supra*.
- 15 See IRC §§ 6721 and 6722. The penalty amounts are an increase over the previous penalty amount of \$100 and apply to information returns filed after December 31, 2015. The penalty amounts are also indexed for inflation.

not willful neglect.¹⁶ If a health insurance company or ALE reports an incorrect TIN on Form 1095-B or 1095-C due to inaccurate input from their customer or employee, the provider may obtain a penalty waiver upon proving reasonable cause. The health insurance company or ALE must establish that the failure to include a correct TIN was due to events beyond its control and that it acted in a responsible manner by soliciting a TIN from the customer or employee in accordance with specific solicitation rules set forth in regulations.¹⁷

The IRS will not impose penalties under IRC §§ 6721 and 6722 for 2015 information returns on reporting entities that can show that they have made good faith efforts to comply with the information reporting requirements. Specifically, relief is provided from penalties for incorrect or incomplete information reported on the return or statement. No relief is provided for reporting entities that cannot show a good faith effort to comply with the information reporting requirements or that fail to timely file an information return or furnish a statement.¹⁸

Under IRC § 3406(i), the Commissioner has the authority to establish TIN matching programs for information returns that report payments subject to backup withholding, such as dividends or other income. Under such a TIN matching program, a payor with reportable payments as defined in IRC § 3406(b)(1) may contact the IRS prior to filing information returns.¹⁹ The IRS will inform the payor (or an agent of the payor) whether or not a name/TIN combination furnished by the payee matches a name/TIN combination maintained in the database utilized for the particular matching program, which will help participating payors avoid TIN errors and reduce the number of backup withholding notices required under IRC § 3406(a)(1)(B).

The IRS online interactive or bulk TIN matching program is accessible 24 hours a day, seven days a week.²⁰ The IRS response is generally limited to notification of a match or mismatch.²¹ If the IRS response indicates a TIN mismatch, the payor has the opportunity to resolve the inaccuracy with the payee, prior to filing an information return. Otherwise, the IRS generally may not disclose a taxpayer's name, TIN, or other return information, pursuant to IRC § 6103.²²

16 See IRC § 6724(a).

17 See Treas. Reg. § 301.6724-1(c)(6) and (d)(2).

18 IRS, *Questions and Answers on Information Reporting by Health Coverage Providers (Section 6055)*, Question 3, available at <https://www.irs.gov/Affordable-Care-Act/Questions-and-Answers-on-Information-Reporting-by-Health-Coverage-Providers-Section-6055> (last visited Nov. 23, 2015). However, consistent with the existing information reporting rules, reporting entities that fail to timely meet the requirements still may be eligible for penalty relief if the IRS determines that the standards for reasonable cause under IRC § 6724 are satisfied.

19 See Treas. Reg. § 31.3406(j)-1; Rev. Proc. 2003-9, 2003-8 I.R.B. 516.

20 See IRS Pub. 2108A, *On-line Taxpayer Identification Number (TIN) Matching Program*.

21 The TIN Matching Program provides a numerical response indicator for each match request. The potential responses include: '0' - Name/TIN combination matches IRS records; '1' - Missing TIN or TIN not nine-digit numeric; '2' - TIN not currently issued; '3' - Name/TIN combination does NOT match IRS records; '4' - Invalid request (i.e., contains alphas, special characters); '5' - Duplicate request; '6' - (Matched on SSN), when the TIN type is (3), unknown, and a matching TIN and name control is found only on the NAP DM1 database; '7' - (Matched on EIN), when the TIN type is (3), unknown, and a matching TIN and name control is found only on the EIN N/C database; '8' - (Matched on SSN and EIN), when the TIN type is (3), unknown, and a matching TIN and name control is found on both the NAP DM1 and the EIN N/C databases. IRS Pub. 2108A, *On-line Taxpayer Identification Number (TIN) Matching Program* § 14, FAQ 9 at 9.

22 See IRC § 6103. See also National Taxpayer Advocate 2003 Annual Report to Congress 232 (Legislative Recommendation: *Confidentiality and Disclosure of Returns and Return Information*). Third-party payors and their authorized agents who participate in the TIN Matching Program must sign an online Terms of Agreement (TOA) clause stating they will attempt to match name/TIN combinations only for the types of reportable payments listed in Rev. Proc. 2003-9. IRS Pub. 2108A, *On-line Taxpayer Identification Number (TIN) Matching Program* § 4.3 at 4.

REASONS FOR CHANGE

Currently, IRC § 3406 authorizes the IRS TIN matching program only for payors of reportable payments subject to backup withholding. Currently, that is the only statutory authorization for TIN matching; the IRS is precluded under IRC § 6103 from disclosing information to filers of returns not subject to backup withholding. The filers of other information returns that are not subject to backup withholding have no ability to verify the accuracy of the information provided to the IRS, yet are subject to the same penalties for failure to file an accurate information return as those who have access to TIN matching. Because these filers do not have access to TIN matching, they may file information returns with incorrect name/TIN combinations and receive penalty notices, and will have to prove reasonable cause to abate penalties imposed, thereby increasing taxpayer burden and IRS rework.

In 2013, the National Taxpayer Advocate included a legislative recommendation to expand TIN matching to colleges and universities to reduce burden on all parties involved.²³ Similarly, a legislative change that would allow filers required to file information returns under IRC §§ 6055 and 6056 to use TIN matching to verify TINs with the IRS prior to filing annual information returns would benefit the IRS, employers, health insurance providers, and taxpayers by facilitating accurate information returns.

While information matching is a critical part of the IRS's compliance strategy, it is only as effective as the accuracy of the data provided.²⁴ Health insurance companies and ALEs have an information reporting requirement for which they need to verify TINs.²⁵ TINs may not match an individual's name for various reasons, such as transposition errors or name changes. The IRS's inability to accurately match a taxpayer against a Form 1095-B or 1095-C will place him or her at risk for receiving notices from the IRS that he or she is liable for an ISRP. Still, other taxpayers may have their PTC claims questioned. Furthermore, ALEs may unnecessarily be required to substantiate coverage to employees if the data is unreliable or in error. If the IRS receives inaccurate data regarding coverage, it may erroneously assess ESRP on ALEs, which can be costly and time-consuming for both employers and the IRS to rectify. This increased burden can be avoided if Congress expands TIN matching beyond the currently authorized program to allow these filers to verify name/TIN combinations and learn of inaccuracies prior to filing information returns. This recommendation benefits the IRS, information return filers, and taxpayers by facilitating accurate information returns.

EXPLANATION OF RECOMMENDATION

ACA was enacted by Congress in 2010 to provide affordable health care coverage for all Americans. To accomplish this goal, the ACA provides targeted tax credits for low income individuals and small businesses while imposing a personal responsibility on individuals to have health coverage.²⁶ Information returns allow the IRS to cross-check taxpayer claims against third-party reports. In the case of ACA, health coverage and offers of coverage are contained on Forms 1095-B and 1095-C, required by IRC §§ 6055

23 See National Taxpayer Advocate 2013 Annual Report to Congress 319-21 (Legislative Recommendation: *Tuition Reporting: Allow TIN Matching By Colleges*).

24 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 83 (calling for improved accuracy of third-party reporting data); National Taxpayer Advocate 2011 Annual Report to Congress 82 (questioning the accuracy of third-party data as a source for math error adjustments).

25 Many of these filers may already have access to TIN matching for other information returns they are required to file.

26 IRC § 4980H(a)(1) imposes a responsibility for ALEs to offer health care to employees in certain circumstances. ACA, Pub. L. No. 111-148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care & Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010); S. Fin. Comm., 111th Cong., DESCRIPTION OF POLICY OPTIONS: EXPANDING HEALTH CARE COVERAGE: PROPOSALS TO PROVIDE AFFORDABLE COVERAGE TO ALL AMERICANS (May 14, 2009), available at <http://finance.senate.gov/download/?id=1DD95955-E95D-4AC7-919D-DAA62490D249>.

and 6056, which include information that helps facilitate accurate administration of the law. The ACA contains a number of new provisions, and 2016 marks the first year applicable entities will have to file these information returns. If the information provided is inaccurate, taxpayers and employers could be assessed penalties, the IRS will have to work through avoidable penalty abatement requests, audits, and amended returns — all of which impacts taxpayers' *right to pay no more than the correct amount of tax*.

The TIN matching process reduces errors in information reported, resulting in fewer inaccurate IRS notices and penalties, saving both taxpayer and IRS resources. As a result, both the Information Reporting Program Advisory Committee (IRPAC)²⁷ and practitioners have called for an expansion of the TIN matching program to filers of Forms 1095-B and 1095-C.²⁸ The IRS has already announced penalty relief for 2015 forms filed in 2016, recognizing that entities will face difficulty with compliance amid potential issues. By extending TIN matching to Forms 1095-B and 1095-C, the recommendation reduces unnecessary burden and work for health insurance companies, ALEs, the IRS, and taxpayers.

27 IRPAC is a federal advisory committee whose primary purpose is to provide a public forum for the IRS and members of the information reporting community in the private sector to discuss relevant information reporting issues.

28 IRPAC, *2014 Information Reporting Program Advisory Committee (IRPAC) Public Report*, 19-22, available at <https://www.irs.gov/pub/irs-utl/2014%20Public%20Report%20Final.pdf>; Treas. Reg. §§ 1.6055-1 and 1.6055-2 (summary of comments), available at <http://www.gpo.gov/fdsys/pkg/FR-2014-03-10/pdf/2014-05051.pdf>; Michael M. Lloyd & S. Michael Chittenden, *Expand TIN Matching Program to Avert Another ACA Debacle*, Tax Notes 424-28 (Jan. 27, 2014).

LR
#10**EXEMPT ORGANIZATIONS (EOs): Require More Frequent Updates to Publicly Available Databases of EOs****TAXPAYER RIGHTS IMPACTED¹**

- *The Right to Be Informed*
- *The Right to Quality Service*

PROBLEM

The IRS's Tax Exempt and Government Entities (TE/GE) division maintains a list of tax exempt organizations (EOs) on two publicly accessible online databases, the Exempt Organizations Business Master File (EO BMF)² and Exempt Organizations Select Check (EO Select Check).³ When an EO fails to file an information return or notice for three consecutive years, its exempt status is automatically revoked.⁴ Shortly after this automatic revocation, which can sometimes be erroneous, the IRS removes the EO from its online-published lists of EOs and lists it as one whose exempt status was automatically revoked.

Unless the automatic revocation was due to IRS error, an automatically revoked organization must submit a new application to have its exempt status reinstated.⁵ Even if the IRS promptly reinstates the organization or discovers its error, IRS databases will not immediately reflect the organization's restored exempt status, as the IRS updates its databases only monthly, on the second Monday of every month. However, these databases are not updated at all during the month of January, meaning there is a two-month updating gap from the second Monday in December until the second Monday in February.⁶ Reinstated EOs may lose out on donations or grants they would have received had IRS databases accurately reflected their status, which may be an existential issue for some organizations. The number of automatic revocation reinstatement cases during this gap period alone exceeded 2,500 in both fiscal years (FYs) 2014 and 2015, and more than 70 percent of these cases were 501(c)(3) organizations.⁷ These delays undermine taxpayers' *right to be informed* and *right to quality service*.⁸

1 See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 The EO BMF (<http://www.irs.gov/Charities-&Non-Profits/Exempt-Organizations-Business-Master-File-Extract-EO-BMF>) contains information about EOs such as the organization's employer identification number (EIN), name and address, the Internal Revenue Code (IRC) § 501(c) subsection under which it is exempt, whether contributions to it are tax deductible, whether it is a private foundation or a public charity (and the type of public charity), the month and year it received its exemption ruling, and information from its Form 990 series return. See Exempt Organizations Business Master File Extract (EO BMF), available at http://www.irs.gov/pub/irs-soi/eo_info.pdf.

3 EO Select Check is an online search tool, available at <http://apps.irs.gov/app/eos/>, that allows users to search for organizations eligible to receive tax deductible contributions (Publication 78 data), organizations whose tax exemption has been automatically revoked for not filing a Form 990-series return or notice for three consecutive years (Auto-Revocation List), and organizations that have filed a Form 990-N (also called an e-Postcard), an annual notice required to be filed by small EOs. Unless otherwise indicated, we use "EO Select Check" to refer to the capability to determine whether an organization is eligible to receive tax deductible contributions (Publication 78 data). See Internal Revenue Manual (IRM) 25.7.6.1 (Jan. 1, 2015).

4 See IRC § 6033(j)(1) (requiring the IRS to publish and maintain a list of automatically revoked organizations).

5 See IRC § 6033(j)(2).

6 See IRM 25.7.5.1(1) (Jan. 1, 2015) (noting that the EO Standard Extract Program is a computer program that is run on a monthly basis (except for January) to allow for extraction of both entity and limited return information from EO accounts contained on the BMF).

7 TE/GE response to TAS research request (July 31, 2015).

8 For a detailed discussion of the EO database updating delay issue, see Most Serious Problem: *Exempt Organizations (EOs): The IRS's Delay in Updating Publicly Available Lists of EOs Harms Reinstated Organizations and Misleads Taxpayers*, *supra*.

EXAMPLE

A small, volunteer-run Internal Revenue Code (IRC) § 501(c)(3) EO is automatically revoked because it did not file a required information return or notice for three consecutive years.⁹ As a result, the IRS places the organization on the automatic revocation list and removes it from the EO BMF and EO Select Check online databases.

Once the organization discovers that its exemption was automatically revoked, it quickly applies for reinstatement of exempt status. The IRS promptly approves the application and sends the organization a new determination letter acknowledging the approval. However, this approval occurs in mid-December, after the IRS has already updated its online databases and the next update will not occur until February. The organization is contacted by a potential donor who would like to make a sizeable donation before the end of the year but wishes to confirm the organization's exempt status beforehand to ensure the donation will be tax-deductible. The potential donor is concerned because although the organization has a new determination letter, its name does not appear on the IRS's online databases. As a result, the organization may lose a critical donation because the IRS's online databases do not accurately reflect its exempt status.

RECOMMENDATIONS

To address IRS delays in updating its publicly available databases of EOs and their adverse impact on automatically revoked organizations that have been reinstated, the National Taxpayer Advocate recommends that Congress amend IRC § 6033 to require the IRS to:

1. Update EO BMF and Select Check on a weekly basis as is the case for Form 990-N updates; and
2. Implement an emergency process that, even when there is weekly updating, allows for manual database updates within 24 hours of the restoration of exempt status.

