INTRODUCTION: The Most Serious Problems Encountered by Taxpayers

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to prepare an Annual Report to Congress that contains a summary of at least 20 of the most serious problems encountered by taxpayers each year. For 2015, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS and Congress in resolving 24 such problems.

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

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

METHODOLOGY OF THE MOST SERIOUS PROBLEM LIST

The National Taxpayer Advocate considers a number of factors in identifying, evaluating, and ranking the most serious problems encountered by taxpayers. In many years, the National Taxpayer Advocate identifies a theme for the report that is reflected in the selection of issues. For example, this year's themes are:

- *IRS Future State Vision: Implications for Today and Tomorrow;*
- *Problems that Undermine Taxpayer Rights and Impose Taxpayer Burden;*
- *Problems that Waste IRS Resources and Impose Burden on Taxpayers; and*
- *Recommendations to Improve Earned Income Tax Credit Compliance.*

The 24 issues in this year's report are ranked according to the following criteria:

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

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

TAXPAYER ADVOCATE MANAGEMENT INFORMATION SYSTEM LIST

The identification of the Most Serious Problems reflects not only the mandates of Congress and the IRC, but TAS's integrated approach to advocacy — using individual cases as a means for detecting trends and identifying systemic problems in IRS policy and procedures or the Code. TAS tracks individual taxpayer cases on TAMIS. The top 25 case issues, listed in Appendix 1, reflect TAMIS receipts based on taxpayer contacts in fiscal year 2015, a period spanning October 1, 2014, through September 30, 2015.

USE OF EXAMPLES

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

MSP #1 TAXPAYER SERVICE: The IRS Has Developed a Comprehensive "Future State" Plan That Aims to Transform the Way It Interacts With Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet

RESPONSIBLE OFFICIALS

John A. Koskinen, Commissioner of Internal Revenue, and Members of the IRS Senior Leadership Team

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

During the past year-and-a-half, the IRS has devoted significant resources to creating a "future state" plan that details how the agency will operate in five years. The plan is explained and developed in a document known as a Concept of Operations (CONOPS). There are many positive components of the plan, including the goal of creating online taxpayer accounts through which taxpayers will be able to obtain information and interact with the IRS.[2]

However, the CONOPS also raise significant questions and concerns. Implicit in the plan — and explicit in internal discussion — is an intention on the part of the IRS to substantially reduce telephone and face-to-face interaction with taxpayers. The IRS is hoping that taxpayer interactions with the IRS through online accounts will address a high percentage of taxpayer needs. It is also developing plans to enable third parties like tax return preparers and tax software companies to do more to assist taxpayers for whom online accounts are insufficient — an approach that will increase compliance costs for millions of taxpayers.

1 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The only right in the Taxpayer Bill of Rights that is not directly affected by the IRS's future state planning is *the right to retain representation*.

2 For a more detailed assessment of online taxpayer accounts, see Most Serious Problem: *Taxpayer Access to Online Account System: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak with an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online*, *infra*.

While online accounts should reduce taxpayer demand for telephone and face-to-face interaction to some degree, they are unlikely to reduce taxpayer demand dramatically. This is true for several reasons, including that millions of taxpayers do not have Internet access, millions of taxpayers with Internet access do not feel comfortable trying to resolve important financial matters over the Internet, and many taxpayer problems are not "cookie cutter," thus requiring a degree of back-and-forth discussion that is better suited for conversation and that taxpayers will insist upon.

Taxpayer demand for IRS services and assistance is high and has remained so for many years:

- Taxpayers place more than 100 million telephone calls to the IRS each year and have done so in every year since FY 2008.[3]
- Taxpayers make more than five million visits to the IRS's walk-in sites (known as Taxpayer Assistance Centers, or TACs) each year.[4]
- Taxpayers send an average of about ten million pieces of correspondence to the IRS in response to proposed adjustment notices each year to which the IRS must respond.[5]

The Concept of Operations (CONOPS) have the potential to bring about a fundamental transformation in the way our government treats its taxpayers and interacts with them. The CONOPS and associated documents speak of contemplated changes in very positive tones. They say little about reductions in core taxpayer services. They say nothing about the increased taxpayer costs and security risks created by relying more on tax return preparers and other third parties for assistance and interacting with the IRS.

Many of the telephone and walk-in contacts take place as taxpayers are trying to prepare their tax returns. But a large number of contacts take place in the post-filing environment, where the IRS has proposed to adjust a taxpayer's tax liability or the IRS has delayed issuing the taxpayer's refund. While some pre-filing contacts may require only generic answers, post-filing contacts are almost always account-specific and require IRS employees to study the details of the taxpayer's account to respond.

If the IRS substantially reduces the opportunity for taxpayers to talk with IRS employees, many taxpayers will find it much harder to resolve their problems and will have to pay third parties to assist them. This will generate a great deal of additional taxpayer frustration with the IRS. As a result, confidence in the fairness of the tax system will erode, and taxpayer frustration and alienation may lead over time to a lower rate of voluntary compliance.

In the National Taxpayer Advocate's mid-year report to Congress, we recommended that the IRS make the CONOPS available for public review and comment.[6] To date, the IRS has not provided comprehensive information about its future state plans to the public, and it has not solicited public comment.

3 See IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot, IRS Enterprise Total* (final week of each fiscal year for FY 2008 through FY 2015).

4 IRS Wage & Investment Division, Business Performance Review 7 (4th Quarter – FY 2015, Nov. 2, 2015); Government Accountability Office (GAO), GAO-15-163, *Tax Filing Season: 2014 Performance Highlights the Need to Better Manage Taxpayer Service and Future Risks* 21 (Dec. 2014) (showing the number of TAC visits in each year from FY 2009 through FY 2014). During the 2015 filing season, the IRS maintained 380 TACs. See Treasury Inspector General for Tax Administration, Ref. No. 2016-IE-R001, *Selected Taxpayer Assistance Centers Were Professional and Organized, and Sensitive Information and Equipment Were Properly Secured* 1 (Oct. 2015).

5 Over the past decade, annual taxpayer correspondence in response to proposed adjustments has ranged from a low of 7.9 million letters to a high of 11.8 million letters and has averaged just over ten million per year. See IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2006 through FY 2015).

6 National Taxpayer Advocate FY 2016 Objectives Report to Congress 7.

The National Taxpayer Advocate is designating the future of taxpayer service as the #1 most serious problem for taxpayers for purposes of this year's report because the CONOPS have the potential to bring about a fundamental transformation in the way our government treats its taxpayers and interacts with them. The CONOPS and associated documents speak of contemplated changes in very positive tones. They say little about reductions in core taxpayer services. They say nothing about the increased taxpayer costs and security risks created by relying more on tax return preparers and other third parties for assistance and interacting with the IRS.

But trade-offs are inevitable if new services are to be developed and rolled out in a tight budgetary environment. Therefore, we believe it is critical that the IRS share its plans in detail with Congress and outside stakeholders and then engage in a dialogue about the extent to which it intends to curtail or eliminate various categories of telephone service and face-to-face service, whether it will provide sufficient support for taxpayers — and how — as it transitions to its future state, and whether it has an adequate "Plan B" if taxpayer demand for telephone and face-to-face service remains higher than the IRS anticipates. We also believe the IRS should estimate the additional financial burden its plan will impose on various categories of taxpayers — including elderly, low income, disabled, and limited English proficiency taxpayers and small businesses — as well as the impact its plan is likely to have on voluntary compliance.

These concerns are detailed below. In addition, the National Taxpayer Advocate provides a broader assessment of the IRS's future state planning in her preface to this report.

ANALYSIS OF PROBLEM

Long-term strategic planning is critical to the success of any organization, particularly one as large and complex as the IRS. In recent years, significant reductions to the agency's funding level have forced it to scale back its activities in almost every area and to rethink its priorities.[7]

Beginning in 2014, each of the IRS's four IRS Business Operating Divisions developed a CONOPS to articulate its vision and strategic approach for the following five-year period. Later, some of the other IRS functions developed a CONOPS, and the discrete CONOPS documents developed by the business units were ultimately consolidated into a single, enterprise-wide CONOPS.[8]

The IRS senior leadership team and IRS personnel in every business unit have devoted substantial time to this effort. The IRS also has entered into contracts with management consultants, costing the agency several million dollars, for support.

The CONOPS encompass both taxpayer service and enforcement activities, and they describe many initiatives that will both benefit taxpayers and make IRS operations more efficient. Because the IRS has chosen not to release the CONOPS, we are limited in our ability to provide much detail. However, the

7 Since FY 2010, the IRS budget has been reduced by about 19 percent in inflation-adjusted terms. In FY 2010, the agency's appropriated budget stood at $12.1 billion. For FY 2016, its budget has been set at $11.2 billion, a reduction of nearly 8 percent over the six-year period. Inflation over the same period is estimated at nearly 11 percent. *See* Office of Management and Budget, Fiscal Year 2016 Budget of the U.S. Government, *Historical Tables* (230-31), Table 10.1, *available at* https://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/hist.pdf (showing Gross Domestic Product (GDP) and year-to-year increases in the GDP). In addition, the IRS has had to implement the statutory requirements of the Patient Protection and Affordable Care Act and the Foreign Account Tax Compliance Act during this time, causing a further drain on its resources.

8 The four IRS Business Operating Divisions are the Wage & Investment Division, the Small Business/Self-Employed Division, the Tax Exempt & Government Entities Division, and the Large Business & International Division. Other functions that developed CONOPS include the Office of Appeals and the Criminal Investigation function.

IRS Chief Counsel recently articulated the following seven themes for the IRS's future state in a written document distributed at a public event:

- Facilitate voluntary compliance by empowering taxpayers with secure innovative tools and support.
- Understand non-compliant taxpayer behavior and develop approaches to deter and change it.
- Leverage and collaborate with external stakeholders.
- Cultivate a well-equipped, diverse, skilled, and flexible workforce.
- Select highest value work using data analytics and robust feedback loops.
- Drive more agility, efficiency, and effectiveness in IRS operations.
- Strengthen cyber defense and prevent identity theft and refund fraud.[9]

These are laudable goals, but they are very general. As always, the devil is in the details, and unless and until the IRS releases the CONOPS, neither the public nor Congress will have access to the details.

In the National Taxpayer Advocate's mid-year report to Congress, we recommended that the IRS make the Concept of Operations available for public review and comment. To date, the IRS has not provided comprehensive information about its future state plans to the public, and it has not solicited public comment.

Online Taxpayer Accounts Are Unlikely to Produce a Substantial Reduction in Taxpayers' Needs for Telephone and Face-to-Face Assistance

One specific initiative that IRS officials have described publicly is the creation of online taxpayer accounts through which taxpayers can interact with the agency.[10] We have recommended in the past that the IRS develop this capability,[11] provided the agency can work through security risks.[12]

Of considerable concern, however, is what is *not* stated in the CONOPS. Nowhere in the CONOPS is there a statement that the IRS plans to reduce telephone service or close walk-in sites, even though that is a central component of its strategy. By proposing to add new services and continuing to note the impact of funding constraints, it is implicit that some existing services will be reduced or eliminated.

9 William J. Wilkins, Chief Counsel, Internal Revenue Service, *Tax Enforcement in a Resource-Challenged World* 7 (written outline distributed in conjunction with address before the 32nd Annual National Institute on Criminal Tax Fraud and the Fifth National Institute on Tax Controversy, Dec. 11, 2015, Las Vegas, Nevada).

10 Luca Gattoni-Celli, *IRS to Roll Out Online Taxpayer Accounts*, 2015 TNT 213-3, Tax Notes Today (Nov. 4, 2015) (quoting Karen Schiller, Commissioner of the IRS's Small Business/Self-Employed Division, as saying: "Our future vision is, interacting with the IRS will be similar to how the interaction is with a financial institution or a bank … more online access, more self-service capability"). *See also* Matthew R. Madara, *IRS to Expand Online Access As Agency Looks to the Future*, 2015 TNT 240-2, Tax Notes Today (Dec. 14, 2015) (reporting on remarks of William J. Wilkins, Chief Counsel, Internal Revenue Service).

11 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers In Return Preparation and Decrease Improper Payments*); National Taxpayer Advocate 2012 Annual Report to Congress 251-61 (Most Serious Problem: *The IRS Is Striving to Meet Taxpayers' Increasing Demand for Online Services, Yet More Needs to Be Done*) and 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 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*).

12 The "Get Transcript" problems involving unauthorized access to taxpayer account information that came to light during 2015 have caused widespread concerns. For more details about those problems, see IRS, *IRS Statement on the "Get Transcript" Application* (May 26, 2015), *available at* https://www.irs.gov/uac/Newsroom/IRS-Statement-on-the-Get-Transcript-Application. The IRS must redouble its efforts to ensure it takes all appropriate steps to guarantee data security and reassure the public it has done so before it rolls out online accounts.

The key unanswered question is by how much. In general, IRS leaders are only indirectly alluding to the possibility of service reductions. In a recent all-employee email, the Commissioner wrote about offering "more online and self-service options to build on our in-person options … [f]or those taxpayers with the ability and interest."[13] An accompanying summary stated that "[t]his approach also has a goal of freeing up limited IRS in-person resources — such as our phone lines — to more easily serve people and tax professionals who need one-on-one assistance."[14]

However, the widespread expectation is that traditional taxpayer services – telephone assistance and face-to-face assistance — will be scaled back dramatically. Based on our internal discussions with IRS officials, TAS has been left with the distinct impression that the IRS's ultimate goal is 'to get out of the business of talking with taxpayers.'

There is an enormous difference between developing online accounts with the hope that they will reduce taxpayer demand for personal service, on the one hand, and making plans to reduce personal service now. It is incumbent upon the IRS to be much more specific about how much personal taxpayer assistance it expects to provide in its "future state."

There are three reasons why we are not optimistic online accounts will dramatically reduce taxpayer demand for telephone or face-to-face service:

1. **Millions of taxpayers do not use the Internet.** A Pew Research Center study published in 2015 found the percentage of American adults who do not use the Internet is about 16 percent.[15]
2. **Millions of taxpayers who use the Internet do not want to handle complex financial transactions online.** According to a Forrester Research study published in 2015, 37 percent of survey respondents said they do not trust the federal government to secure their personal data, and the majority uses non-digital channels more than digital ones.[16] Moreover, a 2014 TAS study of taxpayers with incomes of less than 250 percent of the federal poverty level ($29,175 for a single person in the 48 contiguous states, D.C., or Puerto Rico) found that more than 70 percent of these taxpayers preferred communicating in person, and only about ten percent were willing to interact by computer.[17]

   Example: Assume a taxpayer has been victimized by identity theft or has been asked to supply identity information after IRS filters have flagged his return and frozen his refund pending verification. Many taxpayers whose personal information has been actually or potentially compromised will not feel comfortable entering the very same personal information into an Internet site. Moreover, many taxpayers waiting for a much-needed refund will want to resolve the problem directly with an IRS employee so they know, when the call ends, whether the documentation they are providing is sufficient and when they can expect to receive their refund.

13 Email from John A. Koskinen, Commissioner of IRS, to all employees, *Update on IRS changes, Future State work* (Dec. 16, 2015).