PRESENT LAW

Almost ten years ago, Congress passed the Pension Protection Act of 2006, which among other things, amended IRC § 6033 to provide for the automatic revocation of EOs that did not file a required information return or notice for three consecutive years.¹⁰ Once an organization is automatically revoked, the IRS is required by statute to place it on a list of automatically revoked organizations.¹¹ Automatically revoked organizations seeking reinstatement of exempt status are also statutorily required to submit a new application to the IRS (except for when the revocation was erroneous).¹²

In addition to being placed on the automatic revocation list, organizations that have been automatically revoked are removed from the two online databases of EOs, EO BMF and EO Select Check. These databases are of critical importance for two reasons. First, they allow potential individual donors to verify,

⁹ See IRC § 6033(j)(1).

¹⁰ Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 (2006). The law went into effect for tax periods beginning after 2006. See IRC § 6033(j)(1) (providing that the effective date of the automatic revocation is the due date of the third annual return or notice).

¹¹ See IRC § 6033(j)(1). The only way an automatically revoked organization can be removed from this list is if the revocation was due to IRS error. This list of automatically revoked organizations is available online at https://apps.irs.gov/app/eos/main-Search.do;jsessionid=dK2bhgtr3luhznjUpp62cg__?mainSearchChoice=revoked&dispatchMethod=selectSearch.

¹² See IRC § 6033(j)(2). An automatically revoked organization may obtain retroactive reinstatement of its exempt status. See Rev. Proc. 2014-11, 2014-3 I.R.B. 411.

before making a donation, that their contributions will be tax deductible.¹³ Second, they allow private foundations to verify that they are making a grant to a qualifying public charity.¹⁴ IRS guidance provides that grantors and contributors may rely on an organization's listing on EO Select Check or EO BMF.¹⁵ In addition, grantors and contributors may, in some situations, rely on EO BMF information provided by a third party.¹⁶

There is no current legal requirement for the IRS to update its online EO databases at any particular interval.

REASONS FOR CHANGE

The IRS recognizes that potential donors and grantors may rely exclusively on its online databases.¹⁷ However, it does not update them in a timely manner, causing reinstated automatically revoked organizations, such as the one in the example above, to potentially lose donations or grants.¹⁸ Currently, EO Select Check and EO BMF are only updated monthly, on the second Monday of every month.¹⁹ An organization that misses the updating cutoff will not appear on the IRS lists until the next month. In addition, these databases are not updated at all during the month of January, meaning there is a two-month updating gap from the second Monday in December until the second Monday in February.²⁰ As a result, new and reinstated EOs that receive IRS approval of exemption after the early December cutoff will not appear on publicly available IRS databases until mid-February, which is well after the critical year-end fundraising push.

The number of automatic revocation reinstatement cases during this gap period alone exceeded 2,500 in both FYs 2014 and 2015, and more than 70 percent of these cases were 501(c)(3) organizations.²¹ However, the IRS disavows responsibility if an EO loses a donation or grant because its databases do

13 A charitable contribution deduction is allowed for donations to organizations described in IRC § 170(c). These are most commonly IRC § 501(c)(3) organizations.

14 Private foundations prefer making grants to qualifying IRC § 501(c)(3) public charities over other organizations as doing so relieves them of certain oversight requirements (called expenditure responsibility) that would otherwise arise, and eliminates the risk of incurring liability for an excise tax under IRC § 4945.

15 See Rev. Proc. 2011-33, 2011-25 I.R.B. 887.

16 *Id.*

17 See IRM 25.7.6.1(3) (Jan. 1, 2015); IRM 21.3.8.12.12(3) (June 18, 2012); IRM 21.3.8.12.13(3) (Nov. 16, 2012).

18 This delay may also affect newly-recognized tax exempt organizations that receive a determination letter but are not promptly listed on the online databases. However, the harm to reinstated automatically revoked organizations is arguably greater as these organizations were formerly tax exempt and had the ability to receive tax-deductible contributions.

19 IRM 21.3.8.3.8(1)(f) (Oct. 1, 2015) (noting "online Publication 78 data is generally updated the second Monday of each month"); IRM 21.3.8.12.13(2) (Nov. 16, 2012) (noting that EO BMF is updated or extracted monthly). The term "extracted" is used because the EO BMF is an extract of information regarding EO accounts from the larger BMF. See IRM 25.7.5.1(1) (Jan. 1, 2015). In response to a TAS information request, the IRS stated that the internal IRS EO BMF list is generally updated within two weeks of a favorable case closing. The IRS also stated that the program that produces the online EO BMF and EO Select Check extracts is run approximately the last full week of each month and posted online to irs.gov the second Monday of the following month. Any accounts that are updated and posted prior to the running of the extract program will appear online. This means that an EO account update could take between 30 to 60 days to be reflected on the online EO BMF and EO Select Check databases. TE/GE response to TAS research request (July 31, 2015). Thus, there is a disconnect between IRS internal database updating (approximately two weeks) and external (*i.e.*, online) database updating (30-60 days).

20 See IRM 25.7.5.1(1) (Jan. 1, 2015) (noting that the EO Standard Extract Program is a computer program that is run on a monthly basis (except for January) to allow for extraction of both entity and limited return information from EO accounts contained on the BMF).

21 TE/GE response to TAS research request (July 31, 2015).

not accurately reflect that the organization is exempt.²² It advises reinstated organizations to either show potential contributors a current IRS determination letter or ask them to contact the IRS's TE/GE toll-free line (and face lengthy hold times, courtesy disconnects, and poor levels of service) to verify the organization's exempt status.²³ These suggestions place a burden on the reinstated organization or the potential donor or grantor. Many donors or grantors may simply "move on" and make a donation or grant to an organization that appears on EO Select Check and EO BMF. Other donors or grantors have operational guidelines that require the EO to be listed on the IRS databases before consideration for donations or grants.²⁴

If the IRS were to update its online databases on a weekly basis, as it does for its list of Form 990-N (e-Postcard) filers,²⁵ it would alleviate the hardship on reinstated automatically revoked organizations and their donors or grantors. A legislative change requiring weekly database updating would also support fundamental taxpayer rights. Specifically, it would support donors and grantors' *right to be informed* of organizations that are tax exempt and eligible to receive tax deductible contributions. It would also support EOs' *right to quality service*, which includes a taxpayers' right to receive prompt assistance in their dealings with the IRS. Weekly database updating would also benefit the IRS by reducing the burden on the IRS's TE/GE phone line, as potential donors or grantors would no longer need to call the IRS to verify the exempt status of an organization not listed in the databases.

Although the IRS can update its EO Select Check database manually in between regular database updates and the National Taxpayer Advocate has directed TAS employees to require the IRS to do these manual updates within 24 hours, this *ad hoc* approach is not feasible or sustainable.²⁶ In addition, the IRS states that it cannot update the EO BMF manually.²⁷ Weekly database updating would limit the need for manual updates to emergency cases.

The IRS has previously moved to a more frequent updating interval, as Publication 78 data (that now appears on EO Select Check) used to be updated quarterly, but was moved to a monthly (with the exception of the gap period) updating schedule in January 2012.²⁸ However, due to the harm caused to many

22 IRM 21.3.8.12.13(3) (Nov. 16, 2012).

23 See IRS, *Exempt Organizations Select Check: Timing of Database Updates for Organizations Whose Exempt Status Is Reinstated*, available at <http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check:-Timing-of-Database-Updates-for-Organizations-Whose-Exempt-Status-Is-Reinstated>. For detailed data about hold times, courtesy disconnects, and poor levels of service, see Most Serious Problem: *Exempt Organizations (EOs): The IRS's Delay in Updating Publicly Available Lists of EOs Harms Reinstated Organizations and Misleads Taxpayers*, *supra*.

24 See, e.g., Mathile Family Foundation, *FAQs – Tax Information*, available at <http://www.mathilefamilyfoundation.org/grantmaking/faqs/tax-information/>. These FAQs discuss in great detail the grant making restrictions on private foundations and that the foundation and its managers are subject to severe penalties if these rules are violated. The FAQs also advise potential grantees to **"make sure that the IRS BMF code currently represents your non-profit activities/operation (Form 990) and aligns with your Form 1023 filings and subsequent communications as approved by the IRS. When these separate designations do not agree, your organization is required to rectify discrepancies with IRS. Please consult with your tax advisor."** (bold and italic emphasis in original).

25 See IRS, *Exempt Organizations Select Check: Frequently Asked Questions*, FAQ #5, available at http://www.irs.gov/pub/irs-tege/faqs_eo_selectcheck.pdf.

26 In a February 2015 message to TAS employees, the National Taxpayer Advocate directed her case advocates to request manual updates within 24 hours if the IRS agrees an organization should be listed on EO Select Check as eligible to receive tax deductible contributions and to request an organization's removal from the automatic revocation list if this revocation was erroneous. TAS Wednesday Weekly, *Updates to Exempt Organizations "Select Check"* (Feb. 4, 2015).

27 TE/GE response to TAS research request (July 31, 2015). When asked why it cannot update the EO BMF manually, the IRS stated that the EO BMF is prepared by its IT personnel during a time frame available only once a month, "except in January IT is busy with other priorities and the EO BMF is not prepared." TE/GE response to TAS research request (Dec. 1, 2015).

28 IRM 25.7.6.3.5, *Cumulative List Indicator* (Jan. 1, 2015).

reinstated organizations, more frequent updating is now necessary and the IRS should implement such a change, which should not entail a significant additional cost or expenditure of resources. Because the IRS is unwilling or unable to make such a change, Congress should require it to do so.²⁹

EXPLANATION OF RECOMMENDATIONS

The proposals to amend IRC § 6033 to require the IRS to update its online EO databases more frequently would address IRS delays under the current process and their adverse impact on automatically revoked organizations that have been reinstated. A requirement that the IRS update its databases on a weekly basis would eliminate the current potential month or two updating delay and should not involve significant additional costs or resources. This would be in line with the IRS online weekly updating time frame for the Form 990-N (e-Postcard), which is the notice filed by small EOs.³⁰

Until the IRS can make appropriate programming changes, Congress should direct the IRS, through legislative history, to update EO Select Check manually for reinstated automatically revoked organizations. This short term fix will immediately alleviate the burden placed on these organizations. Once the IRS moves to a weekly updating schedule, the proposal recommends that Congress require the IRS to implement an emergency process that allows for manual online database updates within 24 hours of the restoration of exempt status. These changes would promote fair and efficient tax administration and protect two fundamental taxpayer rights, the *right to be informed* and the *right to quality service*.

29 In a response to a TAS information request regarding whether the IRS can update EO BMF and EO Select Check more frequently than the current monthly (except for January) intervals, the IRS stated that the program used to run these two extracts only runs every four weeks and “there is no way that the IT programmers can run the extracts more frequently.” TE/GE response to TAS research request (Dec. 1, 2015).

30 EOs that normally have annual gross receipts of not more than \$50,000 may file the Form 990-N rather than the more comprehensive Form 990 or Form 990-EZ. See Rev. Proc. 2011-15, 2011-3 I.R.B. 322.

LR
#11

BASIS REPORTING: Reduce Taxpayer Burden and Improve Tax Compliance by Requiring Partnerships and S Corporations to Report Each Partner's or Shareholder's Adjusted Basis Annually on Schedules K-1

TAXPAYER RIGHTS IMPACTED¹

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

PROBLEM

Pass-through entities determine their income, gain, and loss at the entity level, but these items are passed out and taxed at the partner or shareholder level at the owner's income tax rate. Partnerships and S corporations are two common types of pass-through entities, which are becoming the preferred way to structure businesses. Between 1980 and 2012, the number of pass-through business tax returns increased by approximately 294 percent, from nearly two million returns to about 7.6 million returns.² By comparison, the number of returns filed by C corporations, which are not pass-through entities, decreased by about 25 percent.³

Owners of pass-through entities often hold their interest for long periods of time. When the interest in the pass-through entity is sold or liquidated, the IRS requires partners or shareholders to compute their tax basis to determine the amount of gains or losses.⁴ These computations are some of the most complex in the Internal Revenue Code (IRC).

Each year, partnerships and S corporations are required to furnish Schedule K-1s to each partner or member, reporting their allocable share of income, gain, or loss, and file a copy with the IRS.⁵ The Schedule K-1 does not include the partner or shareholder's annual adjusted basis in the partnership or S corporation; rather, a worksheet accompanies the instructions to assist the recipient with the calculation.⁶ Taxpayers often lack the specialized knowledge required to accurately calculate basis, which results in errors and can lead to an overstatement of basis or an overpayment of tax.

¹ See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

² IRS, Statistics of Income (SOI) Tax Stats – Integrated Business Data, *Business Tax Statistics, 1980-2012*, Table 1, available at <https://www.irs.gov/uac/SOI-Tax-Stats-Integrated-Business-Data>. IRS data may double count some businesses because some private partnerships can be owned by one or more other business entities. The number of S corporation and partnership returns filed in 1980 was 1,925,043 and in 2012 the number of returns was 7,594,013.

³ *Id.*

⁴ IRC §§ 704, 1366.

⁵ IRC § 6031(b).

⁶ See IRS, *Partnership Schedule K-1 (2013)*; IRS, *Shareholder's Schedule K-1 (2013)*; IRS, *Partner's Instructions for Schedule K-1 (2013)*; IRS, *Shareholder's Instructions for Schedule K-1 (2013)*.

EXAMPLE

Pat and Sam form an equal partnership by contributing property of equal fair market value. Pat contributes \$40,000 cash plus assets having an adjusted basis of \$200,000 at the time of contribution. In addition, Pat transfers a mortgage on one of the assets of \$80,000. Pat's beginning basis in his partnership interest is \$200,000. Pat's basis is reduced by the \$80,000 mortgage he transferred, but it is increased by \$40,000, his share of the mortgage once it was transferred to the partnership.

Pat's adjusted basis of assets contributed:	\$ 200,000
Plus cash contributed:	\$ 40,000
Less mortgage liability transferred:	\$ (80,000)
Plus partnership debt assumed:	\$ 40,000
Pat's initial basis:	\$ 200,000

Continuing with the above scenario, Sam contributes assets with a basis of \$200,000 and a mortgage balance of \$60,000. Sam's basis in the partnership is \$210,000. Sam increases his basis by the 50 percent share of the \$80,000 mortgage transferred by Pat. In addition, Pat has a new basis of \$230,000 (\$200,000 plus \$30,000) because he increases his basis by his 50 percent share of the \$60,000 mortgage contributed by Sam.