14 Summary explanation titled "A future vision for taxpayers and employees." *Id.*

15 Andrew Perrin & Maeve Duggan, Pew Research Center, *American's Internet Access: 2000-2015* (June 26, 2015).

16 Rick Parrish, Forrester Research, *Washington Must Work Harder to Spur the Public's Interest in Digital Government: Federal Agencies Are Spending Millions on Digital CX That Customers May Not Want* (Apr. 28, 2015).

17 *See* National Taxpayer Advocate 2014 Annual Report to Congress vol. 2 § 1, 9 (Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help From the Clinics*). About 45 percent of taxpayers have incomes at or below 250 percent of the Federal Poverty Level. IRS CDW, Individual Returns Transaction File, tax year 2014

3. **Even among taxpayers who have Internet access and skills and are comfortable handling financial transactions online, the complexity of tax issues and the amount of money at stake will make online resolution impractical or undesirable from the taxpayer's perspective in many cases.** Online resolution will be difficult partly due to the complexity of the transaction and partly due to the difficulty in designing a website that is both easily navigable by first-time users and capable of handling a wide range of transactions. Online accounts work well for "cookie cutter" transactions. For example, a bank website can be easy to use if the account holder is solely seeking to pay bills; an airline website can be easy to use if a passenger is solely seeking to purchase tickets; and a retailer's website can be easy to use if a customer is seeking solely to make a purchase. But if the account holder wishes to dispute an erroneous charge, the passenger is seeking a refund, or the purchaser of retail goods has not received his order by the promised date, a telephone call is often necessary. When dealing with the IRS, little is "cookie cutter" and much is case-specific.

   Example: A taxpayer may claim the earned income tax credit with respect to a child only if the child lives with her for more than one-half of the year.[18] Where parents have been divorced or otherwise live separately and the child lives part-time with each parent, it can be difficult for the parent claiming the credit to substantiate that the child lived with her for more than one-half of the year. An online account cannot substitute for a conversation with an IRS employee in which the parent describes the kinds of records she possesses and can talk through which ones the IRS will accept.

   Example: The IRS denies business deductions claimed by a small business, such as a sole proprietor. Businesses keep expense records in different formats, and it is often not clear to a small business owner what documentation the IRS will accept. Rather than uploading large volumes of records through an online account, the business owner may wish to speak with an IRS employee to clarify the documentation requirements.

In light of the complexity of the tax code and the wide variation in taxpayer circumstances, these are typical problems that arise. Where substantial money is at stake and particularly where a taxpayer is experiencing a financial hardship, an online account will neither resolve issues like these nor provide the taxpayer with the certainty he seeks.

Pre-Filing Requests for Assistance. In 2015, the IRS received about 150 million income tax returns from individuals.[19] It also received more than ten million returns from business entities (corporations and partnerships).[20] Many of these taxpayers seek assistance from the IRS in the course of preparing or filing their returns. Requests for assistance range from the general (*e.g.,* a request for a form or a tax-law

18 *See* IRC § 32(c)(3)(A) (incorporating the definition of a qualifying child in IRC § 152(c)(1)(B)).

19 In calendar year 2015, the IRS received slightly more than 150 million individual income tax returns. *See* IRS, *Filing Season Statistics for Week Ending Nov. 20, 2015*, *available at* https://www.irs.gov/uac/Newsroom/Filing-Season-Statistics-for-Week-Ending-November-20-2015. For fiscal year 2015, the IRS projected it would receive just under 150 million returns but has not released the final count. *See* IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2015-2022,* Table 1 (Rev. Aug. 2015).

20 *See* IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2015-2022*, Table 1 (Rev. Aug. 2015). (projecting the IRS would receive about 6.9 million corporation income tax returns and 3.8 million partnership returns in FY 2015, a slight increase in both categories as compared with FY 2014).

Offloading work to third parties will substantially increase compliance costs for many taxpayers who now work directly with the IRS. Taxpayers deserve better. Having written a tax code so widely and rightly criticized for its complexity, the government has a practical and moral obligation to help taxpayers comply. It should not withdraw existing taxpayer service to the point where taxpayers have to incur additional compliance costs just to file their returns and pay their taxes.

question) to account-specific matters (*e.g.,* a request for a replacement Identity Protection (IP) PIN where a taxpayer has lost the IP PIN the IRS sent him by letter and cannot file his return without it).[21]

Post-Filing Contacts. In FY 2015, the IRS had actual or possible post-filing contacts with more than nine million taxpayers. Most arose because of proposed tax adjustments the IRS made. Others arose because the IRS temporarily or indefinitely froze tax returns and withheld refunds, generating taxpayer inquiries and attempts to provide substantiation.

If one were to focus solely on the individual audit rate of less than one percent,[22] one might assume that fewer than 1.5 million individual taxpayers have contacts with the IRS after filing a tax return. In fact, the number of taxpayers who have post-filing contacts with the IRS is vastly larger. For example:

- The IRS makes adjustments to taxpayer accounts under "math error" authority that do not count as audits.[23]
- The IRS makes adjustments to taxpayer accounts based on document-matching between information a taxpayer reports on his tax return and information the taxpayer's employer reports on a Form W-2 or a payor reports on a Form 1099. These adjustments also do not count as audits.[24]
- The IRS operates an Automated Substitute for Return program in which it creates tax returns for taxpayers who did not file and who the IRS believes should have filed a return.[25]

21 An IP PIN is a number assigned to an eligible taxpayer to help prevent the misuse of his Social Security number on fraudulent federal income tax returns. Once the IRS issues an IP PIN to a taxpayer, the taxpayer currently is required to use an IP PIN to file returns for the rest of his life. According to the IRS website: "You currently can't opt out once you get an IP PIN. You must use an IP PIN to confirm your identity on all federal tax returns you file this year and in subsequent tax years. If you e-file your return and your IP PIN is missing or incorrect, our system will reject your return. Filing a paper return with a missing or incorrect IP PIN delays its processing."

22 In FY 2014, the individual audit rate was 0.86 percent. *See* IRS, *FY 2014 Enforcement and Service Results* 2, *available at* https://www.irs.gov/PUP/newsroom/FY-2014%20Enforcement%20and%20Service%20Results%20–%20web%20version.pdf. At this writing, the individual audit rate for FY 2015 has not yet been released.

23 IRC § 6213(b) & (g).

24 *See* IRC § 7605 and Rev. Proc. 2005-32, 2005-1 C.B. 1206, regarding contacts with taxpayers and other actions taken by the IRS that are not treated as "examinations." In general, an examination involves the IRS's inspection of a taxpayer's books and records. Among contacts not treated as examinations are those resulting from the matching of information on a tax return with information already in the IRS's possession and considering any records the taxpayer provides voluntarily to explain a discrepancy between a filed return and information furnished by third parties that is used as part of a data-matching program. *See* § 4.03(1)(b) & (c) of Rev. Proc. 2005-32.

25 *See* IRC § 6020. For additional information regarding the automated substitute for return program, see Most Serious Problem: *Automated Substitute for Return (ASFR) Program: Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*, *infra*.

- The IRS employs a wide variety of anti-fraud filters to screen out fraudulent tax returns and refund claims. However, these filters are inherently both under-inclusive and over-inclusive. Where filters are over-inclusive, the IRS sometimes notifies taxpayers it has frozen their returns and requires them to submit additional documentation before it can proceed, and it sometimes temporarily suspends the processing of their returns (and the issuance of refunds) pending internal verification measures. Even where the IRS is solely performing internal verification, taxpayers experiencing refund delays will often call the IRS to find out why.

Thus, the number of taxpayers who receive notices and may have to get into a dialogue with the IRS about their unique facts and circumstances is as follows:

FIGURE 1.1.1, Post-Filing Notices and Refund Delays That Generate Taxpayer Contacts[26]

Individual Audits	1,228,693
Document Matching (AUR) Notices	3,836,216
Math Error Notices	1,886,216
Automated Substitute for Returns	184,776
Refund Delays	2,078,311
Total	**9,214,212**

It is not realistic to expect that taxpayers who are told they owe more tax or whose refunds have been significantly delayed are going to be satisfied resolving their problems with the IRS exclusively through an online account. A high percentage of taxpayers in this situation will want to speak with an IRS employee so they can be certain they understand the source of the problem and what more they need to do — and try to obtain reassurance about when they can expect a final resolution.

IRS Technology Advancements Historically Have Not Reduced Taxpayer Demand for Personal Services Despite Hopes to the Contrary

Ever since Congress enacted the IRS Restructuring and Reform Act of 1998,[27] the IRS has been speaking about harnessing technology to improve efficiency and reduce the need for personal service. In fact, the IRS has succeeded in dramatically increasing the percentage of taxpayers who file their returns electronically, it has vastly expanded and improved its website to provide more information to taxpayers, and it

26 Sources for data on audit and similar contacts are as follows: IRS Audit Information Management System, Closed Case Database (showing number of individual examinations closed in FY 2015); IRS Compliance Data Warehouse, Notice Delivery System (showing number of CP2000 and CP2501 document-matching notices mailed to distinct taxpayers by the IRS's Automated Underreporter Program in FY 2015); IRS Individual Master File (showing number of math error notices mailed to distinct taxpayers in FY 2015); IRS Collection Activity Report NO-5000-139 (Oct. 5, 2015) (showing number of automated substitute for return (ASFR) notices issued in FY 2015; ASFRs are created with respect to taxpayers that did not file tax returns but that the IRS believes should have filed tax returns). Sources for data on refund delays are as follows: IRS Generalized Unpostable Framework (GUF) Report, GUF5740 Closed Inventory Summary (Dec. 17, 2015) (showing that 729,487 returns were initially deemed unpostable for inconsistency with ID theft business rules but were later processed in calendar year 2015 through Dec. 17); IRS Return Integrity & Compliance Services (RICS), *Update of the Taxpayer Protection Program (TPP)* 8, (Dec. 9, 2015) (showing that 649,915 returns were stopped by Taxpayer Protection Program filters but were later found to be legitimate in calendar year 2015 through Dec. 9); IRS Individual Master File (showing that 179,459 returns were stopped due to suspected fraudulent income documents that later were found to be legitimate and 155,103 returns were frozen from Jan. 1 through Sept. 30, 2015 because an identity theft return in the taxpayer's name had previously been submitted and posted; refund delays of less than two weeks are generally excluded from these totals). The number of refund delays shown in this figure is under-inclusive overall because there are additional sources of refund delays. However, a small number of returns may fit into more than one category and therefore be double-counted.

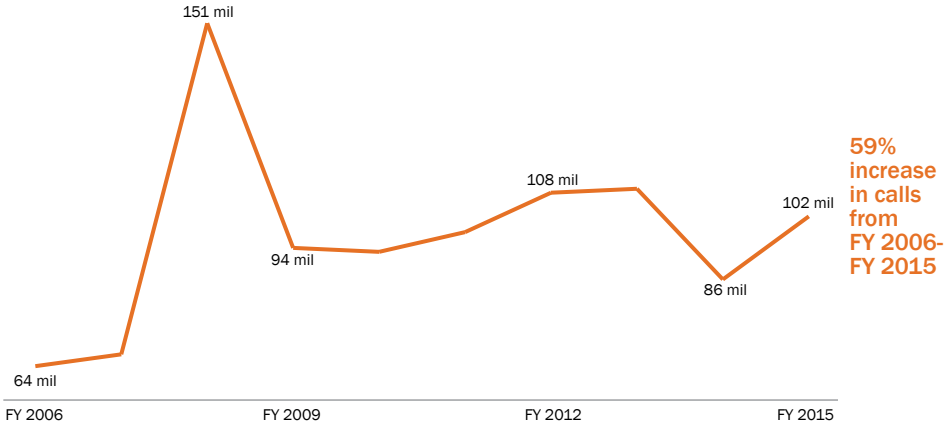
27 Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (1998).

has launched "Where's My Refund" to reduce telephone calls. The hope and expectation was that these measures would have substantially reduced taxpayer demand for personal service by phone or in person.

In fact, taxpayer demand for personal service has *increased* over time. The number of calls the IRS received on its Accounts Management lines over the past decade has risen from about 64 million in FY 2006 to about 102 million in FY 2015, an increase of about 59 percent, as shown in the following figure:

FIGURE 1.1.2[28]

Taxpayer Calls to IRS Accounts Management Telephone Lines



(The one-time spike in telephone calls in FY 2008 was attributable to widespread confusion concerning payments under the Economic Stimulus Act of 2008.) [29]

Taxpayer demand for face-to-face service at the IRS's walk-in sites has also remained high — above 5.6 million visits in FY 2015 — despite IRS service reductions, such as directing employees to refrain from answering tax-law questions and discontinuing the preparation of tax returns.[30]

These results are hardly surprising. The continuing demand for personal service despite greater online functionality is not unique to tax administration. For example, the Board of Governors of the Federal Reserve System conducts an annual survey of bank customers who use mobile phones to conduct their banking. The most recent survey found that 72 percent of bank customers reported they had visited a branch and spoken with a teller within the preceding month (an average of two times), and 68 percent reported they had used telephone banking within the preceding month (also an average of two times).

28 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2006 through FY 2015). The majority of the additional calls were handled by automation. The increase in calls seeking to speak with an IRS customer service representative (CSR) was 20 percent. The IRS's Snapshot Reports do not specify the number of calls routed to CSRs, but that number can be roughly computed by dividing the number of calls answered by CSRs by the percentage of calls answered by CSRs (known as the "CSR Level of Service"). The number of calls routed to CSRs on the Account Management telephone lines increased from about 39.8 million in FY 2006 to about 47.9 million in FY 2015. The percentage increase in calls seeking to reach a CSR likely would have been considerably higher absent IRS policies designed to limit the scope of CSR-eligible subjects, such as sharply restricting the scope of tax-law questions CSRs may answer.

29 Pub. L. No. 110-185, 122 Stat. 613 (2008).

30 IRS Wage & Investment Division, Business Performance Review 7 (4th Quarter – FY 2015, Nov. 2, 2015).

In addition, 85 percent reported they had used an automated teller machine (ATM) within the preceding month (an average of three times).

Summarizing these survey results, the report concluded:

> Taken together, these estimates indicate that while mobile banking users are utilizing technological platforms at a high rate and on a consistent basis, they have also maintained connections to their banks through the more traditional branch and ATM channels.[31]

There is no doubt that secure online taxpayer accounts will be a positive development for both taxpayers and the IRS. But the IRS's own experience with technology improvements and data from other sectors suggest online accounts are unlikely to substantially meet taxpayer demand for telephone and face-to-face service. Therefore, the open question is whether, and to what extent, online accounts will allow the IRS to achieve costs savings without leaving taxpayer needs unmet.

Requiring Taxpayers to Rely More on Tax Return Preparers and Other Third Parties Will Increase Taxpayer Costs and Create Data Security Risks

The CONOPS highlight a second concern. The IRS recognizes that not all taxpayers will be able to resolve problems through online accounts. To address the needs of these taxpayers, the IRS envisions giving tax practitioners, noncredentialed preparers, and tax software companies access to additional taxpayer information so they can assist taxpayers without the need for direct IRS involvement. That may work in some instances, but we have two reservations about this approach.

1. Offloading work to third parties will substantially increase compliance costs for many taxpayers who now work directly with the IRS. Taxpayers deserve better. Having written a tax code so widely and rightly criticized for its complexity, the government has a practical and moral obligation to help taxpayers comply. It should not withdraw existing taxpayer service to the point where taxpayers have to incur additional compliance costs just to file their returns and pay their taxes.
2. Tax return preparers are currently unregulated. Anyone, including individuals with no tax background and even individuals with criminal convictions, can obtain a Preparer Tax Identification Number from the IRS and hang out a shingle as a tax return preparer. Many are competent and conscientious, but as Government Accountability Office (GAO) and Treasury Inspector General for Tax Administration (TIGTA) studies have shown, others are not.[32] The IRS should not even consider giving tax return preparers access to taxpayer account information until it is able to establish minimum standards for competence, to suspend preparers who engage in improper conduct, and to conduct background checks to weed out preparers with criminal records. To grant all preparers access to taxpayer accounts is to put taxpayers' confidential tax information at risk.

Referring taxpayers to third party providers raises important issues — both policy issues regarding the role government should play in assisting taxpayers who are trying to comply with their tax obligations and practical issues regarding data security. These issues deserve a thorough public discussion before the IRS begins to downsize its existing taxpayer service operations and outsource taxpayer assistance to third

31 Board of Governors of the Federal Reserve System, *Consumers and Mobile Financial Services 2015*, at 11 (Mar. 2015), *available at* http://www.federalreserve.gov/econresdata/consumers-and-mobile-financial-services-report-201503.pdf.

32 *See* GAO, GAO-14-467T, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors* (Apr. 2014); TIGTA, Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Sept. 2008); GAO, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* (Apr. 2006).

parties, which will have the effect of introducing a third-party intermediary between the IRS and taxpayers, and increasing taxpayers' compliance costs.

CONCLUSION

The IRS's future state plan has been driven by two considerations. First, long-range strategic planning is always important to ensure an organization achieves its objectives as effectively and efficiently as possible. Second, significant reductions in the IRS's budget since FY 2010 have forced the agency to look for ways to scale back its operations in order to deliver on its tax-collection mission more cheaply.

The National Taxpayer Advocate has been recommending against significant reductions in the IRS's budget because reductions of this magnitude have harmed taxpayers. Moreover, while this report identifies numerous areas where we believe the IRS can and should improve, it is important to acknowledge that the IRS generally speaking is an efficient agency. In FY 2015, the IRS collected about $3.3 trillion on a budget of $10.945 billion, which translates to a return-on-investment of about 300:1.[33]

There is much in the CONOPS that is positive for taxpayers and the IRS. However, the implicit intent to make substantial reductions in telephone and face-to-face taxpayer service — particularly when coupled with the implicit intent to refer more taxpayers to for-profit practitioners and preparers for help that the IRS currently provides — raises concerns about whether the government will continue to meet its responsibilities to taxpayers.

Because the CONOPS lay out proposals that will be transformational for taxpayer service, we believe the IRS should publish its proposed plans and seek public comments and suggestions before it adopts any proposals and before, even if it has not formally adopted them, any of these proposals becomes a *fait accompli*. U.S. taxpayers pay the bills for our government. U.S. taxpayers deserve a say in how the tax collection agency will treat them.

RECOMMENDATIONS

1. The National Taxpayer Advocate recommends that the IRS immediately publish its CONOPS, publicize them widely, and seek comments and suggestions from the public.
2. The National Taxpayer Advocate recommends that Congress hold hearings during the next few months on the future state of IRS operations. These hearings will help foster better communication between the IRS and Congress on the front-end, potentially reducing the risk of continuing conflict in the future. These hearings should seek testimony from groups representing the interests of individual taxpayers (including elderly, low income, disabled, and limited English proficiency taxpayers), sole proprietors, other small businesses, and Circular 230 practitioners and unenrolled tax return preparers. They should also include witnesses who can address the additional compliance burden the CONOPS will impose on various categories of taxpayers as well as the likely impact of the CONOPS on the overall rate of voluntary tax compliance.

33 GAO, GAO-16-146, GAO-16-146, *Financial Audit: IRS's Fiscal Years 2015 and 2014 Financial Statements* 25 (Nov. 2015), *available at* www.gao.gov/assets/680/673614.pdf (showing the IRS collected total tax revenue of about $3.3 trillion in FY 2015); IRS, *IRS FY 2016 Budget-in-Brief*, *available at* https://www.irs.gov/PUP/newsroom/IRS%20Budget%20in%20Brief%20FY%202016.pdf (showing the IRS's enacted FY 2015 IRS appropriation was $10,945,000,000).

MSP #2 IRS USER FEES: The IRS May Adopt User Fees to Fill Funding Gaps Without Fully Considering Taxpayer Burden and the Impact on Voluntary Compliance

RESPONSIBLE OFFICIALS

Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland, Commissioner, Wage and Investment Division
Sunita Lough, Commissioner, Tax Exempt and Government Entities Division
Douglas W. O'Donnell, Commissioner, Large Business and International Division
Kirsten Wielobob, Chief, Appeals
William J. Wilkins, Chief Counsel
Jeffrey S. Wallbaum, Acting Chief Financial Officer

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

Between fiscal years (FY) 2010 and 2015, the IRS's appropriation declined by about ten percent (from $12.15 billion to $10.95 billion), and its user fee revenue increased by about 34 percent (from $290 million to $391 million).[2] The IRS is actively considering user fee increases that would mitigate cuts to its appropriation.[3] The IRS's need for user fee revenue heightens the importance of requiring employees to:

- Avoid fees that impair its service-oriented mission, voluntary compliance, or taxpayer rights;
- Estimate the effect of the fee on demand for service; and
- Publish its user fee analysis and address any comments from internal and external stakeholders before adopting or increasing a fee.

Even user fees that seem reasonable to the IRS in a vacuum may seem outrageous to taxpayers when added to the costs of recordkeeping, filing and paying taxes, and paying professionals for help in navigating complicated rules and procedures that the government created. They may seem even more outrageous

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

2 Treasury Department, *Congressional Justification* (FY 2010-2016), *available at* http://www.treasury.gov/about/budget-performance/Pages/cj-index.aspx; IRS response to TAS information request (May 20, 2015); IRS response to TAS information request (Oct. 22, 2015).

3 IRS response to TAS information request (Oct. 22, 2015). For a discussion of the effect of these cuts, see, *e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 20-39 (Most Serious Problem: *The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance*).

The IRS is not a business selling rights only to those willing to pay.

when combined with the IRS's plans to reduce services it previously provided for free, shifting more tax compliance burdens to taxpayers.[4]

Shifting compliance burdens to taxpayers is inconsistent with the IRS mission and taxpayer rights, and may reduce voluntary tax compliance. The IRS's mission is to "[p]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the tax law with integrity and fairness to all."[5] User fees discourage taxpayers from obtaining services that could help them "understand and meet their responsibilities."

User fees may also erode taxpayer rights, such as the *right to quality service*. This "right" to quality service may be inconsistent with requiring taxpayers to pay a fee for it. The IRS is not a business selling rights only to those willing to pay. If some are able to pay and others are not, then the fee may also erode the *right to a fair and just tax system*.

In addition, IRS services often promote voluntary compliance.[6] Thus, if a fee discourages taxpayers from using services, it may erode tax compliance, particularly if it combines with other burdens to make them lose interest in trying to comply.

ANALYSIS OF PROBLEM

The IRS Has Discretion in Setting User Fees

The Independent Offices Appropriation Act of 1952 (IOAA) generally requires federal agencies to establish user fees at "full cost" for services that convey "special benefits."[7] However, fees must be "fair" and based, in part, on the "public policy or interest served," and agencies can seek a waiver of this requirement from the Office of Management and Budget (OMB).[8] Various other laws give the IRS discretion to set a "reasonable" fee for specific items.[9] Thus, the IRS does not have to impose user fees that have undesirable consequences.

The IRS Seems to Prioritize User Fee Revenue

It took the IRS the 43 years between 1952 and 1995 to charge any fees based on the IOAA. In 1995, after Congress allowed it to retain some of its user fee revenue,[10] the IRS imposed a new $43 user fee to

4 *See, e.g.*, Most Serious Problem: *Taxpayer Access to Online Accounts: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak with an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues that Are Not Conducive to Resolution Online, infra.*

5 Internal Revenue Manual (IRM) 1.1.1.2, *IRS Mission* (June 2, 2015).

6 See, *e.g.*, Dept. of Treasury, *Reducing the Federal Tax Gap a Report on Improving Voluntary Compliance* (Aug. 2, 2007), *available at* http://www.irs.gov/pub/irs-news/tax_gap_report_final_080207_linked.pdf.

7 31 U.S.C. § 9701.

8 *Id.*; OMB, Circular A-25, 58 Fed. Reg. 38,142 (July 15, 1993) (hereinafter "Circular A-25") (directing that an agency may apply for a user fee exception based on anything that "in the opinion of the agency head or his designee, justifies an exception.").

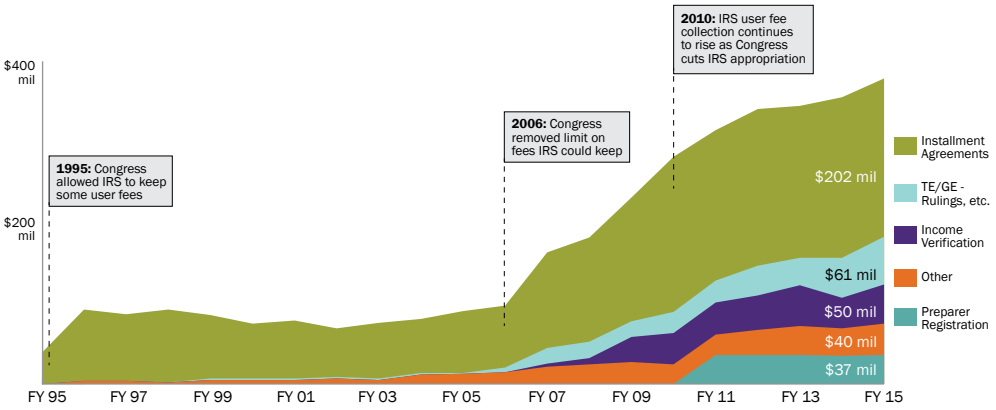
9 *See, e.g.*, Internal Revenue Code (IRC) § 6103(P) (reproduction of returns and the disclosure of return information, such as a U.S. Residency Certification, Income Verification Express Service (IVES), and copies); IRC § 7528 (letter rulings, opinion letters, determination letters, art valuation, and similar requests); IRC § 6104 (copying and mailing exempt organization (EO) materials and returns); IRC § 6108 (statistical studies); 5 U.S.C. § 552(a)(4)(A) (FOIA document search, duplication, and review); IRC § 6110(k) (reproduction of Chief Counsel Advice); 29 U.S.C. 1202a (Employee Plan Compliance Resolution System); IRM 1.32.19.21, *Types of User Fees* (Nov. 8, 2012). The IRS must also collect a $500 user fee from any person claiming a deduction for a historical preservation easement. *See* IRC § 170.

10 31 U.S.C. § 3302(b) (requiring user fees to be deposited with the Treasury, absent specific statutory authority); Treasury Postal Service and General Government Appropriations Act of 1995, Pub. L. No. 103-329, § 3, 108 Stat. 2,382 (1994) (codified at IRC § 7801 (note)) (allowing the IRS to retain certain user fee receipts).

enter into an installment agreement (IA).[11] In 2006, Congress removed the limit on the amount of fee revenue the IRS could keep.[12] User fee receipts immediately increased, and the IRS has acknowledged that with the reductions in enacted appropriations beginning in FY 2011, it has increasingly relied on user fees for funding, as shown in Figure 1.2.1.[13]

FIGURE 1.2.1

IRS User Fee Revenue



Between FYs 2010 and 2015, the IRS's appropriation declined by about ten percent (from $12.15 billion to $10.95 billion), and its user fee revenue increased by about 34 percent (from $290 million to $391 million).[14] Although user fees were historically used, in large part, to fund services, beginning in FY 2015, the IRS shifted user fee revenue expenditures from taxpayer service to operations support, primarily information technology infrastructure to implement the Affordable Care Act (ACA).[15] User fees applied to service expenditures declined by 75.4 percent (from $183 million in FY 2014 to $45 million in FY 2015), while user fees applied to operations support expenditures increased by 77.0 percent (from $222 million in FY 2014 to $393 million in FY 2015), and the IRS plans to allocate more user fee revenue to operations support than to services in FY 2016, as shown in Figure 1.2.2.[16]

Between FYs 2010 and 2015, the IRS's appropriation declined by about ten percent (from $12.15 billion to $10.95 billion), and its user fee revenue increased by about 34 percent (from $290 million to $391 million).

11 T.D. 8589, 60 Fed. Reg. 8298 (Feb. 14, 1995); Treas. Reg. § 300.0-300.2.

12 Pub. L. No. 109-115 § 209, 119 Stat. 2439 (2006) (codified at IRC § 7801 (note)). OMB Circular A-25 also requires agencies to update user fees every two years.

13 IRS response to TAS fact check (Nov. 13, 2015). Even though user fee revenue has been rising, the IRS has spent more of its user fee collections every year since FY 2010 (spending $481,882,027 in FY 2015 (planned), up from $148,124,769 in FY 2010), causing the carryover balance in its user fee account to decline from its high-water mark of $352,928,852 at the beginning of FY 2013 to $193,074,529 as of September 30, 2015. *Id*.

14 Treasury Department, *Congressional Justification* (FY 2010-2016), *available at* http://www.treasury.gov/about/budget-performance/Pages/cj-index.aspx; IRS response to TAS information request (May 20, 2015); IRS response to TAS information request (Oct. 22, 2015).

15 The House Ways and Means Committee expressed concern about this shift. House Ways and Means Committee, *Majority Staff Report, Doing Less with Less: IRS's Spending Decisions Harm Taxpayers*, 114th Cong. (Apr. 22, 2015).

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

FIGURE 1.2.2, User Fee Spending by Account[17]

Account	FY 2013		FY 2014		FY 2015		FY 2016 (Plan)	
Taxpayer Services	$191 mil	48.3%	$183 mil	43.6%	$45 mil	9.7%	$97 mil	22.9%
Enforcement	$20 mil	5.2%	$15 mil	3.5%	$21 mil	4.5%	$10 mil	2.4%
Operations Support	$184 mil	46.6%	$222 mil	52.9%	$393 mil	85.8%	$316 mil	74.7%
Total	**$396 mil**		**$419 mil**		**$459 mil**		**$423 mil**	

The IRS's reliance on user fee revenue to offset cuts creates a conflict of interest. This conflict is stronger when the IRS appropriation declines. Agencies are supposed to reevaluate user fees every two years, but the IRS has asked its business units (BUs) to reevaluate them more often in the last few years due to its declining appropriation.[18]

User Fees Can Undermine the IRS Mission, Voluntary Compliance, and Taxpayer Rights

If fees discourage taxpayers from using IRS services, they may undermine the IRS mission, voluntary compliance, and taxpayer rights. For example, in addition to penalties and interest for late payments, the IRS charges taxpayers a fee to set up an IA, which it increased from $105 to $120 in 2014.[19] It is considering further increases to the IA fee.[20] If this fee discourages taxpayers who cannot pay in full from making arrangements to pay, then it:

1. Reduces voluntary compliance, potentially prompting the IRS to issue more wage levies or classify more accounts as uncollectible;
2. Is inconsistent with the IRS mission to help taxpayers "meet their tax responsibilities;"[21] and
3. Is inconsistent with the taxpayer's *right to privacy*, *i.e.*, that enforcement be "no more intrusive than necessary."[22] Paying in installments would be less intrusive than a levy. It may also be inconsistent with the *right to a fair and just tax system*, which requires the tax system to "consider facts and circumstances that might affect … ability to pay."[23] Similarly, it may be inconsistent with the idea that *quality service* is a fundamental taxpayer right, which should not be subject to a fee.[24]

17 IRS response to TAS fact check (Nov. 13, 2015). The FY 2016 projections are preliminary and subject to change. The IRS increased the user fees allocated to operations support, in large part, to implement the ACA. IRS response to TAS information request (Oct. 22, 2015).