Sam's adjusted basis of assets contributed	\$ 200,000
Plus cash contributed:	\$ 0
Less mortgage contributed:	\$ (60,000)
Plus partnership debt assumed (Sam):	\$ 30,000
Plus partnership debt assumed (Pat):	\$ 40,000
Sam's initial basis:	\$ 210,000
Pat's initial basis:	\$ 200,000
Plus partnership debt assumed (Sam):	\$ 30,000
Pat's revised initial basis:	\$ 230,000

If the partnership was organized as an S corporation, the calculations would be slightly different.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that due to the complexity of pass-through basis computations and the inconsistent reporting of adjusted basis, Congress should require annual adjusted basis reporting on Schedule K-1s issued to each partner or shareholder.

PRESENT LAW

Determining the correct tax basis for pass-through entities is no easy task. Subchapter K,⁷ which covers partnership⁸ taxation, contains some of the most complicated computations in the IRC. It is closely followed in complexity by the sections pertaining to computing the tax basis for an S corporation interest in Subchapter S.⁹

There are several sections of the IRC that determine a partner's tax basis in a partnership. Each partner must calculate his or her basis in the partnership using two separate methods. First, the partner must determine his basis in the partnership interest, commonly referred to as "outside" basis.¹⁰ Outside basis is adjusted annually to reflect the income, gains, and losses from the operation of the partnership. Second, the partner must determine his share of the partnership's basis in the partnership's assets (net of liabilities), commonly referred to as "inside" basis.¹¹ A partner's inside basis is maintained in a capital account and generally differs from the partner's outside basis in that the capital account does not reflect a partner's share of partnership liabilities, or optional basis adjustments under IRC § 754. These different types of basis can result in confusion and misreporting.

When a partner contributes property into a partnership in exchange for a partnership interest, the general rule is that a partner has a tax basis in the partnership interest equal to the adjusted tax basis of the assets

⁷ IRC §§ 701-77.

⁸ A partnership is the relationship existing between two or more persons who join together to carry on a trade or business. Each person contributes money, property, labor, or skill and expects to share in the profits and losses of the business. A partnership must file an annual information return to report the income, deductions, gains, losses, etc., from its operations, but it does not pay income tax. Instead, it "passes through" any profits or losses to its partners in accordance with the partnership agreement. Each partner includes his or her allocable share of partnership income or loss on his or her tax return. Partnerships organized in the United States, or derive income from operations in the United States, are required to file Form 1065, *U.S. Return of Partnership Income*. IRC § 6031(a).

⁹ IRC §1361. S corporations are corporations that elect to pass income, losses, deductions, and credits through to their shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. This allows S corporations to avoid double taxation on the corporate income. S corporations are responsible for tax on certain built-in gains and passive income at the entity level. To qualify for S corporation status, the corporation must meet the following requirements: (1) domestic corporation; (2) eligible shareholders (e.g., individuals, certain trusts, and estates are eligible shareholders and partnerships, corporations or non-resident alien are ineligible shareholders); (3) no more than 100 shareholders; (4) one class of stock. Certain corporations are ineligible to elect to be an S corporation including certain financial institutions, insurance companies, and domestic international sales corporations. IRC §§ 1361-78. Government Accountability Office (GAO), GAO-10-195, *Tax-Gap: Actions Needed to Address Noncompliance With S Corporation Tax Rules* 16 (Dec. 2009). "S corporation stakeholder representatives told us that calculating and tracking basis was one of the biggest challenges in complying with S corporation rules." Curtis J. Berger, *W(h)ither Partnership Taxation?* 47 *Tax L. Rev.* 105, 108 (1991) ("In order to keep tax planners from wholly abusing the partnership's privileged status, while not denying them all remaining flexibility, Congress and Treasury [fashioned] a statutory and regulatory apparatus which [is] one of the most inaccessible and burdensome features of the entire tax system."). Burgess J. W. Raby & William L. Raby, *S Corporation AAA and OAA- Alphabet Soup or Taxpayer Stew?*, 78 *Tax Notes* 1013 (Feb. 23, 1998) (describing Subchapter S as "remarkably complicated"). Andrea Monroe, *Integrity in Taxation: Rethinking Partnership Taxation*, 64 *ALA. L. REV.* 289, 316 (2012) ("Congress's desire to provide partnerships with flexible allocation provisions, coupled with the line drawing that such an approach requires, has burdened partnerships with enormous complexity. Under the substantial economic effect safe harbor, a partnership must apply multiple layers of intricate, mathematical provisions to every allocation it makes, every year."). James Alm & Jay A. Soled, *Tax Basis Determinations, Pass-Through Entities, and Taxpayer Noncompliance*. 40 *Ohio N. U. L.* 693, 699 (2014) ("In the area of tax law, courts, academicians, practitioners, and students generally agree that Subchapter K (the subchapter that details partnership taxation) and the Treasury regulations promulgated thereunder are extraordinarily complex.")

¹⁰ IRC §§ 722, 705.

¹¹ IRC §§ 723, 704.

contributed to the partnership.¹² If a partner purchases a partnership interest, the partner will generally have a tax basis in the partnership interest equal to the purchase price of the interest.¹³

Once the partnership begins to conduct business, rules regarding partnership operation and partnership debt are applicable. IRC § 705 explains how a partner adjusts his basis in his partnership interest based on the entity's gains or losses and/or distributions.¹⁴

Similarly, computing S corporation tax basis is a daunting task. The initial basis in an S corporation is figured much like a partnership. IRC §§ 358 or 1012 govern at the inception of the S corporation.¹⁵ Taxpayers who acquire their S corporation investment by purchase are generally given a tax basis in their S corporation shares equal to the purchase price.¹⁶ Once operations begin, the tax basis goes through annual upward and downward adjustments based upon transactions.¹⁷ If an S corporation incurs debt, no tax basis adjustments are made to the taxpayer's interest.¹⁸ If a shareholder lends funds to an S corporation or personally guarantees an S corporation's debt, then the lending shareholder's will have an additional separate basis account equal to the loan or guarantee amount. A shareholder's basis attributable to loans or guarantees is only taken into account after the shareholder has reduced his tax basis to zero. The shareholder cannot reduce his basis, including his basis from the indebtedness, below zero, by loss and deduction items that flow through the S corporation.¹⁹

Partnerships and S corporations must file information returns (Forms 1065 and 1120-S, respectively).²⁰ Partnerships and S corporations generally do not directly pay taxes on the net income reported on Forms 1065 or 1120-S. Instead, they pass profits, losses, and gains to partners and shareholders, respectively, who pay any applicable taxes.²¹ Partnerships and S corporations are required to furnish Schedule K-1s to their partners or shareholders to report their allocable share of income, loss, or gain for the year and to file a copy with the IRS.²²

The Schedule K-1 for partnerships contains three parts: Part I (Information About the Partnership), Part II (Information About the Partner), and Part III (Partner's Share of Current Year Income, Deductions, Credits, and Other Items). The Schedule K-1 for S corporations mirrors the one for partnerships and has three parts. Both sets of instructions contain short sections pertaining to the calculation of

12 IRC § 722.

13 IRC § 742.

14 IRC § 705(a)(1). Basis adjustments increase for (a) the taxable income of the partnership; (b) income of the partnership exempt from tax; and (c) the excess of depletion deductions over the basis of the property subject to depletion. IRC § 705(a)(2). Basis adjustments decrease (but not below zero) for (a) partnership distributions; (b) partnership losses; (c) partnership expenditures not deductible in computing its taxable income and not properly chargeable to the taxpayer's capital account; and (d) any partnership oil and gas property, by the amount of the partner's deduction for depletion, to the extent that such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such property.

15 IRC §§ 358, 1012.

16 IRC § 1012(a).

17 IRC § 1367.

18 IRC § 1366.

19 IRC § 1367(d)(1)(B).

20 IRC §§ 6031, 6037.

21 IRC § 701.

22 IRC §§ 6031, 6037; Treas. Reg. §§ 1.6031(a)-1, 1.6037-1.

a partner's or shareholder's basis in the partnership interest or stock along with a worksheet to assist with calculations.²³

REASONS FOR CHANGE

Taxpayer Burden

The explosion of growth of pass-through entities as a chosen business structure combined with the complexity of the laws and regulations governing basis computations create a situation where many taxpayers face some of the most complex sections of the IRC.

Partners and shareholders of pass-through entities may hold onto their interest for many years and fail to keep adequate records of the annual changes. Even when shareholders and partners do keep complete records, the process of computing basis changes is exceedingly complex and challenging, which is overwhelming to taxpayers. Upon sale or dissolution of their interest in a pass-through entity, taxpayers face a risk for either an overstatement of basis, with a corresponding underpayment of tax, or an understatement of basis resulting in an overpayment of tax. In some larger partnerships, there are many partners trying to independently calculate their basis with their own preparers.

Revenue Protection

In March 2012, the IRS released a working paper that highlights the growing magnitude of the tax gap.²⁴ The results further support an earlier paper and prior research study findings — when transactions are subject to information reporting to the government, tax compliance is generally very high.²⁵ However, when transactions are not subject to information reporting to the government, the tax compliance rate drops tremendously.²⁶

This change will increase tax compliance by eliminating the ability of partners and S corporation shareholders to overstate their basis and thereby not pay the correct amount of tax. Requiring the annual reporting of adjusted basis on the Schedule K-1 for pass-through entities will further help taxpayers to understand their basis and not pay an incorrect amount of tax. It will also serve to assist taxpayers keep accurate records of their basis and eliminate the need to reconstruct basis many years down the road when many complex adjustments have been made.

In an article written in 2014, Professors James Alm and Jay A. Soled estimated that noncompliance in the pass-through entity basis reporting results in an annual revenue loss of approximately \$8 billion.²⁷ Pass-through entity basis reporting requirements would assist with the collection of this annual revenue loss, while reducing burden and minimizing complexity for taxpayers.

23 See IRS, *Partnership Schedule K-1 (2013)*; IRS, *Shareholder's Schedule K-1 (2013)*; IRS, *Partner's Instructions for Schedule K-1 (2013)*; IRS, *Shareholder's Instructions for Schedule K-1 (2013)*.

24 IRS, Office of Research, *Federal Tax Compliance Research: Tax Year 2006 Tax Gap Estimation* (Mar. 2012).

25 IRS, Office of Research, *Year 2001 Federal Tax Gap* (Feb. 2007); IRS, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study*, IR-2012-4 (Jan. 6, 2012). See also GAO, GAO-06-603, *Capital Gains Tax Gap* (2006).

26 IRS, Office of Research, *Federal Tax Compliance Research: Tax Year 2006 Tax Gap Estimation* (Mar. 2012).

27 See James Alm & Jay A. Soled, *Tax Basis Determinations, Pass-Through Entities, and Taxpayer Noncompliance*, 40 Ohio N. U. L. 693, 721 (2014).

EXPLANATION FOR RECOMMENDATIONS

Requiring pass-through entity basis reporting annually on the Schedule K-1 is a win-win proposition for taxpayers and the government. Taxpayers will no longer have to struggle with reconstructing their basis while following the complex adjustment rules, and the government will be able to collect the proper amount of tax due and better monitor compliance.

Similar to the changes for reporting adjusted stock basis enacted in 2008, pass-through entity basis reporting will reduce the recordkeeping burden on partners and S corporation shareholders seeking to report their tax basis accurately.²⁸ By centralizing basis reporting with third-party preparers, the burden for accurately calculating basis lies with those who have the expertise and resources to do so. Pass-through entities employ bookkeeping services that keep the necessary information regarding basis adjustment, and it is less burdensome for the third-party preparer to issue the annual statement.

Additionally, the Government Accountability Office (GAO) found that the full extent of partnership and S corporation income misreporting is unknown. The IRS's last study of S corporations, using 2003-2004 data, estimated that these entities annually misreported about 15 percent (an average of \$55 billion for 2003 and 2004) of their income. Using IRS data and the study results, the GAO derived an estimate of \$91 billion per year of individuals misreporting partnership and S corporation income for 2006 through 2009.²⁹

In writing regulations to require annual reporting of basis, there are some technical issues.³⁰ One issue involves how reporting would work in light of private party sales. Presently, there is no requirement to notify the IRS when interests in pass-through entities are bought and sold. If one of the 25 partners sells his partnership interest to a third party, the third party's initial basis will be what he paid. Because this is a private transaction, the partnership may not be privy to the sales price. If the partnership does not or cannot know the taxpayer's basis due to origination of the partnership interest either through gift or private party sale, an exception could be created to the pass-through entity basis reporting requirement. The K-1 would note that the basis calculation does not include the original purchase or gift basis of the partnership interest and only includes adjustments since that time.

A second issue involves how much additional work and change in programming to the electronic software packages the annual reporting of pass-through entity basis would require. The technology for electronic preparation and bookkeeping software already exists. Bookkeepers, Certified Public Accountants, and tax attorneys are already maintaining much of the information that individual partners are supposed to be keeping records of annually. There would be a cost and time needed for updating of the software and change in record keeping methods. The burden on preparers could possibly be mitigated by a phased in approach either by tying the reporting to assets or numbers of partners while being phased in over a period of several years.

28 IRC § 6045. Prior to the passage of IRC § 6045(g), taxpayers were required to determine basis for their marketable securities. Many, including the National Taxpayer Advocate, have argued that this resulted in an overly burdensome hardship for taxpayers. See National Taxpayer Advocate 2005 Annual Report to Congress 433-39.

29 GAO, GAO-14-453, *Partnerships and S Corporations: IRS Needs to Improve Information to Address Tax Noncompliance* (May 14, 2014).

30 The National Taxpayer Advocate discussed with many individuals including persons who prepare or advise on pass-through entity returns in developing the concerns and issues regarding this legislative recommendation.

The National Taxpayer Advocate believes these technical issues, while challenging, are resolvable and that an annual basis reporting requirement ultimately benefits all parties in pass-through entities, especially partners who face challenges in computing their adjusted basis to pay no more than the correct amount of tax.