18 Circular A-25 § 8(e) (two years). The IRS held its biennial user fee review process in 2007, 2009, 2011, 2013, and 2015, as well as an out-of-cycle review in 2014. IRS response to TAS information request (May 20, 2015). The IRS also sought revenue-raising ideas in connection with a resource realignment effort in early 2015.

19 T.D. 9647, 78 FR 72016 (2014); Treas. Reg. § 300.1 (IA fee).

20 IRS response to TAS information request (Oct. 22, 2015) (FY 2015 Biennial Review of User Fee Charges, Attachment 2).

21 IRM 1.1.1.2, *IRS Mission* (June 2, 2015).

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

23 *Id*.

24 *Id*. *Cf.*, *Harper v. Virginia State Bd. of Elections*, 383 U.S. 663 (1966) (holding unconstitutional a state-imposed $1.50 poll tax) and *Bullock v. Carter*, 405 U.S. 134 (1972) (holding unconstitutional a state-imposed filing fee of between $1 and $8,900 to register as a candidate in the primary election, even as to fees that were limited to less than ten percent of the candidate's gross income). If an IA fee does not actually discourage any taxpayers from obtaining an IA, then it should not be imposed under existing criteria, because it is not really voluntary. *See, e.g.*, IRM 1.32.19.20, *Review and Implementation of New User Fees* (Nov. 8, 2012). Moreover, the National Taxpayer Advocate questions whether an IA or offer in compromise (OIC) is actually a "special" service, as some people will simply not be able to pay and the IRS will need to deal with them in some way.

As another example, the Private Letter Ruling (PLR) fee increased from $10,000 to $28,300 in 2015 for an exempt organization (EO) with gross income of $1 million or more.[25] If only some taxpayers who need guidance can afford a PLR, the PLR fee is inconsistent with the taxpayer *right to a fair and just tax system*, which includes the right to expect the tax system to "consider facts and circumstances that might affect their underlying liabilities."[26] Although lower PLR fees apply to those with lower gross income, when combined with the amount taxpayers have to pay to an advisor to help with a PLR submission, the PLR fee may discourage taxpayers from obtaining the information they need (*i.e.*, a PLR) to voluntarily comply. According to some practitioners, for the first time in history the $28,000 PLR filing fee may now exceed the legal costs of preparing the PLR request.[27]

The Internal Revenue Manual (IRM) Provides Limited Guidance About How to Evaluate User Fees

The IRM requires IRS employees to consider the following factors in setting user fees:

- The voluntary nature of the user fee activities. The IRS does not charge taxpayers for special services that they do not request.
- The benefit must be identifiable to a specific taxpayer.
- The cost of administering the user fee, as this cannot be a substantial amount of the fee.
- The impact of the user fee on low income taxpayers.[28]

The IRM does not require employees to consider the effect of user fees on the IRS's service-oriented mission, voluntary compliance, taxpayer burden, or taxpayer rights.[29] Nor does it require them to estimate the effect of fees on the demand for service or downstream costs so that they can make better informed decisions about these effects.[30]

User fees that seem reasonable to the IRS in a vacuum may seem outrageous to taxpayers when added to the costs of recordkeeping, filing, and paying taxes, and paying professionals for help in navigating complicated rules and procedures that the government created. They may seem even more outrageous when combined with the IRS plans to reduce services it historically provided for free, shifting even more

25 Previously, the fee for PLRs from Tax Exempt/Government Entities (TE/GE) was a flat $10,000 for all organizations. Rev. Proc. 2014-8, § 6.08, 2014-1 I.R.B. 242 (2014). In form, the 2015 fee for PLRs from IRS Counsel only increased from $19,000 to $28,300 for EOs with gross income of $1 million or more. Rev. Proc. 2015-1, App'x A(3), 2015-1 I.R.B. 1 (2015). However, due to an IRS realignment in 2014, EOs seeking PLRs now pay the rates applicable to IRS Counsel. Rev. Proc. 2015-8, § 6, 2015-1 I.R.B. 235 (2015). As a result, the fee effectively increased from $10,000 to $28,300. EOs with high gross income may have little net income with which to pay a fee. They may also divert funds to pay the user fee that would otherwise be used to provide important services to the public.

26 IRS Pub 1, *Your Rights as a Taxpayer* (2014). Although the fee is lower for those with lower gross income, there is no low income waiver for PLRs. *See, e.g.*, Rev. Proc. 2015-1, App'x A(3), 2015-1 I.R.B. 1 (2015).

27 Paul Streckfus, EO Tax Journal, *Email Update 2015–102* (May 27, 2015) (quoting comments by Rob Wexler at an American Bar Association Tax Section meeting).

28 IRM 1.32.19.20(1), *Review and Implementation of New User Fees* (Nov. 8, 2012). In 2007, the National Taxpayer Advocate reported the IRS did not have a consistent methodology for determining whether to charge a fee. National Taxpayer Advocate 2007 Annual Report to Congress 66-82. The IRS subsequently documented the process for setting fees.

29 As noted above, however, 31 U.S.C. § 9701 generally requires user fees to be "fair" and based, in part, on the "public policy or interest served," and OMB Circular A-25 provides that an agency may apply for a user fee exception based on anything that "in the opinion of the agency head or his designee, justifies an exception."

30 The IRS generally estimates the impact of fees on demand for services only after they are imposed or increased. TAS midpoint call with responsible officials (Sept. 17, 2015). It does not isolate the effect of the fee from other factors that may affect demand. *Id.*

of the burden of tax compliance to taxpayers.[31] In such cases, they may be even more likely to discourage taxpayers from using IRS services.

IRS Employees Sometimes Consider the Downstream Effects of Fees

In its biennial user fee reviews, the IRS sometimes considers the effect of a fee increase on service and compliance.[32] For example, in the FY 2011 Biennial Review the Small Business/Self-Employed Division (SB/SE) recommended retaining the existing IA fee, which was below full cost, because, among other things:

- Keeping the present rates encourages taxpayers to enter into an IA and pay down the current liability; and
- Increasing the rate may discourage taxpayers from using the IA process, age our accounts receivable and move us closer to the statute expiration date without resolution of the account.[33]

In the FY 2013 Biennial Review, the IRS's National Public Liaison (NPL) office — an office that facilitates communications between the IRS and external stakeholders — opposed a user fee for the Nationwide Tax Forums, in part, because there is "significant value in providing a national platform for education and outreach activities."[34] Similarly, the Large Business and International Division (LB&I) opposed a fee for the Compliance Assurance Process (CAP) because CAP encourages voluntary compliance and benefits the IRS.[35] It also opposed increasing the $50,000 fee for Pre-Filing Agreement (PFAs) to the IRS's full cost of $265,475.[36] LB&I reasoned that PFAs "enhance compliance," and as part of its mission to provide taxpayer service, it believes the PFA program helps to prepare taxpayers to become a part of CAP."[37]

Without express guidance that IRS employees should consider the effect of fees on service, the IRS mission, taxpayer rights and burden, and voluntary compliance, they may feel pressure to ignore these considerations.

In the 2011 review, the Tax Exempt and Government Entities Division (TE/GE) opposed charging full cost to issue a PLR to individuals who need guidance about Roth IRA recharacterizations.[38] It reasoned that the fee can be prohibitive for individuals and negatively affect retirement savings. In the 2009 review, it also recommended a less-than-full-cost fee for approving

31 *See, e.g.*, Most Serious Problem: *Taxpayer Access to Online Account System: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak with an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues that Are Not Conducive to Resolution Online*, *infra*.

32 IRS response to TAS information request (May 20, 2015) (attachments A and G).

33 *Id.* (attachment G). SB/SE used a similar justification to avoid increasing the fee for OICs in the FY 2011 Review. *Id.*

34 IRS response to TAS information request (May 20, 2015) (attachment A); IRM 1.1.11.4, *Office of National Public Liaison* (Feb. 12, 2015).

35 CAP is a program that allows large businesses under continuous audit to, in effect, have the IRS audit the return before it is filed, increasing voluntary compliance and reducing the burden of post-filing examinations for both the IRS and taxpayers. *See, e.g.*, IRM 4.51.8 (June 15, 2012).

36 IRS response to TAS information request (May 20, 2015) (attachment A).

37 Similarly, LB&I argued that Advanced Pricing Agreements (APAs) are deliberately set at 50 percent of their total cost because they help reduce enforcement costs while providing a benefit to taxpayers. IRS response to TAS information request (May 20, 2015) (attachment A). In the 2011 review, LB&I also "considered but rejected a user fee for Qualified Intermediaries because the IRS wants to encourage foreign intermediaries to become qualified intermediaries and a user fee would have a negative impact on this process." IRS response to TAS information request (May 20, 2015) (attachment G). As the Business Units (BU) proposed to increase the APA and PFA fees in 2015, LB&I either did not voice these concerns or they were minimized in the latest review. IRS response to TAS information request (Sept. 22, 2015) (Executive Summary).

38 IRS response to TAS information request (May 20, 2015) (attachment G).

User fees that seem reasonable to the IRS in a vacuum may seem outrageous to taxpayers when added to the costs of recordkeeping, filing, and paying taxes, and paying professionals for help in navigating complicated rules and procedures that the government created.

certain (master and prototype volume submitter) employee plans.[39] It reasoned that because these pre-approved plans are ultimately adopted by thousands of employers, they help TE/GE manage its workload by reducing requests for plan approvals.

In some cases the IRS also recommended that fees depart from its full-cost estimates when those estimates were in flux. The IRS's cost estimates depend on assumptions about what overhead costs should be included and how many taxpayers use the service (*e.g.*, when more taxpayers use a service, unit costs decline).[40] Taxpayers should not have to pay excessive user fees simply because there are not enough other taxpayers using a service to lower unit costs, particularly when demand for the service is in flux, or fixed or indirect costs seem excessive.[41] For example, if PLR unit costs increase because fewer taxpayers request them (*e.g.*, because the IRS has increased the fee), the IRS should not use its increased unit costs to justify increasing the fee even further. In such cases, employees should be required to recommend fees based on either the maximum demand expected for the service or on marginal costs, as they may have done in some cases.

Without Additional Guidance, the IRS May Not Consistently Evaluate User Fees, Resulting in Disparate Treatment of Taxpayers

Without express guidance that IRS employees should consider the effect of fees on service, the IRS mission, taxpayer rights and burden, and voluntary compliance, they may feel pressure to ignore these considerations.[42] Alternatively, they may ignore them in some cases and not others, resulting in disparate treatment of taxpayers. For example, the fees for CAP, which is used by the largest businesses may be below cost because LB&I employees raised concerns about voluntary compliance, whereas the fee for regular IAs may be at full cost because SB/SE employees did not.[43] The IRS may also begin to charge full costs for services, even when excessive overhead is included, a service is underutilized, or volume estimates are in flux. As noted above, the pressure to ignore or minimize these considerations is likely greater now that the IRS budget is constrained and it relies on user fees to replace its reduced appropriation.

39 IRS response to TAS information request (May 20, 2015).

40 "Full cost" fees can seem disproportionate to the value provided because they include direct and indirect costs such as "salaries and fringe benefits such as medical insurance and retirement.... Physical overhead, consulting ... material and supply costs, utilities, insurance, travel, and rents or imputed rents on land, buildings, and equipment." Circular 25-A, § d(1).

41 We understand the IRS's costs estimates spread start-up costs over a multi-year period. TAS midpoint call with responsible officials (Sept. 17, 2015). Nonetheless, the IRS's resulting full-cost estimates may still seem disproportionate and discourage taxpayers from utilizing a new or underutilized service.

42 Such considerations are consistent with OMB Circular A-4 (Sept. 17, 2003).

43 It is possible that SB/SE's concerns in this regard may not have been documented.

The IRS Does Not Fully Disclose What It Considers

When IRS employees analyze user fees, they do not fully disclose their analysis to the public (*e.g.*, the biennial review documents).[44] Discussing the rationale for and computation of proposed increases in public before they are adopted would ensure the IRS is better informed about the consequences. Stakeholders can provide relevant and helpful information about the impact of the fees on taxpayers and practitioners. The IRS should disclose everything it considers in connection with its user fee reviews and ask the public for comments before deciding to increase fees.

CONCLUSION

Rather than reactively applying user fees to fill a short-term funding deficit, the IRS should consider whether new and existing fees will discourage voluntary compliance, burden taxpayers excessively, or impair the IRS's service-oriented mission. If the IRS makes compliance too difficult or expensive, then compliance will decline. If a fee for service or a lack of service erodes compliance, the IRS will have to accept more noncompliance or spend more resources on (expensive) enforcement activities.[45] The IRS should quantify and explain these considerations and disclose them to the public.[46]

It may be less expensive in the long run (for the government but not necessarily the IRS) to provide IRS services without a fee, even if that means the IRS needs to reduce the resources it devotes to enforcement activity. About 98 percent of all revenue the IRS collects results from voluntary compliance, as compared to about two percent in enforcement revenue.[47] Moreover, Congress obviously intended for the IRS to focus on service, as it has reduced the IRS's budget for enforcement more severely than its budget for services in recent years.[48] Congress has long urged the IRS to focus on service. In 1998, it went so far as to direct the IRS to "restate its mission to place a greater emphasis on serving the public and meeting taxpayers' needs."[49]

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44 *See, e.g.*, Government Accountability Office, GAO-12-193, *User Fees: Additional Guidance and Documentation Could Further Strengthen IRS's Biennial Review of Fees* 18-19 (Nov. 2011) ("IRS officials consider factors other than cost recovery in setting fee rates. However, we found that IRS has not thoroughly documented these factors, corroborated anecdotal support with data analysis, or studied the effect of user fees on taxpayer behavior."); T.D. 9647, 78 Fed. Reg. 72016 (2014) (briefly referencing the goal of "encouraging the use of installment agreements"); Rev. Proc. 2015-8, § 6, 2015-1 I.R.B. 235 (2015) (no discussion of the basis for master and prototype volume submitter plan fees; no discussion of basis for Roth IRA recharacterization fee); Rev. Proc. 2015-1, App'x A(3), 2015-1 I.R.B. 1 (2015) (same); Rev. Proc. 2006-9, § 4.12, 2006-1 C.B. 278 (no discussion of basis for APA fee). The IRS did not publish the biennial reviews described above or any similarly detailed analysis.