LR
#12

HARDSHIP WITHDRAWALS: Provide a Uniform Definition of a Hardship Withdrawal from Tax-Advantaged Retirement Arrangements

TAXPAYER RIGHTS IMPACTED¹

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

PROBLEM

The Internal Revenue Code (IRC) contains a myriad of tax-advantaged retirement arrangements to encourage taxpayers to save for retirement.² While these planning vehicles help taxpayers save for retirement, they are subject to differing sets of rules regulating eligibility, contribution limits, tax treatment of contributions and distributions, withdrawals, availability of loans, and portability. TAS has discussed in prior reports the problems that such complexity may cause to both retirement plan administrators and participants.³

Particularly confusing are the rules governing distributions made before age 59½. Some tax-advantaged retirement arrangements allow participants to take an early distribution upon the event of a hardship without being subject to the ten percent additional tax imposed by IRC § 72(t). However, these various arrangements do not uniformly apply these so-called “hardship withdrawal” provisions.

IRC § 72(t) does not contain an exception to the ten percent additional tax for taxpayers whose last resort to pay for necessary living expenses is to liquidate their qualified plan. The lack of an exception negatively impacts low income taxpayers (those at or below the 250 percent of the federal poverty guidelines⁴) and those facing severe financial hardship resulting from an extended period of unemployment.⁵

Because the hardship withdrawal provisions do not apply uniformly to all qualified plans, taxpayers’ *right to a fair and just tax system* is compromised⁶ — that is, the type of qualified plan a taxpayer is participating in should not impact his or her ability to receive a hardship withdrawal. The current rules for

1 See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 The term “tax-advantaged” includes the ability to defer the taxation of income by making an elective deferral, the tax-deferred growth of account assets, or the tax-free withdrawals available to plan participants. Types of tax-advantaged retirement arrangements available under the IRC include traditional Individual Retirement Accounts (IRAs), Roth IRAs, rollover IRAs, SIMPLE IRAs, 401(k) plans, profit-sharing plans, employee stock ownership plans, money purchase plans, defined benefit plans, Simplified Employee Pensions, Salary Reduction Simplified Employee Pension, SIMPLE 401(k) plans for small employers, 403(b) tax-sheltered annuity plans for 501(c)(3) organizations and public schools, and 457(b) deferred compensation plans for state and local governments.

3 See National Taxpayer Advocate 2009 Annual Report to Congress 384-90 (Legislative Recommendation: *Provide a Uniform Definition of a Hardship Withdrawal from Qualified Retirement Plans*); National Taxpayer Advocate 2008 Annual Report to Congress 373-74 (Legislative Recommendation: *Simplify and Streamline Retirement Savings Tax Incentives*); National Taxpayer Advocate 2004 Annual Report to Congress 423-32 (Legislative Recommendation: *Simplification of Provisions to Encourage Retirement Savings*).

4 The federal poverty guidelines are a measure of income level issued annually by the Department of Health and Human Services. See U.S. DEP’T OF HEALTH & HUMAN SERV., 2015 POVERTY GUIDELINES (Sept. 3, 2015), available at <http://aspe.hhs.gov/2015-poverty-guidelines>.

5 See Systemic Advocacy Management System Issue 32816 (submitted Apr. 15, 2015).

6 See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

hardship withdrawals are so confusing that they present a trap for the unwary, often leading to unintended consequences that unfairly harm taxpayers who, by definition, are suffering from hardship.

EXAMPLE

Taxpayer A, who is 45 years old, first opened a Roth Individual Retirement Account (IRA) account three years ago and has contributed \$5,000 every year. The taxpayer's Roth IRA balance is \$18,000, of which \$3,000 is attributable to earnings. Taxpayer A currently works full-time for Employer B, a state agency. Taxpayer A participates in Employer B's governmental 457(b) plan and as of October 1, 2015, had \$60,000 in the plan attributable to his elective contributions and contributions made by Employer B. Taxpayer A used to work for Employer C, a company that maintains a 401(k) plan for its employees and made pre-tax contributions to the 401(k) plan while Taxpayer A was employed with Employer C. Taxpayer A's account balance with Employer C's 401(k) plan is \$25,000 as of October 1, 2015.

During 2015, Taxpayer A is faced with a medical emergency that will require surgery and force him to miss six months of work. Because his health insurance will cover only 70 percent of the estimated \$50,000 medical expenses, Taxpayer A will have out-of-pocket costs of \$15,000 for his surgery. Taxpayer A estimates he will need an additional \$20,000 to cover living expenses for his family during the next six months while he is on unpaid leave.

Taxpayer A recalls that some co-workers from Employer C were allowed to make hardship withdrawals from their retirement plans for occasions such as a home purchase. Taxpayer A would like to know whether he can receive a distribution from his Roth IRA or his two employer-based plans to help pay medical and living expenses for the next six months. After spending two weeks reading through plan documents and talking with friends, colleagues, and plan administrators, Taxpayer A arrives at the following conclusions:

- (1) He may withdraw \$15,000 from his Roth IRA (the amount contributed) without any tax consequences. Distributions in excess of the \$15,000 that will be used for medical expenses (to the extent it does not exceed the amount allowable as a deduction under IRC § 213) will not be subject to the ten percent additional tax. Any distribution he uses for living expenses while he is unable to work will be includible in taxable income to the extent the distribution exceeds his contributions to the Roth IRA and subject to the ten percent additional tax.
- (2) His governmental 457(b) plan with Employer B allows in-service distributions for "unforeseeable emergencies." For this purpose, an unforeseeable emergency is a severe financial hardship resulting from an illness or accident. The ten percent additional tax does not apply to distributions from a governmental 457(b) plan.
- (3) His 401(k) plan with Employer C allows in-service distributions on account of hardships. For this purpose, a hardship means an instance of "immediate and heavy financial need" and the plan provides that the regulatory safe harbor rules will be used to determine whether an employee qualifies for the distribution. Medical expenses, but not living expenses, for the period he is unable to work fall under the safe harbor definition of immediate and heavy financial need. Hardship distributions are included in taxable income and subjected to the ten percent additional tax for early withdrawal.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress establish uniform rules regarding the availability and tax consequences of hardship withdrawals from tax-advantaged retirement plans and arrangements. Hardship withdrawals should be permitted when a participant is faced with an unforeseeable emergency or severe financial hardship. Examples of unforeseeable emergency or severe financial hardship may include:

1. Expenses for medical care incurred by the employee, the employee's spouse, or dependents;
2. Payments necessary to prevent the eviction of the employee from his or her principal residence or foreclosure on the mortgage on that residence;
3. Loss of property due to casualty;
4. Basic living expenses of low income taxpayers (those at or below the 250 percent of the federal poverty guideline); or
5. Financial hardship resulting from an extended period of unemployment.

The National Taxpayer Advocate further recommends that the IRS exempt such hardship distributions from the ten percent additional tax imposed by IRC § 72(t).

PRESENT LAW

Determining the tax treatment of early distributions from certain tax-advantaged retirement arrangements involves a three-pronged analysis. First, we must ascertain whether the distribution is allowed in the first place. If allowed, there must be a determination regarding the taxability of such distribution. Finally, we must determine whether the distribution is subject to the IRC § 72(t) addition to tax.

The following sections discuss the application of this analysis with respect to distributions from various qualified plans.

401(k) Plans

In the absence of a hardship, a 401(k) plan may generally only distribute benefits attributable to elective contributions upon an employee's death, disability, attainment of age 59½, or severance from employment.⁷ Applicable Treasury regulations provide that a distribution is made due to hardship only if (1) the distribution is made due to an immediate and heavy financial need of the employee, and (2) the distribution is necessary to satisfy the immediate and heavy financial need.⁸

Applicable Treasury regulations provide that whether an employee has an immediate and heavy financial need and the amount necessary to meet such need is determined by the plan administrator based on a consideration of all relevant facts and circumstances.⁹ The regulations also provide a safe harbor under which a distribution may be deemed to be on account of an immediate and heavy financial need in the following six circumstances:

1. Expenses for medical care incurred by the employee, spouse, or certain dependents;
2. Costs directly related to the purchase of a principal residence for the employee;

⁷ IRC § 401(k)(2)(B)(i).

⁸ Treas. Reg. § 1.401(k)-1(d)(3)(i).

⁹ Treas. Reg. § 1.401(k)-1(d)(3)(iii) and (iv).

3. Payment of certain tuition, related educational fees, and room and board expenses for the employee, spouse, children, or certain dependents;
4. Payments necessary to prevent the eviction of the employee from his or her principal residence or foreclosure on the mortgage of that residence;
5. Payments for burial or funeral expenses for the employee's deceased parent, spouse, children, or dependents; or
6. Expenses for the repair of damage to the employee's principal residence that would qualify for the casualty deduction under IRC § 165.¹⁰

The regulations also provide that a distribution is deemed necessary to satisfy an immediate and heavy financial need if:

1. The employee has obtained all other currently available distributions and nontaxable loans under the plan and all other plans maintained by the employer; and
2. The employee is prohibited from making elective deferrals to the plan and all other plans maintained by the employer for at least six months following the hardship distribution.¹¹

Hardship withdrawals are generally includible in the participant's gross income in the taxable year in which paid to the participant and are taxed as ordinary income.¹² In addition, hardship withdrawals are subject to the ten percent additional tax imposed under IRC § 72(t) if no exception applies.¹³

457(b) Plans¹⁴

In general, a governmental 457(b) plan (which covers state and local government employees) participant may not receive a distribution until he or she reaches age 70½ or separates from service, whichever is earlier.¹⁵ However, a governmental 457(b) plan may permit an early distribution to a participant faced with an "unforeseeable emergency."¹⁶

The Treasury regulations define unforeseeable emergency as:

1. A severe financial hardship resulting from an illness or accident;
2. Loss of property due to casualty; or
3. Other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.¹⁷

10 Treas. Reg. § 1.401(k)-1(d)(3)(iii)(B).

11 Treas. Reg. § 1.401(k)-1(d)(3)(iv)(E).

12 IRC § 402(a).

13 Exceptions to the ten percent additional tax under § 72(t)(2)(A) include distributions: (1) made on or after the date on which the employee attains age 59½, (2) made to a beneficiary on or after the death of the employee, (3) attributable to the employee's being disabled, (4) part of a series of substantially equal periodic payments, (5) made to an employee after separation from service after attainment of age 55, (6) dividends paid with respect to stock of certain corporations, or (7) made on account of an IRS levy on the qualified plan.

14 While tax-exempt organizations may also maintain 457 plans, we will limit our discussion to governmental 457(b) plans here.

15 IRC § 457(d)(1)(A).

16 IRC § 457(d)(1)(A)(iii). If certain requirements are met, participants in 457(b) plans may be eligible to receive an in-service distribution of \$5,000 or less. IRC § 457(e)(9)(A).

17 Treas. Reg. § 1.457-6(c)(2)(i).

The regulations provide several examples of events that may constitute unforeseeable emergencies, such as the imminent foreclosure of or eviction from a primary residence, the need to pay for medical expenses, or the need to pay for the funeral expenses of a spouse or dependent.¹⁸ However, the regulations specifically note that the purchase of a home or the payment of tuition are not generally unforeseeable emergencies for purposes of this exception.¹⁹

The ten percent additional tax imposed by IRC § 72(t) does not apply to 457(b) plans because a 457(b) plan is not included in the definition of a “qualified retirement plan” under IRC § 4974(c).²⁰

Roth IRAs

In general, a distribution from a Roth IRA is only includable in taxable income if it exceeds the IRA owner’s basis in the IRA and is not a “qualified distribution.”²¹ For this purpose, a qualified distribution includes a distribution that is:

1. Made on or after the date on which the owner attains age 59½;
2. Made to a beneficiary or the estate of the owner on or after the date of the owner’s death;
3. Attributable to the individual’s being disabled; or
4. Made for a first-time home purchase.²²

Distributions from a Roth IRA that are not qualified distributions are generally includable in taxable income to the extent the distribution exceeds the contributions to the Roth IRA and are generally subject to a ten percent tax, in addition to the ordinary income taxes on the distribution.²³ There are several statutory exceptions to the ten percent additional tax under IRC § 72(t) that include distributions that are attributable to death or disability, certain medical expenses, first-time homebuyer expenses, qualified higher education expenses, health insurance expenses of unemployed individuals, or as part of a series of substantially equal periodic payments.²⁴

18 Treas. Reg. § 1.457-6(c)(2)(i).

19 *Id.*

20 IRC § 72(t)(1).

21 See IRC § 408A(d).

22 IRC § 408A(d)(2)(A) and (d)(5).

23 See IRC §§ 408A(d)(1) and 408A(d)(4)(B); IRC § 72(t).

24 IRC § 72(t)(2).

Figure 2.12.1 lists certain hardship withdrawal exceptions to IRC § 72(t).

FIGURE 2.12.1, Certain Exceptions to IRC § 72(t) Ten Percent Additional Tax for Early Distributions

	Exception	Limitations
IRC § 72(t)(2)(A)(iii)	Attributable to the employee being disabled	Medically determinable physical or mental impairment to be of long-continued and indefinite duration
IRC § 72(t)(2)(B)	Medical expenses	Distribution may not exceed amount allowable as a deduction under IRC § 213
IRC § 72(t)(2)(D)	Health insurance premiums for unemployed individuals	Distribution allowable after individual has received unemployment compensation for 12 consecutive weeks
IRC § 72(t)(2)(E)	Higher education expenses	Qualified higher education expenses (e.g., tuition, fees, books, supplies, equipment) of the taxpayer, taxpayer's spouse, or child/grandchild of taxpayer or spouse
IRC § 72(t)(2)(F)	First-time home purchases	No ownership interest in a principal residence during prior two-year period
IRC § 72(t)(2)(G)	Called to active duty	Qualified reservist distribution may be made at any time during the two-year period after the end of an active duty period

Figure 2.12.2 summarizes the early withdrawal provisions of certain tax-advantaged retirement vehicles.

FIGURE 2.12.2, Summary of Early Withdrawal Provisions of Certain Tax-Advantaged Retirement Plans and Arrangements

	401(k)	457(b) Governmental Plans	Roth IRA
Who is eligible?	Employees of all non-governmental employers	Employees and independent contractors of state & local governments	Individuals (subject to income limitations if covered by employer-provided retirement plan)
Hardship withdrawal allowed while employed or before age 59½?	Yes, if distribution is necessary to satisfy “immediate and heavy financial need”	Yes, for “unforeseeable emergency”	Yes
10% additional tax assessed?	Yes	No	Yes, to the extent the distribution exceeds contributions, except in cases of death or disability, certain medical expenses, first-time homebuyer expenses, qualified higher education expenses, health insurance expenses of unemployed individuals, or as part of a series of substantially equal periodic payments

In summary, 401(k) plan participants are able to take an early distribution of their elective deferrals while still employed with the employer maintaining the plan “upon hardship of the employee,”²⁵ but such distributions may be subject to the ten percent additional tax on early distributions if made before age 59½.²⁶ Participants in 457(b) plans are permitted to take an early distribution of their entire benefit for “unforeseeable emergencies,” and those distributions, like all 457(b) distributions, are not subject to the ten percent additional tax.²⁷ IRAs (including Roth IRAs) are not required to limit early distributions to the account beneficiary.²⁸ However, such distributions are subject to the ten percent additional tax, unless an exception applies.²⁹

25 IRC § 401(k)(2)(B)(i)(IV).

26 IRC § 72(t).

27 IRC § 457(d)(1)(A)(iii).

28 IRC §§ 408(d) and 408A(d).

29 IRC § 72(t)(1).

REASONS FOR CHANGE

The rules covering tax-advantaged retirement plans and arrangements are among the most intricate and complex rules of the tax code and associated regulations.³⁰ In particular, the hardship withdrawal provisions for certain tax-advantaged retirement plans and arrangements lack uniformity and may cause confusion among plan participants. By establishing uniform rules regarding the availability and tax consequences of hardship withdrawals from tax-advantaged plans, Congress will reduce complexity and eliminate meaningless distinctions between the types of plans that may be offered by different types of employers.

As noted above, some retirement plans allow participants to receive an early distribution in cases of financial hardship, such as a medical emergency. There is no uniform definition of “hardship” among the various retirement plans that would enable a participant to easily determine when an early withdrawal is allowable. Even if a plan allows for a hardship withdrawal, participants must deal with inconsistent rules for triggering the ten percent additional tax for early withdrawal imposed by IRC § 72(t).

EXPLANATION OF RECOMMENDATIONS

To ensure taxpayers’ *right to a fair and just tax system*, the National Taxpayer Advocate recommends that Congress establish uniform rules regarding the availability of hardship withdrawals from tax-advantaged retirement plans and arrangements. These scenarios are common examples of when a taxpayer faces an unforeseen emergency that would require him or her to tap into funds earmarked for retirement savings:

1. Expenses for medical care incurred by the employee, the employee’s spouse, or dependents;
2. Payments necessary to prevent the eviction of the employee from his or her principal residence or foreclosure on the mortgage on that residence;
3. Loss of property due to casualty;
4. Basic living expenses of low income taxpayers (those at or below the 250 percent of the federal poverty guidelines); or
5. Financial hardship resulting from an extended period of unemployment.

Admittedly, it will be impossible to identify all possible instances of unforeseen emergencies, and there may be disagreement as to what is “unforeseen.” For example, we are not including educational expenses as an unforeseen emergency that would qualify as a hardship withdrawal. Congress, in its discretion, could authorize withdrawals for other situations. If it does, it should apply the exception uniformly to all tax-advantaged retirement vehicles and exempt the exception from the ten percent additional tax uniformly.

30 Part of this complexity arises because retirement plans fall under the jurisdiction of three federal agencies — the IRS, the Department of Labor, and the Pension Benefit Guaranty Corporation.

LR #13 WHISTLEBLOWER PROGRAM: Enact Anti-Retaliation Legislation to Protect Tax Whistleblowers

TAXPAYER RIGHTS IMPACTED¹

- The Right to Challenge the IRS's Position and Be Heard
- The Right to Appeal an IRS Decision in an Independent Forum
- The Right to a Fair and Just Tax System

PROBLEM

In recognition of the valuable role whistleblowers can play in detecting underpayments of tax and to encourage whistleblowers to come forward, Internal Revenue Code (IRC) § 7623 permits, and in some cases requires, the IRS to compensate those who report violations of the internal revenue laws.² In this respect, the IRC is similar to the False Claims Act, which allows whistleblowers who report fraud on the government to share in amounts recovered from the wrongdoer.³ In 2006, Congress amended the whistleblower provisions of the IRC to more closely parallel the provisions of the False Claims Act.⁴ However, the IRC, unlike the False Claims Act and unlike whistleblower statutes that apply in other areas of the law, does not protect tax whistleblowers from retaliation.⁵ This lack of protection could impede employees, who may have unique skills and insights, from investigating and ascertaining whether their employers underpay taxes and from reporting those underpayments to the government.

EXAMPLE

While she is employed by X, a whistleblower learns of a tax structure involving X and several related entities and subsidiary companies.⁶ When she raises concerns over the tax structure to X, X uses physical force and armed men to intimidate her, then fires her. The whistleblower reports X and the related entities to the government, assists the government with its tax investigation of X and the related entities, and is subpoenaed to provide documents to the government as part of the investigation. X and the related entities learn of the subpoena (but not the whistleblower's identity) and file multiple retaliatory actions against the whistleblower to ascertain her identity and her role in the tax investigation and to threaten and intimidate her. Defending these actions consumes the whistleblower's time, requires her to incur significant personal expense, and adversely affects her professional reputation. X and the related entities also make death threats against the whistleblower, which forces her to hire counterterrorism experts to advise her family on safety and to protect her on trips abroad.

1 See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 IRC § 7623.

3 False Claims Act, 31 U.S.C. §§ 3729-3733, discussed below.

4 For a discussion of the legislative history of IRC § 7623 and the False Claims Act, see Most Serious Problem: *Whistleblower Program: The IRS Whistleblower Program Does Not Meet Whistleblowers' Need for Information During Lengthy Processing Times and Does Not Sufficiently Protect Taxpayers' Confidential Information from Re-Disclosure by Whistleblowers*, supra.

5 31 U.S.C. § 3730(h), discussed below, contains the anti-retaliation provisions of the False Claims Act.

6 The facts of this example are based on the court's description of events in *Whistleblower 11332-13W v. Comm'r*, T.C. Memo. 2014-92.

There are no IRC provisions affording the whistleblower a remedy for the retaliation she experienced as a consequence of investigating whether X and the related companies underpaid taxes and reporting the underpayments to the government. Other potential whistleblowers faced with this lack of protection from retaliation may hesitate to ascertain whether their employers underpay tax and may decide not to report tax underpayments to the government. Those who do come forward may hesitate to contest the IRS's award determination out of fear that further proceedings will increase the chances their employers will learn their identity and retaliate against them, for which they will have no remedy under the IRC.

RECOMMENDATIONS

To address the lack of a remedy available to tax whistleblowers subject to retaliation, the National Taxpayer Advocate recommends that Congress add a new provision to the IRC modeled on the anti-retaliation provisions of the False Claims Act.

PRESENT LAW

The False Claims Act provides for a civil suit for statutory penalties and damages against a person who “knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval,” and allows a whistleblower to share in the collected proceeds from such a suit.⁷ In 1986, recognizing that “few individuals will expose fraud if they fear their disclosures will lead to harassment, demotion, loss of employment, or any other form of retaliation,” Congress added an anti-retaliation provision to the False Claims Act.⁸ Amendments in 2009 extended anti-retaliation protection to “[a]ny employee, contractor, or agent,” and clarified that the provision:

Protects not only steps taken in furtherance of a potential or actual *qui tam* action, but also steps taken to remedy the misconduct through methods such as internal reporting to a supervisor or company compliance department and refusals to participate in the misconduct that leads to the false claims, whether or not such steps are clearly in furtherance of a potential or actual *qui tam* action.⁹

Further amendments in 2010 supplied a three-year statute of limitations for seeking relief from retaliatory conduct.¹⁰

⁷ See 31 U.S.C. § 3729(a)(1)(A)-(G) for enumerated acts that give rise to liability. Under the False Claims Act, if the government declines to bring a civil suit for statutory penalties and damages on the basis of a whistleblower's information, the whistleblower may bring suit on behalf of the government, in what is referred to as a *qui tam* suit, and share in the collected proceeds. 31 U.S.C. § 3730. Whistleblowers in other areas of the law who are protected from retaliation are not necessarily rewarded for identifying or reporting illicit activity. See Joel D. Hesch, *Whistleblower Rights and Protections: Critiquing Federal Whistleblower Laws and Recommending Filling in Missing Pieces to Form a Beautiful Patchwork Quilt*, 6 Liberty U. L. Rev. 51 (2011), grouping federal whistleblower statutes into six categories: (1) reporting fraud against the government; (2) federal employees reporting violations of laws, waste, or mismanagement; (3) reporting discrimination; (4) reporting violations of environmental laws; (5) reporting conduct adverse to health; and (6) reporting violations of securities law.

⁸ False Claims Amendments Act of 1986, S. Rep. No. 99-345, at 34, reprinted in 1986 U.S.C.C.A.N. 5266, 5299.

⁹ Fraud Enforcement and Recovery Act of 2009 (FERA), Pub. L. No. 111-21, § 4, 123 Stat. 1617, 1621 (2009), extending protection not only to acts taken “in furtherance of an action under this section” but also to acts taken “in furtherance of other efforts to stop 1 or more violations of this subchapter [the False Claims Act]”; 155 Cong. Rec. E1295, 1300 (daily ed. June 3, 2009) (statement of Rep. Berman).

¹⁰ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1079A(c)(2), 124 Stat. 1376, 2077, adding paragraph (3), superseding *Graham Cnty. Soil & Water Conservation Dist. v. U.S. ex rel. Wilson*, 545 U.S. 409 (2005) (holding that the statute of limitations for the most closely analogous state cause of action applies).

As amended, the anti-retaliation provision of the False Claims Act states:

1. In general. – Any employee, contractor, or agent shall be entitled to all relief necessary to make that employee, contractor, or agent whole, if that employee, contractor, or agent is discharged, demoted, suspended, threatened, harassed, or in any other manner discriminated against in the terms and conditions of employment because of lawful acts done by the employee, contractor, agent or associated others in furtherance of an action under this section or other efforts to stop 1 or more violations of this subchapter.
2. Relief. – Relief under paragraph (1) shall include reinstatement with the same seniority status that employee, contractor, or agent would have had but for the discrimination, 2 times the amount of back pay, interest on the back pay, and compensation for any special damages sustained as a result of the discrimination, including litigation costs and reasonable attorneys' fees. An action under this subsection may be brought in the appropriate district court of the United States for the relief provided in this subsection.
3. Limitation on bringing civil action. – A civil action under this subsection may not be brought more than 3 years after the date when the retaliation occurred.¹¹

In addition to federal legislation, many states have anti-retaliation statutes to protect whistleblowers.¹² Notably, New York's False Claims Act proscribes retaliatory conduct by *prospective* employers, important protection for whistleblowers whose chief concern is obtaining and retaining future employment (rather than returning to the job from which they were fired).¹³

The False Claims Act does not apply to tax fraud.¹⁴ The tax whistleblower provision is in IRC § 7623, which Congress amended in 2006 by *requiring* the IRS to pay awards in some cases, creating the IRS Whistleblower Office (WO), and providing for United States Tax Court review of the WO's award determinations.¹⁵ The purpose of the amendments was to encourage tax whistleblowers.¹⁶ In 2012, the Tax Court, recognizing that whistleblowers sometimes face serious threats of retaliation, formalized its procedures for allowing whistleblowers to proceed anonymously.¹⁷ However, neither IRC § 7623 nor any other Code provision contains an anti-retaliation provision.

11 31 U.S.C. § 3730(h).

12 Ethan D. Wohl, *Confidential Informants in Private Litigation: Balancing Interests in Anonymity and Disclosure*, 12 *FORDHAM J. CORP. & FIN. L.* 551, 557 (2007), noting that “forty-seven states have enacted statutes protecting public-sector whistleblowers, and seventeen states also provide some statutory protection for private sector employees who report illegal conduct.”

13 N.Y. State Fin. Law § 191 (2010).

14 31 U.S.C. § 3729(d) provides: “[t]his section does not apply to claims, records, or statements made under the Internal Revenue Code of 1986.”

15 Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432 § 406(a)(1)(D), (b), 120 Stat. 2922, 2958-2959 (adding subsection (b) to IRC § 7623 and in an “off-Code” provision creating the Whistleblower Office); IRC § 7623(b)(4) (providing for Tax Court review of the IRS's award determination).

16 See *Grassley Says IRS, Treasury Need to Put Out “Welcome Mat” for Whistleblowers*, 2006 TNT 112-96 (June 12, 2006).

17 See *Whistleblower 14106-10-W v. Comm’r*, 137 T.C. 183, 203 (2011), noting the anti-retaliation provision of the False Claims Act, the existence of state statutes protecting workers who report illegal conduct from retaliation, and the “stark” contrast with the lack of an anti-retaliation provision in IRC § 7623; U.S. Tax Court Rules of Practice and Procedure, Rule 345, *Privacy Protections for Filings in Whistleblower Actions* (effective July 6, 2012); see also U.S. Tax Court, *Press Release* (Dec. 28, 2011), available at www.ustaxcourt.gov/press/122811.pdf (discussing the adoption of a new Rule 345).

REASONS FOR CHANGE

Employees may be uniquely qualified to detect their employers' underpayments of tax, and in many instances, the only way the IRS would know about a given transaction or behavior is because someone blew the whistle. Congress, by amending IRC § 7623 in 2006, intended to encourage tax whistleblowers to come forward. However, if the employer learns of an employee's investigation or that the employee reported its tax underpayments to the government, then retaliation against the employee may ensue. The Tax Court recognized this reality and adjusted its rules accordingly.¹⁸ Despite the IRS's and Tax Court's measures to protect whistleblowers' identities, it may not be difficult for an employer to determine who, out of a small group of informed employees, came forward to the IRS. As one district court judge observed:

The case law, academic studies, and newspaper accounts well document the kind of treatment that is usually visited upon public and private employees who speak out as a matter of conscience on issues of public concern. For example, a six-year study on whistleblowers by Myron Peretz Glazer and Penina Migdal Glazer details the full spectrum of management retaliation against ethical resisters who speak out against company or government policy and the long-term adverse consequences such employees can face. See Myron Peretz Glazer and Penina Migdal Glazer, *The Whistleblowers: Exposing Corruption in Government and Industry* 231 (1990) (study of sixty-four whistleblowers showed significant percentage "remain out of work or underemployed, bitter about their punishment, and uncertain of ever being able to restore their lives fully").¹⁹

Faced with the possibility of retaliation, for which the IRC provides no remedy, tax whistleblowers may be reluctant to investigate or report tax underpayments. The lack of an anti-retaliation provision may undermine Congress's efforts to encourage tax whistleblowers. The lack of such a provision may also have a chilling effect on whistleblowers' willingness to challenge the IRS's determination of the amount of their award. A whistleblower may prefer to truncate or avoid altogether any administrative or judicial proceeding, fearing an increased likelihood his or her identity will become known and will result in retaliation for which there will be no remedy under the IRC.