45 Department of Treasury, *Congressional Justification for Appropriation and Annual Performance Report and Plan*, IRS-7 (2015) ("By assisting taxpayers with their tax questions before they file their returns, the IRS helps prevent inadvertent noncompliance and reduces burdensome post-filing notices and other correspondence from the IRS.").

46 This recommendation is generally consistent with OMB Circular A-4 (Sept. 17, 2003).

47 In FY 2015, the IRS collected total tax revenue of about $3.3 trillion. Of that amount, it collected $54.2 billion through enforcement actions. GAO, GAO-16-146, *Financial Audit: IRS's Fiscal Years 2015 and 2014 Financial Statements* 25 (Nov. 2015), *available at* www.gao.gov/assets/680/673614.pdf.

48 *Compare* Department of Treasury, *Congressional Justification for Appropriation and Annual Performance Report and Plan*, Table 2.3 (2011) (reflecting an appropriation of $2,278,830,000 for service and $5,504,000,000 for enforcement for FY 2010), *with* Department of Treasury, *Congressional Justification for Appropriation and Annual Performance Report and Plan*, Table 2.3 (2016) (reflecting an appropriation of $2,156,554 for service and $4,860,000 for enforcement for FY 2015).

49 The IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 722, Title I, § 1002 (1998).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Revise the IRM to require the IRS to avoid adopting (or retaining) a fee that would:
   - Have a significant negative impact on the IRS's service-oriented mission, voluntary compliance, or taxpayer rights and burden (including other compliance burdens taxpayers may face, such as the costs of hiring preparers or other third parties); or
   - Include fixed or indirect costs when demand for a service is in flux or that make the fee disproportionate to the value received.
2. Before establishing or raising any user fee, estimate the effect of the fee on demand for service, as needed to determine if the fee would impair the IRS mission, voluntary compliance, or taxpayer rights. This analysis should also demonstrate that the proposed fee does not pass along indirect or fixed costs or combine with other costs that would make it seem excessive from the taxpayer's perspective.
3. Publish the user fee analysis (described above) and address any comments from internal and external stakeholders before adopting or increasing a fee.

User Fees Memo

In the memo below, the National Taxpayer Advocate analyzes the most recently proposed fee increases under the principles described in the Most Serious Problem. However, the IRS has requested the redactions shown below.

TAXPAYER ADVOCATE SERVICE
YOUR VOICE AT THE IRS

THE OFFICE OF THE TAXPAYER ADVOCATE OPERATES INDEPENDENTLY OF ANY OTHER IRS OFFICE AND REPORTS DIRECTLY TO CONGRESS THROUGH THE NATIONAL TAXPAYER ADVOCATE.

December 4, 2015

MEMORANDUM FOR JOHN A. KOSKINEN
Commissioner of Internal Revenue

FROM: Nina E. Olson
National Taxpayer Advocate

SUBJECT: IRS User Fee Increases

You recently received recommendations to increase various user fees, which were developed by IRS business units (BUs) in connection with the IRS's FY 2015 Biennial User Fee Review. Particularly in light of the current budget situation, I am concerned that the BUs have not quantified or sufficiently considered:

- The indirect costs that are likely to result from fee increases;
- The effect of fee increases on taxpayer rights or burden;
- Any resulting reductions in voluntary compliance; or
- Any impairment of the IRS mission to "[p]rovide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all."[1]

Although the sections below discuss TAS's concerns with each of the major user fee proposals, other internal and external stakeholders may have additional concerns. Thus, the IRS should engage in an open dialog with the public before determining whether to submit fee increases for approval, or at least before they are approved.

1 See, e.g., IRS, Publication 1, *Your Rights as a Taxpayer* (2014); IRM 1.1.1.2, *IRS Mission* (June 2, 2015). In addition, if TAS (rather than the taxpayer) requests or orders the IRS to provide a service (*e.g.*, under IRC § 7811) on the basis that the taxpayer would otherwise suffer a significant hardship, it is not clear that the IRS would be authorized to withhold service if the taxpayer did not pay the fee. For example, to avoid a significant hardship, a taxpayer may need Appeals to expedite calculations or for Collection to withdraw a Notice of Federal Tax Lien (NFTL), but the IRS is considering fees for these services, as described below.

User Fees Memo

Offer in Compromise Fee Increase

[redacted] When the IRS determines a taxpayer is unlikely to be able to repay a delinquent tax debt, it may accept an offer to compromise the debt based upon "doubt as to collectibility."[3] The goal of the OIC program is for the IRS to collect what is reasonably collectible at the least cost and at the earliest possible time, and to promote future compliance by providing taxpayers with a "fresh start."[4] An accepted OIC also provides an extra incentive to report and pay future tax liabilities by requiring, as a condition of the OIC agreement, that the taxpayer file returns and pay taxes for the following five years.[5] Thus, an acceptable OIC is a good deal for both taxpayers and the government, and enhances voluntary compliance, furthering the IRS's mission to help taxpayers "meet their responsibilities." It is also consistent with the taxpayer *right to finality*, *to quality service*, and *to privacy*, which includes the right to expect that enforcement action will "be no more intrusive than necessary."[6]

When combined with the requirement for applicants to submit a down payment with an OIC,[7] the substantial OIC fee increase being considered — [redacted] — will almost certainly reduce utilization of the OIC program, thereby reducing voluntary compliance and impairing the IRS mission.[8] Because taxpayers generally have to fund an offer by selling illiquid assets that the IRS could not otherwise reach or convincing a non-liable party to pay, they are unlikely to make this effort unless they are sure the IRS will accept the offer. They cannot be sure the IRS will accept the offer up front when the fee is due.

As the IRS has acknowledged, "the fee for an offer in compromise could dissuade a low-income taxpayer from making an offer because the taxpayer cannot be assured of reaching an agreement."[9] The OIC fee could also dissuade taxpayers in every other income category from making offers. [redacted] Indeed, when the IRS first imposed a $150 OIC fee in 2003, OIC submissions declined by over 20 percent among taxpayers at every income level.[10] Further, in FY 2016 the Administration proposed to repeal the OIC down payment requirement based its conclusion that repealing the requirement

2 [redacted]

3 *See* IRC § 7122; Treas. Reg. § 301.7122-1; Form 656, *Offer in Compromise* (2015).

4 Policy Statement P-5-100, *reprinted at*, IRM 1.2.14.1.17, *Policy Statement 5-100* (Jan. 30, 1992).

5 Form 656, *Offer in Compromise* (2015). An IRS study found that about 80 percent of taxpayers in its sample with accepted OICs remained substantially compliant during the requisite period. Small Business/Self-Employed (SB/SE) Payment Compliance and Office of Program Evaluation and Risk Analysis (OPERA), *IRS Offers in Compromise Program, Analysis of Various Aspects of the OIC Program*, 6 (Sept. 2004).

6 *See, e.g.*, IRS, Publication 1, *Your Rights as a Taxpayer* (2014).

7 Section 509 of the *Tax Increase Prevention & Reconciliation Act of 2005 (TIPRA)*, P.L. 109-223, effective July 16, 2006, imposed a requirement to submit a down payment with offer submissions.

8 Further, such a steep fee increase seems inconsistent with the Conference Report for the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA98), which states "the conferees believe that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements." H.R. REP. NO. 105-599, at 288-89 (1998) (Conf. Rep.).

9 T.D. 9647, 78 F.R. 72016, 72017 (Dec. 2, 2013).

10 The Treasury Inspector General for Tax Administration (TIGTA) has concluded that the $150 OIC user fee, imposed in November 2003, was responsible for reducing OIC submissions by 28 percent overall. *See* TIGTA, Ref. No. 2005-30-096, *The Implementation of the Offer in Compromise Application Fee Reduced the Volume of Offers Filed by Taxpayers at All Income Levels* (June 2005). The smaller $36 increase in 2014 (from $150 to $186) would be less likely to trigger a significant reduction in OICs. *See* T.D. 9647, 78 F.R. 72016 (Dec. 2, 2013).

User Fees Memo

would raise revenue by improving access to the OIC program, which is less costly than other collection avenues.[11]

The IRS should estimate the effect of a [redacted] increase on demand for OICs, the resulting decline in future compliance, and the costs of trying to collect these debts (and future debts, which will continue to accrue) in some other way before considering an OIC fee increase. Any such analysis would probably find that it is less costly and burdensome to eliminate the OIC fee altogether than to increase it. The IRS should use such projections to help justify a full OIC fee waiver from the Office of Management and Budget (OMB).

Moreover, because the OIC fee reduces the amount the taxpayer can afford to pay on the offer, the OIC fee may be viewed as an accounting gimmick that elevates form over substance — like a tax shelter — allowing the IRS to retain and use funds that would otherwise return to the U.S Treasury in the form of higher offer amounts. The IRS should avoid giving this impression, which can only reduce respect for the IRS and the government — views which research shows correlate with noncompliance.[12]

If the IRS nonetheless pursues the OIC fee increase, it should minimize taxpayer burden by collecting the fee from the last OIC payment or at least in installments (for OICs structured that way), as it does when collecting the Installment Agreement (IA) fee. It should also waive the fee to the extent it would otherwise exceed the total OIC amount. For example, where the taxpayer can only pay $500, the fee should not exceed $500 and the IRS should accept an offer for $0, rather than rejecting the offer as insufficient or declining to process it because the taxpayer did not pay the fee. Although the OIC fee under consideration would not apply to low income taxpayers, rejecting or refusing to process such an offer would undermine IRC § 7122(d)(3)(A), which provides that "an officer or employee of the Internal Revenue Service shall not reject an offer-in-compromise from a low-income taxpayer solely on the basis of the amount of the offer."

Installment Agreement Fee Increase

The FY 2015 Biennial Review [redacted]

11 Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals* 237 (Feb. 2015), *available at* http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx ("Requiring nonrefundable payments with an offer-in-compromise may substantially reduce access to the offer-in-compromise program. The offer-in-compromise program is designed to settle cases in which taxpayers have demonstrated an inability to pay the full amount of a tax liability. The program allows the IRS to collect the portion of a tax liability that the taxpayer has the ability to pay. Reducing access to the offer-in-compromise program makes it more difficult *and costly* to obtain the collectible portion of existing tax liabilities." (Emphasis added)). The administration's analysis must have applied to high income taxpayers because low income taxpayers are exempt from the down payment requirement. *See, e.g.*, IRC § 7122(c)(2)(C); IRS, Form 656, *Offer in Compromise* (2015).

12 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-70 (*Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*); National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 33-56 (*Small Business Compliance: Further Analysis of Influential Factors*).

13 IRS response to TAS information request (Nov. 9, 2015). [redacted] *Id*.

14 IRS response to TAS information request (Nov. 9, 2015).

User Fees Memo

While an IA fee may seem reasonable on the basis that creditors charge financing fees to allow customers to pay over time, the IRS is not a commercial creditor. For taxpayers who cannot afford to pay their taxes timely and in full, the choice is to either pay their taxes (plus penalties and interest) using an IA or not to pay them. The choice for the IRS is to accept the IA, pursue enforced collection, or collect nothing. If enforced collection (or placing the taxpayer into currently not collectible (CNC) status) is more expensive, the government is the primary beneficiary when taxpayers agree to pay using IAs – at least they agreed to pay.[15]

The IRS should not discourage taxpayers from utilizing IAs by charging a fee that is difficult to avoid, particularly when they feel they cannot use the lower cost IA options. For example, some do not have bank accounts they could use to set up an online direct debit IA. Some do not have internet access or the computer literacy that would enable them to use the online IA application.[16] According to the U.S Census Bureau, more than 50 percent of the U.S. population with household income below $25,000 had no Internet access in 2013.[17] About 40 percent of the returns the IRS received for tax year (TY) 2013 (or 59.0 million out of 147.4 million) reported adjusted gross income of less than that amount.[18]

Even those with access may be concerned about entering their most sensitive financial information into a web application. Security breaches of the IRS's "Get Transcript" online application and the Office of Personnel Management (OPM)'s federal employee records have likely increased the public's anxiety in this area.[19]

Like offers, IAs promote voluntary compliance, furthering the IRS's mission to help taxpayers "meet their tax responsibilities." IAs are also consistent with the *right to quality service* and *to privacy*, which includes the right to expect that enforcement action will "be no more intrusive than necessary," as enforced collection would be more intrusive than an IA.[20]

To the extent that IA fees reduce IA utilization, they are likely to reduce voluntary compliance and damage the IRS's ability to further its mission. In theory, one might construe many routine IRS services as being eligible for a user fee, such as answering the telephone, processing a tax return, or sending a refund. Presumably, the IRS has decided that charging fees for these services does not make sense or would impair its mission. However, the IRS has not analyzed how IA fees make any more sense or impair its mission any less.

Even if the IRS does not believe an IA fee undermines its mission or reduces voluntary compliance, it should nonetheless project the effect of proposed IA fee increases on IA applications, voluntary compliance, and the cost to the IRS of dealing with these delinquencies in some other way before it decides whether to approve them. It could use such analysis to help justify a fee waiver from OMB.

15 Taxpayers sometimes even ask the IRS to levy their wages to avoid the IA user fee.

16 Only about 84 percent of American adults had Internet access in 2015, and those who are minorities, low income, poor, elderly, or who live in rural areas are less likely to have access. *See* Pew Research Center, *Americans' Internet Access*: 2000-2015 (June 26, 2015), http://www.pewinternet.org/files/2015/06/2015-06-26_internet-usage-across-demographics-discover_FINAL.pdf.

17 U.S. Census Bureau, ACS-28, *Computer and Internet Use in the United States: 2013*, 5 (Nov. 2014), *available at* http://www.census.gov/history/pdf/2013computeruse.pdf.

18 IRS Data Book, Table 1.1, *All Returns: Selected Income and Tax Items, by Size and Accumulated Size of Adjusted Gross Income* (TY 2013), *available at* http://www.irs.gov/uac/SOI-Tax-Stats--Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income.

19 IRS, *IRS Statement on the "Get Transcript" Application* (May 26, 2015); OPM, *OPM to Notify Employees of Cybersecurity Incident* (June 4, 2015).

20 *See, e.g.*, IRS, Publication 1, *Your Rights as a Taxpayer* (2014).

User Fees Memo

[redacted]

21 IRS response to TAS information request (Oct. 22, 2015) [redacted] *2015 Biennial Review of SB/SE User Fees* [redacted] *Id*.

22 Program Manager Technical Advice (PMTA) 2009-158 (Oct. 8, 2009), *available at* http://www.irs.gov/pub/lanoa/pmta_2009-158.pdf ("[t]axpayers seek post-release withdrawals in order to improve their credit. This reason alone would not support a withdrawal under the first three sub-elements of section 6323(j)(1)… withdrawal can be said to be in the United States' best interests insofar as the improvement in the taxpayer's credit history assists him with future tax compliance.")

23 *See, e.g.*, National Taxpayer Advocate 2009 Annual Report to Congress 17, 29-30 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*); PMTA 2009-158 (Oct. 8, 2009).