EXPLANATION OF RECOMMENDATIONS

The proposal would require a new IRC provision or the amendment of an existing provision to provide a remedy for a tax whistleblower who is subjected to retaliation for investigating or reporting underpayments of tax. The provision could be modeled on section 3730(h) of the False Claims Act, and could further be made applicable to prospective employers. Providing protection from retaliation to tax whistleblowers would place them on similar footing as whistleblowers in other areas of the law, would further Congress's objective of encouraging them to come forward, and would support their rights to pursue administrative and judicial review of the IRS's award determination.

18 See *Whistleblower 14106-10-W v. Comm'r*, 137 T.C. 183, 201 (2011), quoting *Mgmt. Info. Technologies, Inc. v. Alyeska Pipeline Serv., Co.*, 151 F.R.D. 478, 481 (D.D.C. 1993).

19 *Mgmt. Info. Technologies, Inc. v. Alyeska Pipeline Serv., Co.*, 151 F.R.D. 478, 481 (D.D.C. 1993).

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WHISTLEBLOWER PROGRAM: Make Unauthorized Disclosures of Return Information by Whistleblowers Subject to the Penalties of IRC §§ 7431, 7213, and 7213A, Substantially Increase the Amount of Such Penalties, and Make Whistleblowers Subject to the Safeguarding Requirement of IRC § 6103(p)

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Confidentiality*

PROBLEM

In 1976, when Congress amended Internal Revenue Code (IRC) § 6103 to generally prohibit the disclosure of tax return or return information, it also enacted what is now IRC § 7431, authorizing civil suits for damages for knowing or negligent unauthorized disclosures, and enhanced IRC § 7213, a criminal enforcement provision that penalizes willful unauthorized disclosures.² The maximum amount of statutory damages (\$1,000) or fines (\$5,000) under these provisions has remained the same for almost four decades. In 1997, Congress added IRC § 7213A, criminalizing the willful unauthorized inspection of returns or return information; eighteen years later, the \$1,000 maximum fine under this provision is the same.³

The Internal Revenue Service (IRS) discloses taxpayers' returns and return information to whistleblowers pursuant to exceptions to IRC § 6103.⁴ However, a whistleblower is not subject to the civil or criminal penalty provisions of IRC §§ 7431, 7213, or 7213A for unauthorized inspection or re-disclosure of that information. Tax whistleblowers are also not subject to the safeguarding requirements of IRC § 6103(p).

EXAMPLE

Whistleblower X, while assisting the IRS in detecting A's underpayments of tax, acquires return information about A, such as:

- The reporting positions on A's return that resulted in the underpayments;
- Other items on A's tax return, including A's earnings, the identity of A's dependents, the amount of alimony A claimed as a deduction, A's religious and political affiliations, and the recipients of A's charitable donations;
- A's tax compliance history, including the fact that A was audited several times over the past ten years and assessed additional amounts; and
- Communications between A and the IRS that would be embarrassing to A if made public.

1 See Taxpayer Bill of Rights available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976), in § 1202(a) amending IRC § 6103; in § 1202(e) enacting IRC § 7217, later redesignated as IRC § 7431, authorizing civil suits for damages; and in § 1202(d) amending IRC § 7213(a) to make willful unauthorized disclosure of return information a felony rather than a misdemeanor, increase the maximum imprisonment from one year to five years, and increase the maximum fine from \$1,000 to \$5,000, among other things.

3 Taxpayer Browsing Protection Act, Pub. L. No. 105-35, § 2(a), 111 Stat. 1104 (1997), authorizing imposition of a maximum fine of \$1,000 and imprisonment of up to one year.

4 See, e.g., IRC § 6103(k)(6) and (h)(4), discussed below.

X does not take any measures to safeguard A's return information, such as maintaining a secure place to store it, restricting access to it, or returning or destroying the information when there is no longer a need for it.

Pursuant to IRC § 7623(b), X receives a portion of the proceeds the IRS collects after auditing A and assessing additional amounts. Thereafter, X makes public the return information he learned about A while assisting the IRS. IRC § 7431 provides for civil suits for the unauthorized inspection or disclosure of return information by IRS employees, among others, but with one exception not present here, the statute does not specifically apply to whistleblowers.⁵ Even if A could bring suit against X pursuant to IRC § 7431, A's recovery may not sufficiently compensate him or aid in the enforcement of confidentiality rules.

RECOMMENDATIONS

To address the lack of an effective remedy for injury sustained by taxpayers whose return information is inspected or disclosed by a tax whistleblower without authorization, and to aid in the enforcement of the confidentiality rules, the National Taxpayer Advocate recommends that Congress:

1. Amend IRC §§ 7431, 7213, and 7213A to provide that any whistleblower (*i.e.*, a person making a claim for award under IRC § 7623) or legal representative of a tax whistleblower who receives a taxpayer's return or return information pursuant to an exception under IRC § 6103 is subject to the civil and criminal penalty provisions of IRC §§ 7431, 7213, and 7213A for the unauthorized inspection or disclosure of that information;
2. Amend IRC § 7431, which authorizes a civil suit for the negligent or knowing unauthorized inspection or disclosure of return or return information, to increase statutory damages to a more substantial amount, such as \$5,000, for violations by tax whistleblowers seeking or obtaining an award pursuant to IRC § 7623(b);
3. Amend IRC §§ 7213 and 7213A, which sanction willful unauthorized disclosure or inspection of return or return information, to increase the maximum amount of fines to more substantial amounts, such as \$20,000 and \$1,500, respectively; and
4. Amend IRC § 6103(p) to make tax whistleblowers subject to its safeguarding requirements.

PRESENT LAW

Prior to 1976, income tax returns were "public records," open to inspection under regulations approved by the President, or under Presidential order.⁶ The Senate Finance Committee, in its report on H.R. 10612, the Tax Reform Act of 1976, proposed significant revisions to the treatment of tax returns and other information, noting:

Although present law describes income tax returns as "public records", open to inspection under regulations approved by the President, or under Presidential order, the committee felt that returns and return information should generally be treated as confidential and not subject

⁵ The exception is when the IRS enters into a contract, sometimes referred to as a "tax administration contract" with a whistleblower pursuant to IRC § 6103(n). See Treas. Reg. § 301.6103(n)-2(c). The IRS has never entered into a tax administration contract with a tax whistleblower.

⁶ S. REP. No. 94-938, 94th Cong., 2d Sess. (1976) at 318.

to disclosure except in those limited situations delineated in the newly amended section 6103 where the committee decided that disclosure was warranted.⁷

The Tax Reform Act of 1976 changed several aspects of IRC § 6103 (*e.g.*, by broadly defining “return” and “return information”), and added or amended other code sections to enhance enforcement of the nondisclosure rules.⁸ However, the Act did not extend the restrictions on disclosure to everyone who receives returns or return information; IRC § 6103 contains no provision concerning disclosures by whistleblowers specifically. Moreover, existing exceptions to the general rule of nondisclosure that allow the IRS to disclose return information to whistleblowers were left undisturbed. For example, IRC § 6103(k)(6) allows what are sometimes referred to as “investigative disclosures,” necessary to obtain information related to the IRS’s official duties or to accomplish properly any activity connected with such official duties. IRC § 6103(h)(4) allows the IRS to disclose returns and return information during an administrative proceeding, including a whistleblower administrative proceeding.⁹ A whistleblower and the IRS may enter into a contract under IRC § 6103(n), sometimes referred to as a “tax administration” contract, for the whistleblower’s services relating to the detection of violations of the internal revenue laws or related statutes, and the IRS may disclose return information in connection with the contract.

The 1976 Act added IRC § 7217, later designated IRC § 7431, “to redress any injury sustained and to aid in the enforcement of the confidentiality rules.”¹⁰ The statute provides that a taxpayer whose return or return information was knowingly or negligently inspected or disclosed in violation of IRC § 6103 may recover actual damages or statutory damages of \$1,000, as well as court costs and attorney’s fees, for such unauthorized inspection or disclosure. Congress provided for recovery of statutory damages in recognition of “the difficulty in establishing in monetary terms the damages sustained by a taxpayer as the result of the invasion of his privacy caused by an unlawful disclosure of his returns or return information.”¹¹

7 S. REP. No. 94-938, 94th Cong., 2d Sess. (1976) at 318.

8 As amended, IRC § 6103(b)(1) defines “return” as “any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for or permitted under, the provisions of this title which is filed with the Secretary by, on behalf of, or with respect to any person, and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed.” IRC § 6103(b)(2)(A) defines “return information” to include “a taxpayer’s identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer’s return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.” See Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, 94th Cong., 2d Sess., 343 (Dec. 29, 1976), noting that “Congress decided that the prior provisions of law designed to enforce the rules against the improper use or disclosure of returns and return information were inadequate.”

9 Treas. Reg. § 301.6103(h)(4)-1. The IRS’s notification to the whistleblower of a preliminary, or proposed, award through a preliminary award recommendation letter, which the whistleblower may dispute, is the beginning of an IRC § 6103(h)(4) administrative proceeding. Treas. Reg. § 301.7623-3(b)(1); Treas. Reg. § 301.7623-3(c)(1). Issuance of a preliminary denial letter or preliminary rejection letter in IRC § 7623(b) cases also marks the beginning of a whistleblower administrative proceeding. See Treas. Reg. § 301.7623-3(c)(7) and (8). The National Taxpayer Advocate recommends revising the regulations under IRC § 7623 to provide that a whistleblower administrative proceeding, within the meaning of IRC § 6103(h)(4) commences, with the whistleblower’s submission of Form 211, *Application for Award for Original Information*. See Most Serious Problem: *Whistleblower Program: The IRS Whistleblower Program Does Not Meet Whistleblowers’ Need for Information During Lengthy Processing Times and Does Not Sufficiently Protect Taxpayers’ Confidential Information from Re-Disclosure by Whistleblowers*, *supra*.

10 S. REP. No. 94-938, 94th Cong., 2d Sess. (1976) at 347; Tax Reform Act of 1976, Pub. L. No. 94-455, § 1202(e), 90 Stat. 1520, 1687 (1976). IRC § 7217 was redesignated as IRC § 7431 by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248, § 357, 96 Stat 324, 645-6.

11 Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, 94th Cong., 2d Sess., 345 (Dec. 29, 1976).

The statute also provides for recovery of punitive damages if the inspection or disclosure was willful or the result of gross negligence.¹²

As noted, IRC § 7431 applies to inspections and disclosures “in violation of any provision of IRC § 6103,” and thus does not generally apply to disclosures by whistleblowers, who are not generally subject to the nondisclosure rules of IRC § 6103.¹³ An exception to this general rule is where a tax whistleblower discloses a taxpayer’s return or return information obtained in connection with a contract authorized by IRC § 6103(n). In that situation, regulations provide that the civil remedies afforded by IRC § 7431 would be available to a taxpayer whose return or return information was re-disclosed by the whistleblower.¹⁴ However, the IRS has never entered into an IRC § 6103(n) contract with a tax whistleblower.

The 1976 Act also adjusted IRC § 7213(a) to make the willful disclosure of returns or return information a felony rather than a misdemeanor, increase the maximum imprisonment from one year to five years, and increase the maximum fine from \$1,000 to \$5,000.¹⁵ The sanction applies to, among others, federal and state employees, and would apply to a tax whistleblower with whom the IRS entered into a contract pursuant to IRC § 6103(n).¹⁶ Where disclosure of return information to a whistleblower violates the law, *e.g.*, disclosure by a federal employee in violation of IRC § 6103, the whistleblower would be subject to the penalty for publishing the information.¹⁷ However, the sanction does not apply to whistleblowers who acquire return information legitimately pursuant to IRC § 6103(k)(6) or (h)(4) and then re-disclose the information.

In 1997, Congress further protected taxpayers’ returns and return information by enacting IRC § 7213A, a new criminal penalty providing for a fine of up to \$1,000 and imprisonment of up to one year for willful unauthorized inspection of any tax return or return information.¹⁸ Like IRC § 7213, this penalty would apply to tax whistleblowers with whom the IRS entered into a contract pursuant to IRC § 6103(n), but does not apply to tax whistleblowers who acquire return information pursuant to IRC § 6103(k)(6) or (h)(4).¹⁹

12 In 1982, Congress redesignated this statute as IRC § 7431 and amended it to provide that if a U.S. officer or employee knowingly or negligently discloses return information in violation of the disclosure restrictions, the wronged party will be permitted to bring a civil action for damages against the U.S. (rather than against the officer or employee). If a person other than a federal employee violates IRC § 7431, a suit may be brought against that person in District Court. The provisions setting the amount of liquidated damages was left unchanged. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248, § 357, 96 Stat. 324, 645-6.

13 IRC § 7431(a)(2) provides: “If any person who is not an officer or employee of the United States knowingly, or by reason of negligence, inspects or discloses any return or return information with respect to a taxpayer *in violation of any provision of section 6103* or in violation of section 6104(c), such taxpayer may bring a civil action for damages against such person in a district court of the United States” (emphasis added).

14 Treas. Reg. § 301.6103(n)-2(c).

15 Tax Reform Act of 1976, Pub. L. No. 94-455, § 1202(d), 90 Stat. 1520, 1686-7 (1976).

16 IRC § 7213(a)(1), (2); see also Treas. Reg. § 301.6103(n)-2(c).

17 IRC § 7213(a)(3) provides: “Other persons: It shall be unlawful for any person to whom any return or return information (as defined in section 6103(b)) is disclosed in a manner unauthorized by this title thereafter willfully to print or publish in any manner not provided by law any such return or return information.”

18 Taxpayer Browsing Protection Act, Pub. L. No. 105-35, § 2(a), 111 Stat. 1104 (1997).

19 IRC § 7213A(a)(1)(B); see also Treas. Reg. § 301.6103(n)-2(c).

The 1976 Act also amended IRC § 6103 to impose safeguarding requirements on Federal and State agencies, among others, that receive return information pursuant to exceptions to IRC § 6103.²⁰ The safeguarding requirements were intended as “a comprehensive system of administrative, technical, and physical safeguards designed to protect the confidentiality of the returns and return information and to make certain that they are not used for purposes other than the purposes for which they were disclosed.”²¹ Affected recipients of return information are required, as a condition of receiving the information, to explain how they will safeguard it.²² Thereafter, they are required to maintain a secure area for storing the return information, restrict access to it, return or destroy it when they are finished with it, and “provide such other safeguards which the Secretary determines (and which he prescribes in regulations) to be necessary or appropriate to protect the confidentiality of the returns or return information.”²³ The safeguarding provisions of IRC § 6103(p)(4) do not apply to whistleblowers specifically. A whistleblower who receives return information in connection with an IRC § 6103(n) contract, however, would be subject to separate safeguard provisions, including the requirement, as a condition to disclosure, that the whistleblower “permit an inspection of the whistleblower’s or the legal representative’s premises by the IRS.”²⁴

In 2006, Congress significantly expanded the reach of IRC § 7623, which authorizes the IRS to pay awards to tax whistleblowers who assist it in detecting underpayments of tax or “detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same.”²⁵ Under IRC § 7623(a), the IRS has discretionary authority to make awards to whistleblowers. The 2006 amendments added subsection (b) to the statute, making whistleblower awards mandatory in certain cases, generally specifying an award amount from 15 to 30 percent of the tax recovered (with no cap on the amount of the award), creating the IRS Whistleblower Office (WO), and providing for United States Tax Court review of whistleblower award determinations.²⁶ The new provision generally applies if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed \$2,000,000.²⁷

REASONS FOR CHANGE

Since 2006, when Congress enhanced the provisions of IRC § 7623 by adding subsection (b), whistleblowers have responded by seeking awards pursuant to subsection (b), as well as continuing to seek discretionary awards under subsection (a).²⁸ Although the IRS shares return information with whistleblowers pursuant to exceptions to the general rule of nondisclosure under IRC § 6103, it has never entered into a tax administration contract with a whistleblower pursuant to IRC § 6103(n). Thus, in the event a whistleblower re-discloses return information legitimately acquired pursuant to an IRC § 6103 exception,

20 Tax Reform Act of 1976, Pub. L. No. 94-455, § 1202(a), 90 Stat. 1520, 1683-4 (1976), adding subsection (p)(4) to IRC § 6103.

21 Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, 94th Cong., 2d Sess., 341 (Dec. 29, 1976).

22 IRC § 6103(p)(4)(E).

23 IRC § 6103(p)(4)(B-D, F).

24 Treas. Reg. § 301.6103(n)-2(d)(3).

25 IRC § 7623(a).

26 Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432 § 406(b), 120 Stat. 2922, 2958-9, adding subsection (b) to IRC § 7623, including subsection (b)(4) which provides for Tax Court review of the IRS’s award determination, and creating the Whistleblower Office in an “off-Code” provision. IRC § 7623(b)(2) and (3) authorize awards of less than 15 percent in certain cases.

27 IRC § 7623(b)(5). If the award is made with respect to an individual taxpayer, the individual’s gross income must exceed \$200,000 for any taxable year subject to the IRS’s action.

28 See Most Serious Problem: *Whistleblower Program: The IRS Whistleblower Program Does Not Meet Whistleblowers’ Need for Information During Lengthy Processing Times and Does Not Sufficiently Protect Taxpayers’ Confidential Information from Re-Disclosure by Whistleblowers*, *supra*.

no provision in the IRC provides for a civil suit against the whistleblower, and the whistleblower is not subject to any criminal sanction under the Code. That whistleblowers are not subject to the safeguarding provisions of IRC § 6103(p)(4) leaves taxpayers at an even greater risk of dissemination of their confidential return information.

Even if they applied to whistleblowers who do not have an IRC § 6103(n) contract, the maximum amount of statutory damages (\$1,000) and fines (\$5,000) imposed by IRC §§ 7431, 7213, and 7213A are insufficient to “redress any injury” or “aid in the enforcement of the confidentiality rules.” The \$1,000 maximum amount of statutory damages under IRC § 7431 and the \$5,000 maximum fine imposed by IRC § 7213 were both established in 1976, four decades or so ago. The same amounts in 2015 dollars, adjusted for inflation, are about \$4,000 and \$21,000, respectively.²⁹ The \$1,000 maximum fine under IRC § 7213A has been in place since 1997, and is about \$1,500 in 2015 dollars.³⁰

EXPLANATION OF RECOMMENDATIONS

The proposals would make the provisions of IRC §§ 7431, 7213, and 7213A applicable to whistleblowers whether or not the whistleblower has entered into an IRC § 6103(n) contract, and would make the safeguarding provisions of IRC § 6103(p)(4) applicable to such whistleblowers. These changes are intended to protect taxpayers’ fundamental right to confidentiality and thereby enhance voluntary reporting and compliance with the tax laws.

The statutory minimum award to a whistleblower under IRC § 7623(b), where the amount in dispute must be at least \$2 million, is generally 15 percent of the collected proceeds. Whistleblowers who seek these awards should be subject to greater liability if they re-disclose returns or return information they obtained while earning, or attempting to earn, their award, or in the award determination process. Thus, the proposal would increase the amount of statutory damages provided by IRC § 7431 to a more substantial amount, such as \$5,000, for violations by whistleblowers who request awards under IRC § 7623(b).

The penalties imposed by IRC §§ 7213 and 7213A apply to willful behavior, and the existing fines, which have been unchanged for decades, are insufficient to punish or deter it. Thus, the proposal would increase the amount of these fines to more substantial amounts, such as \$20,000 and \$1,500, respectively.

29 When adjusted for inflation, \$1,000 in 1976 is worth \$4,166 in 2015, and \$5,000 in 1976 is worth \$20,829 in 2015. TAS Research (Dec. 3, 2015).

30 When adjusted for inflation, \$1,000 in 1997 is worth \$1,477 in 2015. TAS Research (Dec. 3, 2015).

LR
#15

WHISTLEBLOWER PROGRAM: Amend IRC §§ 7623 and 6103 to Provide Consistent Treatment of Recovered Foreign Account Tax Compliance Act (FATCA) and Report of Foreign Bank and Financial Accounts (FBAR) Penalties for Whistleblower Award Purposes

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Confidentiality*
- *The Right to a Fair and Just Tax System*

PROBLEM

Pursuant to two separate statutory regimes, U.S. taxpayers may be required to report their ownership of foreign bank accounts to the government.² If the foreign account balance exceeds \$10,000 at any time during the year, the taxpayer must file an FBAR, pursuant to provisions of Title 31 of the U.S. Code.³ If the balance exceeds \$75,000 at any time during the year or exceeds \$50,000 on the last day of the year, the same taxpayer, if an individual living in the U.S., must again report the foreign account, this time on IRS Form 8938, *Statement of Specified Foreign Financial Assets*.⁴ Filing Form 8938 is required pursuant to provisions of FATCA, codified in the Internal Revenue Code (IRC), which is Title 26 of the U.S. Code.⁵ Both the FBAR and FATCA statutory regimes impose penalties on foreign account holders for failing to report as required, and the IRS may assess and collect penalties under both statutes for the same failure to report.⁶

The IRC permits, and in some cases requires, the IRS to pay an award to whistleblowers who provide information that assists the IRS “in detecting underpayments of tax, or detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same.”⁷ The amount of the award, paid “from the proceeds of amounts collected,” or “collected proceeds,” takes into account

1 See Taxpayer Bill of Rights, available at www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Bank Records and Foreign Transactions Act, better known as the Bank Secrecy Act (BSA), Pub. L. No. 91-508, 84 Stat. 1114 (1970), portions of which are codified at 31 U.S.C. §§ 5311-5332; FATCA, enacted as part of Title V of the Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010).

3 31 U.S.C. § 5314.

4 See Treas. Reg. § 1.6038D-2(a) (containing other thresholds for married taxpayers filing a joint return and those living abroad).

5 FATCA, Pub. L. No. 111-147, § 511(a), 124 Stat. 71, 109 (2010), adding IRC § 6038D to the IRC. As discussed below, FATCA also requires foreign financial institutions (FFIs), in order to avoid withholding on certain U.S. source income, to report to the U.S. government accounts with balances in excess of \$50,000 belonging to U.S. persons. See IRC § 1471.

6 31 U.S.C. § 5322; IRC § 6038D(d). The authority to assess and collect FBAR penalties has been delegated to the IRS. 31 C.F.R. § 1010.810(g). The National Taxpayer Advocate has questioned the appropriateness of twice penalizing the same failure to report, noting “penalizing someone more than once for essentially the same mistake—failing to report a foreign account—may be considered stacking, which is generally not viewed as an effective way to promote compliance, in part because it is perceived as confusing, disproportionate, and unfair.” National Taxpayer Advocate 2014 Annual Report to Congress 335 (Legislative Recommendation: *FBAR Forms: Reduce the Burden of Foreign Account Reporting*).

7 IRC § 7623.

penalties the IRS collected for violations of FATCA.⁸ However, the award does not take into account penalties the IRS collected for FBAR violations.⁹ This imbalance may discourage whistleblowers from reporting foreign bank accounts to the IRS.

EXAMPLE

A U.S. citizen with dual nationality, X, owns a foreign bank account that had a \$10 million balance throughout 2015. X reports on Schedule B of his U.S. tax return that he does not own a foreign bank account and he does not file an FBAR with respect to the account. Pursuant to an agreement with the IRS, X's bank reports to the IRS the names of its account owners who are U.S. persons. Because X has concealed from his bank the fact that he is a U.S. citizen, however, the bank does not report X's account to the IRS. A tax whistleblower, Y, informs the IRS of X's foreign bank account. The IRS verifies the existence of the account and the account balances and assesses against X a \$10,000 penalty for failing to report the account as required by FATCA. The IRS also assesses against X a penalty of \$5 million for failing to file an FBAR. The IRS collects both penalty amounts. Because the IRS would not have known of the bank account had Y not come forward, and because Y meets the other requirements for obtaining an award under IRC § 7623, the IRS proposes to award Y a portion of the \$10,000 FATCA penalty it collected from X. The IRS will not award Y any of the \$5 million FBAR penalty it collected from X.

RECOMMENDATIONS

To address the inconsistency with which amounts collected by the IRS on the basis of whistleblower information are included in a whistleblower award, the National Taxpayer Advocate recommends that Congress amend IRC § 7623 to provide that the terms “proceeds of amounts collected” and “collected proceeds” include civil penalties recovered pursuant to 31 U.S.C. § 5321 for failing to file an FBAR. Information the IRS receives as part of its FBAR investigation should be designated as return or return information within the meaning of IRC § 6103, subject to the same limitations on disclosure, and whistleblowers should be subject to existing penalties for the unauthorized use or re-disclosure of such information.¹⁰

PRESENT LAW

FBAR Reporting Requirements

31 U.S.C. § 5314 authorizes the Secretary of the Treasury to require U.S. citizens, residents, and entities to report their foreign bank accounts.¹¹ Under this authority, the Secretary of the Treasury developed Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts (FBAR)*, requiring information about all foreign accounts exceeding \$10,000 at any time during the calendar year.¹² Under

8 IRC § 7623.

9 See PMTA 2012-10 (Apr. 23, 2012).

10 See Legislative Recommendation: *Whistleblower Program: Make Unauthorized Disclosures of Return Information by Whistleblowers Subject to the Penalties of IRC §§ 7431, 7213, and 7213A, Substantially Increase the Amount of Such Penalties, and Make Whistleblowers Subject to the Safeguarding Requirements of IRC § 6103(p), supra.*

11 31 U.S.C. § 5314(a) provides: “the Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency. The records and reports shall contain the following information in the way and to the extent the Secretary prescribes...”

12 31 C.F.R. § 1010.350. FBARs are now filed electronically on FinCEN Form 114, *Report of Foreign Bank and Financial Accounts (FBAR)*, available at http://www.fincen.gov/forms/bsa_forms/.

31 U.S.C. § 5321(a)(5)(C), a person who willfully violates the requirement to file an FBAR is subject to a penalty equal to the greater of \$100,000 or 50 percent of the account balance, with no ceiling on the amount of the penalty.¹³ The Financial Crimes Enforcement Network (FinCEN), a bureau of the Department of the Treasury tasked with enforcing the FBAR provisions, delegated its authority to enforce FBAR provisions to the IRS in 2003.¹⁴

FATCA Reporting Requirements

U.S. citizens, resident aliens, and certain non-resident aliens with certain assets, such as foreign bank accounts, in excess of a specified threshold must file IRS Form 8938.¹⁵ A person who fails to make the required disclosure on Form 8938 is subject to a penalty of \$10,000, which rises as high as \$60,000 if the nondisclosure continues after notification from the IRS.¹⁶ Form 8938, as the Government Accountability Office (GAO) has observed, duplicates much of the information required on the FBAR.¹⁷ The National Taxpayer Advocate has recommended coordinating the two regimes by raising the FBAR filing threshold to \$50,000 and aligning the two reporting requirements so that one form could be used to report affected accounts.¹⁸

In addition to requiring the foreign account holder to file Form 8938, FATCA generally requires foreign financial institutions (FFIs) to report to the U.S. government information about individual account holders who are U.S. persons and whose accounts exceed \$50,000.¹⁹

Awards to Whistleblowers

Both Title 31 and the IRC authorize the payment of awards to whistleblowers. Under 31 U.S.C. § 5323, which the IRS does not administer, the payment of such an award, which cannot exceed \$150,000, is discretionary.²⁰ Funds for such awards must be appropriated (*i.e.*, paying the awards must be separately

13 Under 31 U.S.C. § 5321(a)(5)(A), the Secretary of the Treasury has discretion to impose a penalty of up to \$10,000 for non-willful violations. Criminal sanctions for failing to file FBARs also apply, and can result in penalties of up to \$500,000. See 31 U.S.C. § 5322(a), (b) (providing for a penalty of up to \$250,000 and imprisonment of up to five years for willful violations and a penalty of up to \$500,000 and imprisonment of up to ten years for willful violations “while violating another law of the United States or as part of a pattern of any illegal activity involving more than \$100,000 in a 12-month period”). As discussed in PMTA 2012-10 (Apr. 23, 2012), pursuant to 42 U.S.C. § 10601(b)(1), such amounts are currently paid into the Crime Victims Fund. This proposal does not include making these recovered criminal fines subject to awards under IRC § 7623.