24 IRM 1.1.1.2, *IRS Mission* (June 2, 2015).

25 IRS response to TAS information request (Nov. 9, 2015). For further discussion of this recommendation, *see, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 402-25; National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 108-30; National Taxpayer Advocate 2011 Annual Report to Congress 109-28; National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111; National Taxpayer Advocate 2010 Annual Report to Congress 302-10; National Taxpayer Advocate 2009 Annual Report to Congress 17-40; National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18.

User Fees Memo

[redacted]

26 IRS response to TAS information request (Oct. 22, 2015) [redacted]

27 *See* IRC § 6109; Treas. Reg. § 301.6109-1(d)(3); Instructions to IRS Form W-7, *Application for IRS Individual Taxpayer Identification Number* (Feb. 2012). For the Bank Secrecy Act requirement, see *generally* Bank Secrecy Act, 31 U.S.C. §§ 5311-5314, 5316-5322; 12 U.S.C. § 1829(b); USA Patriot Act, § 326, Pub. L. No. 107-56, 115 Stat. 307 (2001); 31 C.F.R. §§ 1010.410, 1010.620, 1022.400.

28 IRS, *IRS Strengthens ITIN Application Requirements; Interim Changes Will Protect the Integrity of the ITIN Process*, IR-2012-62 (June 22, 2012), *available at* https://www.irs.gov/uac/Newsroom/IRS-Strengthens-ITIN-Application-Requirements;-Interim-Changes-Will-Protect-the-Integrity-of-the-ITIN-Process; National Taxpayer Advocate 2012 Annual Report to Congress 152, 163.

29 If the applicant is a dependent (other than a military dependent), the AA will still send the identifying document to Austin. *See* IRS, *Instructions for Form W-7, Application for IRS Individual Taxpayer Identification Number*, 3 (2014). If the applicant is using anything other than an original passport or national identification card (*e.g.*, a copy of an original document certified by the issuing agency) at least some TACs will still send the document to Austin. *See*, IRS, *Individual Taxpayer Identification Number (ITIN) Authenticating Taxpayer Assistance Centers* (Mar. 12, 2015), *available at* http://www.irs.gov/uac/ITIN-Authenticating-TACs-Link (last visited Nov. 10, 2015).

30 IRS, *2012 ITIN Review, Frequently Asked Questions* (Apr. 23, 2015), *available at* http://www.irs.gov/uac/2012-ITIN-Review-Frequently-Asked-Questions-1 (last visited Sept. 24, 2015).

31 The IRS has a responsibility to ensure it returns these original documents safely and promptly, but returning them by express mail could cost in the range of $1.2 to $4.1 million, making it more economical for the IRS to review the documents at a TAC or to allow a AA to review them. Conference call between TAS and IRS W&I, discussing *Authenticating Identification Documents at SPEC, AA and VITA Sites* (Oct. 29, 2015).

32 IRS response to TAS information request (Oct. 22, 2015) (Memo from Commissioner, W&I Division to CFO, B*iennial Review of User Fee Charges* (June 19, 2015)).

User Fees Memo

[redacted]

33 During calendar year 2015 dependents made up 43.8 percent of ITIN applicants, but they cannot use AAs to avoid parting with their documents because, as noted above, the AAs have to mail their original documents to the IRS. IRS, Compliance Data Warehouse, Form W-7 Database (Oct. 2, 2015). Moreover, only 21 countries around the world have AAs, with some big countries like India or Brazil only having one or two. IRS, *Acceptance Agent Program, available at* https://www.irs.gov/Individuals/Acceptance-Agent-Program (Oct. 27, 2015).

34 *See* National Taxpayer Advocate 2012 Annual Report to Congress 152, 159. In evaluating the pros and cons of this fee, the IRS acknowledges that it "may reduce voluntary tax compliance." IRS response to TAS information request (Oct. 22, 2015).

35 IRM 1.1.1.2, *IRS Mission* (June 2, 2015).

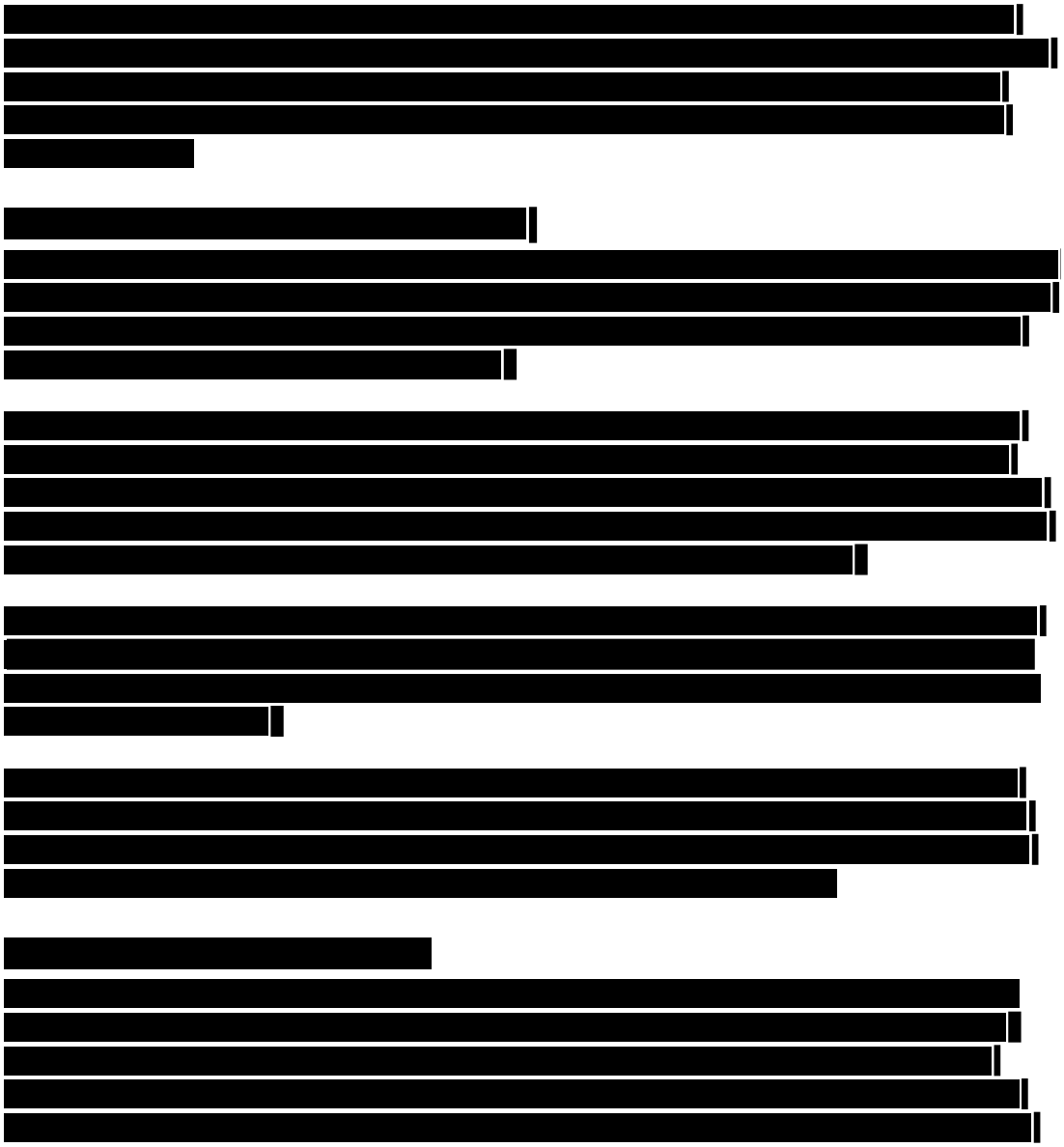
36 IRS response to TAS information request (Oct. 22, 2015) (CFO Briefing).

37 IRS response to TAS information request (Oct. 22, 2015) (Memo from SB/SE Commissioner to CFO, *2015 Biennial Review of SB/SE User Fees* (June 18, 2015)). [redacted]

38 IRS, Letter 627, *Estate Tax Closing Letter* (2007) ("This letter is evidence that the Federal Estate Tax Return has either been accepted as filed or has been accepted after an adjustment to which you have agreed. You should keep this letter as a permanent record. You may need it to close probate proceedings, transfer title to property and/or settle state taxes…. We will not reopen or examine this return unless you notify us of changes to the return or there is: (1) evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of a material fact; (2) a clearly defined substantial error based upon established Internal Revenue Service position; or (3) a serious administrative error. (See Revenue Procedure 2005-32, 2005-1 Cumulative Bulletin 1206.)").

39 *See, e.g.*, IRS, Publication 1, *Your Rights as a Taxpayer* (2014).

User Fees Memo



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

41 *Id*. The IRS could waive the fee if the government caused a delay that resulted in the need for expedited calculations. *Id*. The IRS has also suggested that the processing time is almost always shorter for low-dollar disputes, obviating the need for an expedite fee. IRS response to TAS fact check (Nov. 13, 2015).

42 IRS response to TAS information request (Nov. 9, 2015). According to the IRS, this estimate is an approximation. IRS response to TAS fact check (Nov. 13, 2015).

43 IRM 8.1.1.1(1) *Accomplishing the Appeals Mission* (Feb. 10, 2012).

44 IRS response to TAS information request (Oct. 22, 2015). Appeals proposed to apply the fee only to examination cases because taxpayers already pay a fee for offers. *Id*. Its revenue estimate assumes the fee would not discourage any taxpayers from mediation. *Id*.

45 IRC § 7123(b)(1) ("The Secretary shall prescribe procedures under which a taxpayer or the Internal Revenue Service Office of Appeals may request non-binding mediation on any issue unresolved at the conclusion of— (A) appeals procedures; or (B) unsuccessful attempts to enter into a closing agreement under section 7121 or a compromise under section 7122.")

User Fees Memo

[redacted]

46 *See* IRM 8.1.1.1(1), *Accomplishing the Appeals Mission* (Feb. 10, 2012) ("The Appeals Mission is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service.").

47 Rev. Proc. 2015-44, 2015-38 I.R.B. 354 ("Although Appeals arbitration is being eliminated, taxpayers may be eligible to request mediation for unresolved issues that remain after completion of settlement discussions in Appeals. *See* Rev. Proc. 2014-63, 2014-53 I.R.B. 1014.")

48 Rev. Proc. 2014-63, § 9.01, 2014-53 I.R.B. 1014.

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

50 *See* Rev. Proc. 2012-31, 2012-33 I.R.B. 256.

51 IRS, *FOIA Guidelines* (Appendix B, Fee Schedule), *available at* https://www.irs.gov/uac/Freedom-of-Information-Act-(FOIA)-Guidelines#Fees (last updated Sept. 3, 2015). [redacted]

52 Memo for Distribution from Deputy Commissioner for Operations Support and Deputy Commissioner for Services and Enforcement, *Freedom of Information Act (FOIA) Obligations* (Aug. 24, 2011); IRS, Routine Access to IRS Records" *available at* http://www.irs.gov/uac/Routine-Access-to-IRS-Records ("If you [taxpayer] are working with an IRS employee on an open case, you may request information from the case file (such as copies of workpapers or other records) directly from the IRS employee assigned to the matter."). *See also* IRM 4.26.14.4(2)(b) (July 24, 2012).

53 *See* TIGTA, Ref. No. 2015-30-084, *Fiscal Year 2015 Statutory Review of Compliance With the Freedom of Information Act* 12 (Sept. 18, 2015) (showing the FOIA backlog).

User Fees Memo

[redacted]

Pre-Filing Agreements and Advance Pricing Agreement Fees

[redacted] The PFA procedure allows taxpayers under the jurisdiction of the Large Business and International Division (LB&I) to undergo an examination and reach an agreement (a

54 Treas. Reg. §§ 601.702(c)(12)-(c)(13).

55 IRS response to TAS information request (May 20, 2015).

56 IRS response to TAS information request (Oct. 30, 2015).

57 IRS response to TAS information request (May 20, 2015) (attachment G).

58 IRS response to TAS information request (Oct. 30, 2015) (Memo from Commissioner, TE/GE to CFO, *FY 2015 Biennial Review of User Fee Charges* (July 21, 2015)).

59 IRS response to TAS information request (Oct. 22, 2015) (FY 2015 Biennial Review of User Fee Charges, Attachment 2).

User Fees Memo

PFA) with the IRS about how specific items should be reported before the returns are filed.[60] Similarly, the IRS describes the APA program as "a voluntary process whereby the IRS and taxpayers may resolve transfer pricing issues and issues for which transfer pricing principles may be relevant in a principled and cooperative manner on a prospective basis."[61] In other words, both of these agreement programs further the IRS mission, improve voluntary compliance, reduce controversy, save resources, and implement the taxpayer rights *to be informed*, *to quality service*, *to pay no more than the correct amount of tax*, *to finality*, *to privacy*, and *to a fair and just tax system*. Yet, the IRS only offers them to taxpayers willing to pay a very steep fee.

While the taxpayers who use these programs can mostly afford to pay the fees being considered, ability to pay should not be the sole basis for imposing a fee. If it charges a fee, the IRS should articulate a basis for doing so that does not, in essence, charge taxpayers for services that further the IRS mission (*i.e.*, charge them when it is simply doing its job more effectively than usual).

Although only the government can audit returns and sign closing agreements with taxpayers, one potential basis for imposing a fee for these programs may be that the IRS would otherwise compete with tax practitioners and accounting firms, who may also examine a taxpayer's records and provide opinions about the accuracy/certainty of the tax treatment of the items it reflects.[62] On that basis it might be reasonable for the government to charge for its fact-finding or examination activities (assuming these taxpayers were not certain to be examined in any event), but not for executing the closing agreement itself, which only the government can do. This might also provide a basis for the IRS to explain to the public why the agreement programs that it charges for (*i.e.*, the PFA and APA programs) are different from a similar agreement program that LB&I does not charge for — the Compliance Assurance Process (CAP).[63] Specifically, taxpayers eligible for CAP are already under continuous audit — a function only the government can undertake — making it even less reasonable for the IRS to charge for the audit or fact-finding component of the program. Moreover, the IRS should explain to the public why — aside from its own budget situation — it is suddenly increasing f[redacted]

[redacted]

60 Rev. Proc. 2009-14, 2009-3 I.R.B. 324; IRM 4.60.8.3.4, *IMS Procedures in APA Cases* (June 5, 2014); IRM 4.30.1.1(1) (Jan. 9, 2002) ("The pilot demonstrated that PFAs were cost efficient, they allowed taxpayers to file more compliant tax returns within prescribed time frames, taxpayer burden decreased and both the IRS and taxpayers conserved resources.").

61 Rev. Proc. 2015-41 § 2.02(2), 2015-35 I.R.B. 263 (also noting "[T]he APA process increases the efficiency of tax administration by encouraging taxpayers to come forward and present all the facts necessary for a proper evaluation of their proposed covered issues and to work towards a resolution of such issues in a spirit of openness and cooperation."). *See also* IRM 4.60.8.3.3, *Advance Pricing Agreement (APA) Cases* (June 5, 2014).

62 *See* National Taxpayer Advocate 2007 Annual Report to Congress 66, 68 ("[W]hen government and private businesses provide the same services, user fees may also help keep the government from stifling private-sector competition.").