14 31 U.S.C. § 310; 31 C.F.R. § 1010.810(g).

15 IRC § 6038D; Treas. Reg. § 1.6038D-2(a)(1)-(4). An unmarried taxpayer living in the U.S. must file a Form 8938 if the total value of the taxpayer’s specified foreign financial assets is more than \$50,000 on the last day of the tax year or more than \$75,000 at any time during the tax year. This threshold is doubled in the case of specified individuals who are married filing jointly. A qualifying unmarried taxpayer living abroad must file a Form 8938 if the total value of the taxpayer’s specified foreign financial assets is more than \$200,000 on the last day of the tax year or more than \$300,000 at any time during the tax year. This threshold is doubled as well in the case of qualified individuals living abroad who are married filing jointly.

16 IRC § 6038D(d)(1) and (d)(2). The two penalties contemplated by IRC § 6038D(d) can potentially aggregate to \$60,000.

17 GAO, GAO-12-403, *Reporting Foreign Accounts to IRS, Extent of Duplication Not Currently Known, but Requirements Can Be Clarified* 15 (Feb. 2012).

18 See Legislative Recommendation: *Foreign Account Reporting: Eliminate Duplicative Reporting of Certain Foreign Financial Assets and Adopt a Same-Country Exception for Reporting Financial Assets Held in the Country in which a U.S. Taxpayer is a Bona Fide Resident*, *supra*; National Taxpayer Advocate 2014 Annual Report to Congress 343-45.

19 See IRC § 1471(c),(d)(1). Non-compliant FFIs will be subject to a thirty percent withholding penalty on certain U.S. source payments made to the institution. See IRC § 1471(a).

20 31 U.S.C. § 5323(a).

authorized by Congress).²¹ No funds have been so appropriated, and no awards have been paid under this provision.²² Under IRC § 7623(a), the IRS has discretionary authority to make awards to whistleblowers out of “proceeds of amounts collected.” If the requirements of IRC § 7623(b) are met, the IRS *is required* to pay an award out of “collected proceeds.” For awards under IRC § 7623(b), appropriated funds are apportioned by the Office of Management and Budget (OMB) based on prior year actual awards.²³

IRC § 7623 authorizes awards for detecting “underpayment of tax” or violations of the “internal revenue laws” “in cases where such expenses are not otherwise provided for by law.” Thus, the IRS’s position is that IRC § 7623 does not permit awards for recovered FBAR penalties, which are not derived from violations of the internal revenue laws and for which an award provision exists under Title 31.²⁴ The Tax Court, while it has been presented with the issue, has not decided whether the IRS’s position is correct.²⁵ In the Tax Court case in which the issue arose, a whistleblower sought to recover an award under IRC § 7623(b) for recovered FBAR penalties. When informed of the IRS’s position that FBAR proceeds are not the subject of an award under IRC § 7623, the whistleblower viewed the communication as a de facto denial of his claim, arguing to the court that “[b]ecause the bulk of the proceeds collected from Taxpayer 1 consisted of FBAR payments for violation of title 31...there was nothing meaningful left for the Office [IRS Whistleblower Office] to investigate with respect to this claim.”²⁶ The court held that the communications from the IRS did not constitute a “determination regarding an award” within the meaning of IRC § 7623(b)(4) sufficient to confer jurisdiction on the court and thus did not address the issue of whether FBAR penalties are “collected proceeds.”²⁷

Protection of Taxpayer Information

IRC § 6103 generally prohibits IRS employees from disclosing a taxpayer’s “return” or “return information,” and civil and criminal penalties are imposed for violating the bar.²⁸ Form 8938, which is filed with the tax return, qualifies as “return” or “return information.”²⁹

21 See PMTA 2012-10 (Apr. 23, 2012) (noting “amounts paid as BSA penalties should be deposited into Treasury’s General Fund). See GAO, 2 *Principles of Federal Appropriations Law* 6-166 – 6-175 (3d ed. 2006) (agencies must deposit into the General Fund of the Treasury any funds received from sources outside the agency absent statutory authority to retain the funds or deposit them elsewhere). Once these amounts go into the General Fund, only a specific appropriation can get them out. See *id.* at 6-168 – 6-169.” See also OMB Circular No. A–11, *Section 20 Terms and Concepts* 3 (noting “[a]ppropriation means a provision of law... authorizing the expenditure of funds for a given purpose”).

22 IRS Whistleblower Officer (WO) response to TAS information request (Aug. 26, 2015).

23 See OMB Circular No. A–11, *Section 20 Terms and Concepts* 3, noting “[a]pportionment is a plan, approved by OMB, to spend resources provided by one of the annual appropriations acts, a supplemental appropriations act, a continuing resolution, or a permanent law (mandatory appropriations)”; Internal Revenue Manual (IRM) 25.2.2.13, *Award Payment Procedures* (Aug. 7, 2015).

24 See PMTA 2012-10 (Apr. 23, 2012).

25 *Whistleblower 22231-12W v. Comm’r*, T.C. Memo. 2014-157 (2014).

26 *Id.* slip op. at 6-7.

27 *Id.*

28 IRC § 6103 (a); IRC §§ 7431, 7213, 7213A.

29 IRC § 6103(b)(1) defines “return” as “any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for or permitted under, the provisions of this title which is filed with the Secretary by, on behalf of, or with respect to any person, and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed.” IRC § 6103(b)(2)(A) defines “return information” to include “a taxpayer’s identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer’s return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.”

The status of information the IRS gathers in an FBAR investigation under IRC § 6103 is not as straightforward, and stems from rules pertaining to how the IRS may access Title 26 information during a Title 31 investigation. IRC § 6103(h)(1) permits the IRS to share returns and return information with Department of Treasury employees “whose official duties require such inspection or disclosure for tax administration purposes.” IRC § 6103(b)(4) defines “tax administration” as including “the administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws or *related statutes*” (emphasis added). Thus, if the IRS determines that a Title 31 investigation is considered to be tax administration under the “related statute” portion of the definition of tax administration, IRS employees are authorized to access returns or return information in conducting a Title 31 investigation.³⁰ It follows, according to IRS Chief Counsel guidance, that “information collected or generated in that [Title 31] investigation after the related statute call has been made is protected by section 6103.”³¹ However, if in a particular case Title 31 is not a related statute (*e.g.*, because there are no possible Title 26 violations), the information would not be return information under IRC § 6103.³²

Exceptions to the general rule of nondisclosure in IRC § 6103 permit the IRS to disclose a taxpayer’s return or return information to a whistleblower in limited circumstances and for specific purposes. For example, IRC § 6103(h)(4) permits the IRS to disclose, to the extent necessary, a taxpayer’s return information to a whistleblower in a whistleblower administrative proceeding.³³ The preliminary award the IRS communicates to the whistleblower includes “a summary report that states a preliminary computation of the amount of collected proceeds, the recommended award percentage, the recommended award amount... and a list of the factors that contributed to the recommended award percentage.”³⁴ The National Taxpayer Advocate has noted that existing procedures do not protect taxpayers from re-disclosure of their confidential information by whistleblowers and has recommended corrective legislation.³⁵

Whether or not they qualify as “return” or “return information,” FBARs and information derived or extracted from FBARs are not subject to disclosure under the Freedom of Information Act.³⁶ FBARs

30 See IRM 4.26.14.2, *Access to Title 26 Returns and Return Information* (July 24, 2012) (providing guidance on “related statute” determinations). Moreover, according to IRM 4.26.17.2(1)(d), *FBAR Procedures Starting the Case - Related Statute Memorandum* (Jan. 1, 2007), “[i]f the source of the FBAR information is a Title 26 examination... the information acquired is return information protected by IRC Section 6103. The examiner must obtain a related statute determination, signed by a Territory Manager before using the return information in an FBAR case.” The IRM does not specify what the “source” of the FBAR information is where a whistleblower provides information that leads to a Title 26 examination.

31 IRS Chief Counsel, Procedure and Administration, Publication 4639, *Disclosure & Privacy Law Reference Guide* (Rev. 10-2012) 7-5. An accompanying note advises “[a]lthough there are no cases addressing the related statute determination, there are cases suggesting that a money laundering charge, standing alone, is not ‘tax administration.’ See *United States v. Hobbs*, 991 F.2d 569, 573 (9th Cir. 1993); *United States v. Callahan*, 981 F.2d 491, 494 n.3 (11th Cir. 1993), *cert. denied*, 508 U.S. 976 (1993).”

32 See IRM 4.26.17.2.3, *Cases Where No Related Statute Memorandum (RSM) Needed* (May 5, 2008) (noting “[i]f the examiner is conducting an examination under the BSA, a related statute determination is not needed to examine for FBAR compliance. This is because no information from a tax examination or other 6103 protected source is involved.”).

33 IRC § 6103(h)(4); Treas. Reg. § 301.6103(h)(4)-1.

34 Treas. Reg. § 301.7623-3(c)(2)(ii) (regarding preliminary awards under IRC § 7623(b)). See Treas. Reg. § 301.7623-3(b)(1) (regarding a similar provision for preliminary awards under IRC § 7623(a)).

35 See Most Serious Problem: *Whistleblower Program: The IRS Whistleblower Program Does Not Meet Whistleblowers’ Need for Information During Lengthy Processing Times and Does Not Sufficiently Protect Taxpayers’ Confidential Information from Re-Disclosure by Whistleblowers*, *supra*; Legislative Recommendation: *Whistleblower Program: Make Unauthorized Disclosures of Return Information by Whistleblowers Subject to the Penalties of IRC §§ 7431, 7213, and 7213A, Substantially Increase the Amount of Such Penalties, and Make Whistleblowers Subject to the Safeguarding Requirements of IRC § 6103(p)*, *supra*.

36 31 U.S.C. § 5319 provides that FBARs are exempt from disclosure under the Freedom of Information Act (5 U.S.C. § 552) and “may not be disclosed under any State, local, tribal, or territorial ‘freedom of information,’ ‘open government,’ or similar law.” See *Berger v. I.R.S.*, 487 F. Supp. 2d 482, 496 (D.N.J. 2007) *aff’d*, 288 F. App’x 829 (3d Cir. 2008) (holding the IRS was not required to disclose information derived or extracted from BSA reports).

may be disclosed at the discretion of the Secretary, but guidelines issued pursuant to this authority do not specifically contemplate IRS disclosures of FBAR information to whistleblowers.³⁷

REASONS FOR CHANGE

The FATCA and FBAR statutory regimes allow the IRS to recover penalties against taxpayers who fail to report the same foreign bank account, an outcome about which the National Taxpayer Advocate has significant concerns. However, once the IRS actually collects both penalties on the basis of information provided by a whistleblower, it is anomalous to pay awards to whistleblowers with respect to recovered FATCA penalties but not recovered FBAR penalties. Moreover, information from whistleblowers may be the *only* way for the IRS to learn of foreign accounts that do not meet the FATCA third-party reporting thresholds or those that exceed the FATCA reporting thresholds but escape third-party reporting. As the whistleblower in one Tax Court case asserted, FBAR penalties may far exceed amounts recovered under Title 26.³⁸ Thus, whistleblowers would have more of an incentive to report undetected foreign bank accounts if FBAR penalties were included in the award amount.

Information the IRS collects as part of an FBAR investigation may not constitute “return” or “return information” under IRC § 6103, but may nevertheless be unavailable to a whistleblower pursuant to nondisclosure provisions of Title 31. To the extent a whistleblower cannot access information the IRS obtains in the course of an FBAR investigation, he or she may not be able to effectively challenge the IRS’s determination about the amount of a proposed award that stems from collected FBAR penalties.³⁹ The proposal to include FBAR proceeds in whistleblower awards necessitates additional proposals to allow the IRS to disclose FBARs and information the IRS receives in ascertaining a taxpayer’s liability for FBAR violations to whistleblowers and to simultaneously ensure the confidentiality of that information. Designating such information as return or return information within the meaning of IRC § 6103, subject to the same limitations on disclosure and making whistleblowers subject to existing penalties for violating IRC § 6103, would accomplish both objectives.

EXPLANATION OF RECOMMENDATIONS

The proposal would:

- Amend IRC § 7623 to include collected FBAR penalties in the definition of “proceeds of amounts collected” and “collected proceeds;”
- Designate FBARs and information the IRS receives in ascertaining a taxpayer’s liability for FBAR violations as return or return information within the meaning of IRC § 6103; and
- Make whistleblowers subject to existing penalties for the unauthorized use or re-disclosure of such information.

37 31 C.F.R. § 1010.950 provides “[t]he Secretary may within his discretion disclose information reported under this chapter for any reason consistent with the purposes of the Bank Secrecy Act.” According to IRM Exhibit 4.26.14-3, *Re-Dissemination Guidelines for Bank Secrecy Act Information*, Section VI (July 24, 2012), the IRS may not disseminate BSA information without the consent of FinCEN in the absence of exceptions that would not apply to whistleblowers. See also IRM Exhibit 4.26.14-2, *Memorandum of Understanding Between the FinCEN and the IRS dated Sept. 24, 2010* (July 24, 2012) (including FBARs in the definition of BSA information).

38 *Whistleblower 22231-12W v. Comm’r*, T.C. Memo. 2014-157 (2014), slip op. at 6-7.

39 See, e.g., *Berger v. I.R.S.*, 487 F. Supp. 2d 482, 496 (D.N.J. 2007) *aff’d*, 288 F. App’x 829 (3d Cir. 2008) (rejecting the contention that the IRS, based on IRM provisions, had discretion to release information it obtained in a Title 31 investigation).

The proposal would lead to consistent treatment, for whistleblower award purposes, of recovered FATCA and FBAR penalties, supporting the *right to a fair and just tax system*. The proposal would strengthen the right to be heard and the right to confidentiality by:

- Clearly bringing within the ambit of IRC § 6103 information the IRS obtains as part of its FBAR investigation without the need for a “related statute” determination; and
- Allowing the IRS to share that information pursuant to exceptions of IRC § 6103, which in turn would permit whistleblowers to make an informed decision about whether to challenge a proposed whistleblower award; yet
- Adopting measures to prevent whistleblowers from re-disclosing that information.

The proposal would also provide incentive to whistleblowers to report foreign accounts that are likely to escape detection by the IRS.