63 CAP is a program that allows large businesses under continuous audit to, in effect, have the IRS audit the return before it is filed, increasing voluntary compliance and reducing the burden of post-filing examinations for both the IRS and taxpayers. *See, e.g.*, IRM 4.51.8, *Compliance Assurance Process (CAP) Examinations* (Sept. 25, 2015).

64 [redacted] response to TAS information request (Nov. 9, 2015).

User Fees Memo

65 IRS response to TAS information request (May 20, 2015) (attachment A); IRM 1.1.11.4, *Office of National Public Liaison* (Feb. 12, 2015).

66 IRS response to TAS information request (Oct. 22, 2015) (2015 Biennial Review, Attachment 2); IRS response to TAS information request (Nov. 3, 2015).

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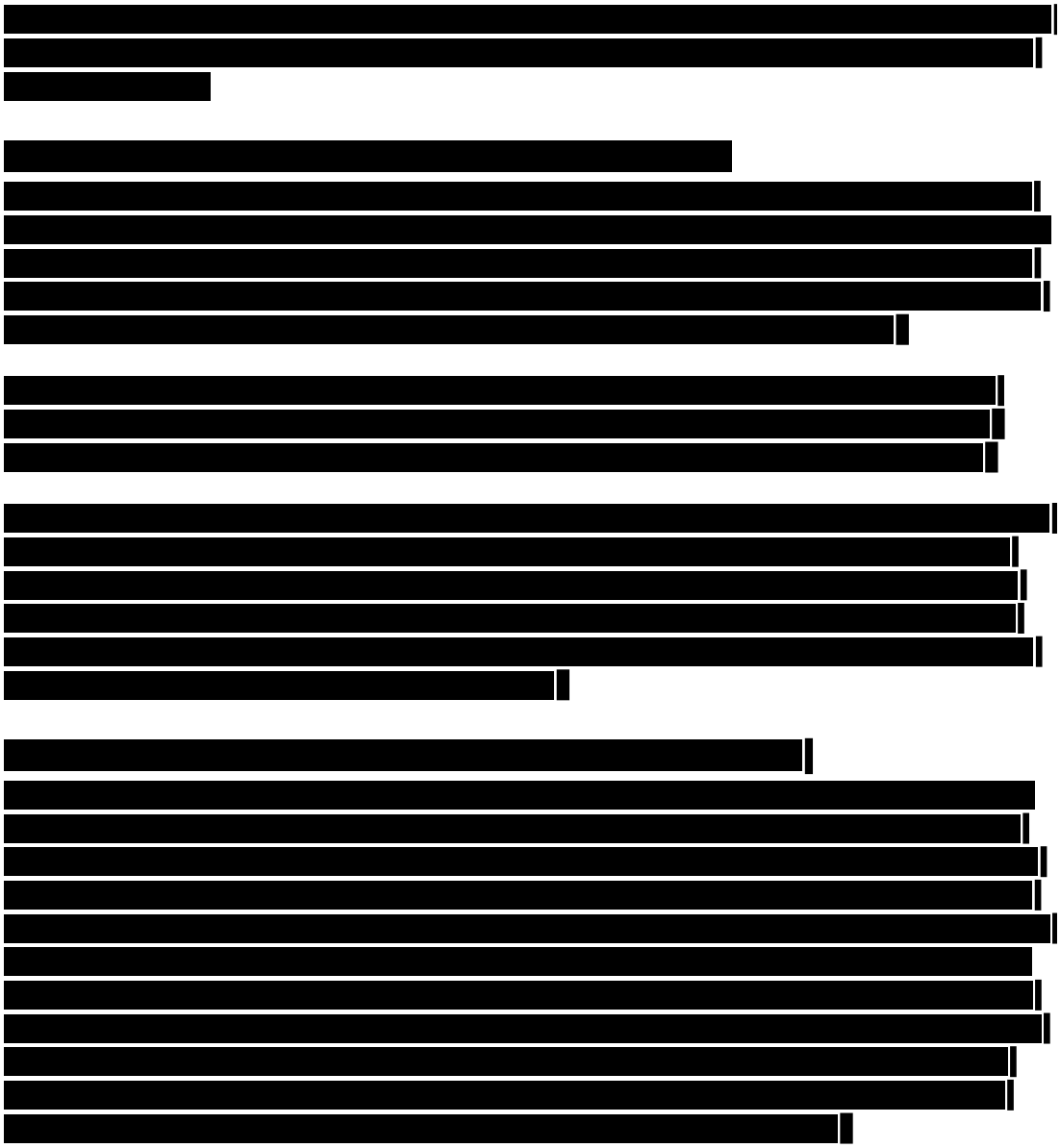
70 IRM 1.32.19.20, *Review and Implementation of New User Fees* (Nov. 8, 2012).

User Fees Memo



71 IRS response to TAS fact check (Nov. 13, 2015).

72 Ann. 2006-74, 2006-2 C.B. 746 (Oct. 16, 2006); IRS, *IRS Income Verification Express Service* (Sept. 14, 2015), *available at* https://www.irs.gov/Individuals/Income-Verification-Express-Service.

73 *See, e.g.*, Form 4506T, *Request for Transcript of Tax Return* (2015); Form 4506T-EZ, *Short Form Request for Individual Tax Return Transcript* (2014).

74 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 553-59 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 538-44 (Legislative Recommendation: *Taxpayer Protection From Third Party Payer Failures*); National Taxpayer Advocate 2004 Annual Report to Congress 394-99 (Legislative Recommendation: *Protection from Payroll Service Provider Misappropriation*).

75 The Tax Increase Prevention Act of 2014, Tax Technical Corrections Act of 2014, and Achieving a Better Life Experience (ABLE) Act of 2014, Pub. L. No. 113-295 § 206, 128 Stat. 4010, 4065-4073 (Dec. 19, 2014) (codified at IRC §§ 3511, 7705, 3302, 3303, 6053, 6652, and 7528(b)(4)).

76 IRC § 7528(b)(4).

MSP #3 FORM 1023-EZ: Recognition As a Tax-Exempt Organization Is Now Virtually Automatic for Most Applicants, Which Invites Noncompliance, Diverts Tax Dollars and Taxpayer Donations, and Harms Organizations Later Determined to Be Taxable

RESPONSIBLE OFFICIAL

Sunita Lough, Commissioner, Tax Exempt and Government Entities Division

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Finality*

DEFINITION OF PROBLEM

In 2014, over the objections of the National Taxpayer Advocate and other stakeholders, the IRS began addressing backlogs in its inventory of applications for tax-exempt status by allowing certain organizations to use new Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*.[2] Form 1023-EZ adopts a "checkbox approach," requiring applicants merely to attest, rather than demonstrate, that they meet fundamental aspects of qualification as an exempt entity.

Unlike Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, Form 1023-EZ does not solicit any narrative of the organization's activities, any financial data, any substantiating documents, or any explanatory material.[3] With the adoption of Form 1023-EZ, the IRS effectively abdicated its responsibility to *determine* whether an organization is organized and operated for an exempt purpose.[4]

Experience thus far with the "streamlined" application procedures that Form 1023-EZ exemplifies has not been encouraging:

- IRS audits demonstrate that eight percent of Internal Revenue Code (IRC) § 501(c)(3) organizations do not make required changes to their organizing documents even after they attest they have done so;[5]

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

2 See National Taxpayer Advocate Fiscal Year (FY) 2015 Objectives Report to Congress 54-7. Among other things, organizations eligible to submit Form 1023-EZ must generally have annual gross receipts of less than $50,000 and assets of less than $250,000.

3 Form 1023-EZ applicants, who must file electronically, cannot submit anything with the application other than the three-page form itself, even if they want to.

4 See Patricia Cohen, *I.R.S. Shortcut to Tax-Exempt Status Is Under Fire*, N.Y. Times (Apr. 9, 2015) (noting "[a]n unlikely coalition of tax lawyers, state enforcement agents and even many nonprofits that favor simpler rules say that the agency — by not asking any questions about governance, conflicts of interest or function, and saying applicants don't have to reveal any such issues — is making it too easy to commit fraud").

5 Tax Exempt and Government Entities (TE/GE) Division Second Qtr Business Performance Review (BPR) 2015 at 2 (May 2015).

- The IRS's own analysis of a representative sample of Form 1023-EZ filers shows that the IRS approves a significant number of applications it would have rejected had the applications been subject to a slight amount of scrutiny;[6]
- TAS's analysis of a representative sample of Form 1023-EZ applicants whose applications were approved by the IRS shows that 37 percent were not, as a matter of law, IRC § 501(c)(3) organizations; and[7]
- The frequency at which IRC § 501(c)(3) organizations were referred to the Exempt Organization (EO) Examination function increased almost ninefold from FY 2014 to FY 2015.[8]

As the Tax Exempt and Government Entities division (TE/GE) acknowledges, the IRS intends to address the "perceived inadequate oversight" that stems from its new Form 1023-EZ procedures by shifting more resources to audits. This back-end, labor-intensive approach invites noncompliance, diverts tax dollars and taxpayer donations, and harms taxpayers that could have adjusted their organizing documents or the activities they pursued if the IRS had advised them of the need to do so from the outset.[9] While audits serve a role in furthering taxpayer compliance, they are no substitute for preventive, front-end efforts to avoid compliance issues in the first place. Thus, the proposed 1023-EZ audit strategy is a misallocation of IRS resources and an unnecessary burden on compliant exempt organizations.

ANALYSIS OF PROBLEM

The Law Requires an Exempt Entity's Organizing Document to Contain Key Elements, and It Is Not Difficult to Determine Whether the Requirements Are Met

In order to be exempt from tax as an IRC § 501(c)(3) organization, an entity's organizing documents must establish that it is "organized and operated exclusively" for one of eight enumerated exempt purposes.[10] Form 1023 requires applicants to submit their organizing documents; instructions for the form explain the need for and provide examples of appropriate purpose and dissolution clauses.[11] By inspecting organizing documents and withholding exempt status until the organization's documents meet the legal

6 TE/GE, *Form 1023-EZ First Year Report* 5; EO Response to TAS information request (Oct. 29, 2015).

7 *See Study of Taxpayers that Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*, vol. 2, *infra*, (describing TAS's analysis of a representative sample of 408 corporations obtaining exempt status on the basis of Form 1023-EZ located in one of 20 states that make articles of incorporation available online at no cost). Reports of increased levels of customer satisfaction with Form 1023-EZ are not surprising, given that recognition as an IRC § 501(c)(3) organization is now easily available to some organizations that do not actually qualify for that status. *See* Diane Freda, *Exempt Organizations: First Year Survey of Form 1023-EZ Confirms Popularity*, BNA Daily Tax Report (Dec. 5, 2015).

8 TE/GE responses to TAS information request (June 11, 2015; Nov. 25, 2015).

9 TE/GE BPR First Qtr 2015 Appx. B, TE/GE Risk Register (Feb. 2015) (noting that "[p]erceived inadequate oversight of the tax-exempt sector as we undertake strategic shifts in how we conduct the up-front review of applications for tax-exempt status…" will be mitigated by "[e]xpanded compliance efforts.").

10 IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(1)(i) (providing "[a]n organization is organized exclusively for one or more exempt purposes *only* if its *articles of organization*," among other things, limit the purposes of such organization to one or more exempt purposes); Treas. Reg. § 1.501(c)(3)-1(b)(4) (providing "[a]n organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, *by reason of a provision in the organization's articles* or by operation of law, be distributed for one or more exempt purposes…" (emphasis added)). In nine states, sometimes referred to as *cy pres* states, a dissolution clause is not required because by operation of state law, the organization's assets would be distributed upon dissolution for one or more exempt purposes, or to the federal government, or to a state or local government, for a public purpose. *See* Rev. Proc. 82-2, 1982-1 C.B. 367; Tex. Bus. Orgs. Code Ann. § 22.304(a)(2) (2012).

11 *See* Part II of Form 1023; Instruction, Form 1023 at 7 (providing examples of acceptable purpose and dissolution clauses).

requirements, EO can correct noncompliance and avert noncompliance that might otherwise arise as the organization operates.

On the other hand, when EO fails to inspect articles of incorporation, it risks recognizing as IRC § 501(c)(3) organizations those that do not meet the legal requirements. For example, the IRS recognized as tax-exempt a Form 1023-EZ applicant whose articles of incorporation describe its purpose as:

> My father [named individual], sufferred [sic] a spinal cord injury in February 2013, which left him a quadriplegic [sic]. His physicians and physical therapists say he is capable of recovering and walking again but his insurance ([name of State] Medicaid) will not cover the expense, so we are hosting fundraisers/benefits to try to raise the money on our own to pay for his therapy out of pocket.[12]

This description raises serious doubts about whether the applicant intends, or would even be permitted by its articles, to serve a public, as opposed to a private, interest. Presumably, if EO had reviewed these articles of incorporation before conferring exempt status, it would have required additional information and insisted on changes to the articles before granting exempt status.

As another example, the IRS recognized as exempt a corporation whose articles are devoid of any purpose clause or description of current or planned activities (and do not allow any insight about what those activities may be), and contain the following dissolution clause: "Assets will be distributed to registrant of entity [individual taxpayer's name], if this nonprofit dissolves."[13] Assets that are ultimately destined for the founder's or some other individual's pocket cannot be viewed as dedicated to an exempt purpose. Had EO reviewed these articles of incorporation before it conferred exempt status, it presumably would have required their amendment.

It appears that reviewing an applicant's case file and its articles of incorporation and then requesting amendments to the articles of incorporation takes the Tax Exempt and Government Entities Exempt Organizations function about an hour. This is a small price to pay to prevent waste, error, and abuse.

TAS evaluated articles of incorporation of a representative sample of approved Form 1023-EZ filers incorporated in the 20 states in which the Secretary of State maintains a website that permitted TAS to view legible copies of articles of incorporation at no charge to determine whether they meet the organizational test. Such review took about three minutes on average and identified a significant portion of organizations whose applications have been erroneously approved.[14] It appears that reviewing an applicant's case file and its articles of incorporation and then requesting amendments to the articles of incorporation takes EO about an hour.[15] This is a small price to pay to prevent waste, error, and abuse.

12 This is the entire text that appears as the "purposes/nature of the business" in the articles of incorporation of an organization included in a representative sample of corporations whose Form 1023-EZ application was approved. *See Study of Taxpayers That Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*, vol. 2, *infra*.

13 This is the actual entire dissolution clause in the articles of incorporation of an organization included in a representative sample of corporations whose Form 1023-EZ application was approved. *Id.*

14 *Id.*

15 TE/GE response to TAS information request (June 11, 2015), noting "anecdotally, employees charge approximately one hour to review a case file, check the state website, and write an additional information letter which would include the request for the Articles of Incorporation and/or amendments, as needed."

For Years, the Form 1023 Application Process Was Plagued by Delay

In the decade prior to the introduction of Form 1023-EZ, the National Taxpayer Advocate voiced concerns about delays in processing applications submitted on Form 1023.[16] By 2012, the volume of EO's open inventory was 36,034 cases, applications requiring little or no development were taking four months to close, and applications requiring assignment to a reviewer were taking nine months just to be assigned.[17] By 2013, the application inventory backlog stood at about 66,000 cases, and applications requiring review took a year and a half to be assigned.[18]

The National Taxpayer Advocate has, since 2011, recommended that the IRS develop a Form 1023-EZ for use by small organizations.[19] Little did she know that the IRS, after initially dismissing the suggestion outright, would ultimately take that idea and run with it to the point of absurdity.

EO Implemented Streamlined Procedures That Addressed the Form 1023 Inventory Backlog But at the Price of Actual Oversight

In October and November of 2013, as part of a three-week pilot project, EO adopted "streamlined procedures" to address its existing inventory backlog of applications submitted on the 12-page Form 1023 that needed further development. These procedures allowed some applicants to provide "assurance of meeting the organizational and operational tests through representational attestations" rather than by submitting substantiating documents.[20] EO expanded the project in January of 2014 and now uses streamlined procedures to evaluate *all* Form 1023 applications.[21] For example, if the applicant is a corporation and does not submit its articles of incorporation as required, the agent reviewing the application may retrieve the articles from official online State records, and if the corporation is legally formed and appears to otherwise qualify for favorable determination under IRC § 501(c)(3), the agent simply asks the organization for confirmation.[22] On the other hand, if the articles of incorporation do not meet the organizational test, but the applicant appears to otherwise qualify for favorable determination and no other organizing document issues need to be addressed, the agent merely asks the applicant to attest that the articles have been amended to correct the deficiency (but the organization is not required to submit amended articles).[23]

The Tax Exempt and Government Entities Exempt Organizations function approved Form 1023-EZ applications much less frequently — 77 percent of the time, compared to 95 percent of the time — when it requested documents or basic information from the applicants, rather than relying on the attestations contained in the form.

16 *See, e.g.*, National Taxpayer Advocate 2004 Annual Report to Congress 193 (Most Serious Problem: *Application and Filing Burdens on Small Tax-Exempt Organizations*); National Taxpayer Advocate 2007 Annual Report to Congress 210 (Most Serious Problem: *Determination Letter Process*); National Taxpayer Advocate 2011 Annual Report to Congress 437 (Status Update: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*).

17 National Taxpayer Advocate 2012 Annual Report to Congress 192, 196, 205.

18 National Taxpayer Advocate 2013 Annual Report to Congress 165 (Most Serious Problem: *Exempt Organizations: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*).

19 National Taxpayer Advocate 2011 Annual Report to Congress 437, 444, 562.

20 *See Proposal to Apply the Concepts from the Streamlined Application Process Pilot to Existing Inventory*, attached to TEGE-07-0215-0005, *Reissued Streamlined Processing Guidelines for All Cases* (Feb. 27, 2015).

21 *Id.*

22 TEGE-07-0315-0006, *Streamlined Processing Guidelines for All Cases* (Mar. 12, 2015). More than 20 states currently make corporations' articles of incorporation viewable online free of charge. TE/GE Third Qtr BPR 2015 at 5 (Aug. 2015).

23 TEGE-07-0315-0006, *Streamlined Processing Guidelines for All Cases* (Mar. 12, 2015).

TE/GE has begun to audit some filers that obtained exempt status using streamlined procedures.[24] As of March 27, 2015, TE/GE had started 284 audits and closed 51.[25] Of the closed audits of IRC § 501(c)(3) organizations, eight percent failed to meet the organizational test at the time the examination commenced, even though they had already interacted with TE/GE after they had filed Form 1023 — *i.e.*, assuming that TE/GE followed its own procedures, after reviewing the Form 1023, it notified the organizations of the deficiencies in their organizing documents and the organizations attested that those deficiencies had been corrected.[26] For the amount of time it took to correspond with and audit these organizations, EO could have required a copy of the amended articles after its initial review in the application phase, making certain, while it had the organizations' attention and leverage over them, that they met the organizational test. Instead, the IRS substituted an exchange of correspondence (and issued a favorable determination letter) for actual oversight of organizations it knew were not compliant.

The IRS Approved Virtually All Form 1023-EZ Applications, Despite Its Own Analysis Showing Form 1023-EZ Provides Insufficient Information

In the first year after introduction, EO approved 95 percent of applications submitted on Form 1023-EZ.[27] When it introduced Form 1023-EZ, TE/GE committed to review a sample of Form 1023-EZ applications in greater detail before making a determination.[28] As of June 26, 2015, EO had selected 1,191 organizations for pre-determination review, and had closed 965 of these 1,191 cases.[29] EO agents requested additional information from these applicants, such as "the organizing document with language required to meet the organizational test" and "a detailed description of past, present, and future activities; revenues and expenses."[30] As Figure 1.3.1 shows, EO approved Form 1023-EZ applications much less frequently — 77 percent of the time, compared to 95 percent of the time — when it requested documents or basic information from the applicants, rather than relying on the attestations contained in the form.

24 In 2014, TE/GE began a post-determination audit program of organizations (both Form 1023 filers and those that filed Form 1024, *Application for Recognition of Exemption Under Section 501(a)*) that received exempt status from April - September 2014 under the streamlined procedures. Correspondence audits of a statistical sample of these organizations began in October 2014, with the plan of starting 1,400 new audits and closing 1,200 in FY 2015. *See Post-Determination Compliance (PDC) Examinations*, TE/GE BPR Second Qtr 2015 at 2 (May 2015).

25 TE/GE Second Qtr BPR 2015 at 2 (May 2015).

26 TE/GE's third quarter BPR reports that as of June 26, 2015, TE/GE had closed 204 audits, but does not report how many organizations failed to meet the organizational test at the time the audit commenced. TE/GE Third Qtr BPR 2015 at 7 (Aug. 2015). TE/GE requests any necessary amendments to organizing documents during the audit process. TE/GE response to TAS information request (June 11, 2015).

27 TE/GE Third Qtr BPR 2015 at 4 (Aug. 2015) (reporting that in the year since it introduced Form 1023-EZ, EO received 43,157 Form 1023-EZ applications). It closed 42,089, of which it approved 39,907, an approval rate of 95 percent.

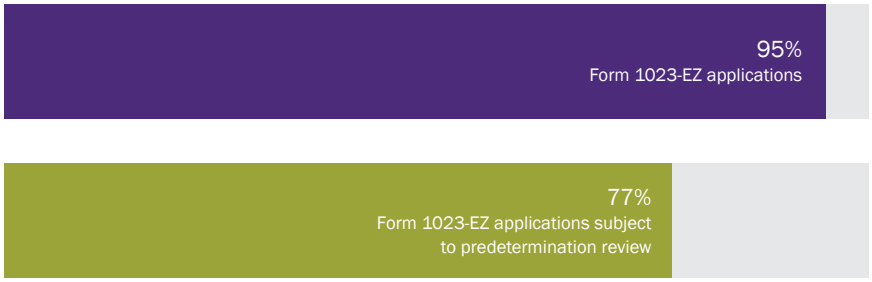
28 See Rev. Proc. 2014-40, § 5.03, 2014-30 I.R.B. 229 (providing that "the Service will select a statistically valid random sample of Forms 1023-EZ for pre-determination reviews"); Rev. Proc. 2015-5, § 5.03, 2015-1 I.R.B. 186 (providing the same). Interim guidance to employees describes as the goals of the review to: "Identify applicants that do not qualify for exemption; Identify applicants that are not eligible to file Form 1023-EZ (those that should have completed the full Form 1023); Gauge the effectiveness of Form 1023-EZ (*i.e.*, identify situations in which a streamlined application was not appropriate such as where the activities should have been addressed in full development); Learn about the population of organizations applying for exemption using Form 1023-EZ; Enhance public trust by reinforcing that submission of Form 1023-EZ does not guarantee tax exemption will be recognized." TEGE-07-0714-0017, *Interim Guidance on Processing Form 1023-EZ* (July 1, 2014).

29 TE/GE, *Form 1023-EZ First Year Report* 5-6, EO Response to TAS information request (Oct. 29, 2015).

30 *Id*.

FIGURE 1.3.1[31]

Form 1023-EZ Approval Rates



EO rejected 152 applications included in the pre-determination review sample because the organization was ineligible to apply using Form 1023-EZ (even though Form 1023-EZ applicants attest they have completed an Eligibility Worksheet included in the instructions to the form and are eligible to use the form), or because the organization did not respond to the request for additional information.[32] It is possible that these applicants would qualify as IRC § 501(c)(3) organizations. However, as of March 27, 2015, EO had also identified 181 cases in which a review of the organization's articles of incorporation revealed that the applicant did not initially meet the organizational test, despite their attestations to the contrary.[33] Even assuming that no further such organizations were identified by the time TE/GE made its determinations in all 965 cases it had closed by June 26, 2015, the 181 organizations that did not initially meet the organizational test represent a rate of noncompliance of almost 20 percent.[34]

31 TE/GE, *Form 1023-EZ First Year Report* 5, EO Response to TAS information request (Oct. 29, 2015).

32 *Id.* at 5-6, EO Response to TAS information request (Oct. 29, 2015) (reporting that 68 applications were rejected because the applicant was not eligible to apply using Form 1023-EZ and 84 applications were rejected because the organization did not respond to a request for additional information). Because TE/GE adopted the practice of making follow-up calls to nonresponsive organizations, the rate of nonresponse has declined from 12 percent of all applications (in the first six months of Form 1023-EZ processing) to six percent (in the second six months of Form 1023-EZ processing), which has presumably resulted in an increase in the approval rate.

33 TE/GE response to TAS information request (June 11, 2015). In those cases, EO requested the organizations to amend their organizational documents and accepted an attestation, under penalties of perjury, that the document had been amended to include the required provisions.

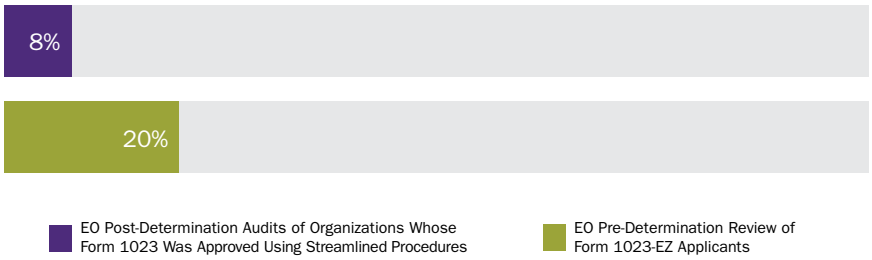
34 Moreover, EO's initial review of the description of the organization's activities identified 40 organizations that did not meet the operational test. To the extent these 40 organizations were not already counted among those that failed the organizational test, the rate of noncompliance was greater than 20 percent. In these cases, EO requested clarification in an additional information letter, or, as happened in four cases, if the description indicated the applicant could qualify under a different subsection of the Code, such as IRC § 501(c)(4), EO asked the organization to reapply on Form 1024. In one case, the description indicated the applicant did not qualify for recognition of exemption, and EO advised the applicant it would propose an adverse determination. TE/GE response to TAS information request (June 11, 2015). Ultimately, 21 of the 40 applications were approved. Fifteen applications were rejected (eight because the organization did not respond to the request for information, six were not eligible to use Form 1023-EZ, and one had an invalid EIN. Four organizations appeared to not qualify as IRC § 501(c)(3) organizations and withdrew their applications (three of these four were encouraged to reapply by submitting Form 1024). TE/GE response to TAS information request (Oct. 27, 2015).

Figure 1.3.2 summarizes the rate at which EO's own analyses showed that organizations did not meet the organizational test, as demonstrated by the two separate review or audit programs:

- EO's post-determination audits of organizations whose Form 1023 was approved using streamlined procedures; and
- EO's pre-determination review of a representative sample of organizations that submitted Form 1023-EZ.

FIGURE 1.3.2[35]

Rate at Which Applicants for Exempt Status Did Not Meet Organizational Test for Qualification as an IRC § 501(c)(3) Organization



TAS Analysis of Approved Organizations Shows Many Did Not Meet the Requirements for Exempt Status, Often for Reasons They Could Have Easily Corrected Had EO Reviewed Their Documents

From July through September 2015, TAS reviewed a representative sample of 408 organizations whose Form 1023-EZ applications were approved.[36] The analysis showed that 149, or 37 percent, of the organizations in the sample did not satisfy the organizational test. Of these 149 organizations, 22 appeared to have an adequate purpose clause, but lacked a sufficient dissolution clause (where one was required), a condition the organizations could have easily corrected had they been advised to do so. For some organizations, an exempt purpose could be inferred even though the articles did not have an adequate purpose clause. These organizations might very well have been able to craft an accurate, tax-compliant purpose clause had they been advised of the need to do so, and correcting that deficiency might have averted future noncompliance as they commenced or continued their operations.

The numbers show that the IRS is actually undermining compliance by failing to take simple prophylactic measures, such as requesting and reviewing an applicant's organizing documents, before conferring exempt status.

35 TE/GE Second Qtr BPR 2015 at 2 (May 2015); TE/GE response to TAS information request (June 11, 2015).

36 *See Study of Taxpayers That Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*, vol. 2, *infra* (describing TAS's analysis of a representative sample of 408 corporations obtaining exempt status on the basis of Form 1023-EZ located in one of 20 states that make articles of incorporation available online at no cost).

From July through September 2015, TAS reviewed a representative sample of 408 organizations whose Form 1023-EZ applications were approved. The analysis showed that 149, or 37 percent, of the organizations in the sample did not satisfy the organizational test.

The IRS Intends to Audit Its Way Out of the Potential Noncompliance It Helped Create

TE/GE will begin correspondence audits of Form 1023-EZ filers in FY 2016, selecting cases through a statistical sample of organizations that have operated for a complete tax year after receiving a determination letter.[37] However, TE/GE, rather than sampling from all organizations that received exempt status on the basis of Form 1023-EZ, will only sample from approved Form 1023-EZ filers that filed a 990-series return.[38] E-Postcard submitters are required to submit the e-Postcard annually, and will lose their exempt status if they fail to do so, but only if the failure persists for three consecutive years.[39] To the extent organizations required to submit an e-Postcard do not do so every year, TE/GE will have an incomplete sample of approved Form 1023-EZ filers. It remains to be seen whether, if the post-determination audits of Form 1023-EZ filers show high levels of noncompliance, TE/GE will adjust its procedures by strengthening its initial review process.

We also note that from FY 2014 to FY 2015, the frequency with which EO Determinations employees referred IRC § 501(c)(3) organizations to TE/GE's EO Examination function increased almost ninefold.[40] In view of the fact that this surge in referrals coincided with the introduction of Form 1023-EZ, TE/GE might gain further insight into compliance levels of Form 1023-EZ filers by analyzing these referrals in greater detail.

To its credit, TE/GE is implementing a broader compliance risk framework, expected to unfold over several years, that entails defining and measuring compliance for the exempt organization population. It plans to divide the population into meaningful market segments, grouped by common traits, behavior, and interactions with the IRS. It will then (1) select a random sample for each market segment, both to establish an initial baseline compliance rate and to develop a market segment-specific compliance risk model; (2) assign different treatment types to each organization based on its risk score; and (3) re-evaluate the model and treatments based on the results.[41] The National Taxpayer Advocate has long advocated for more research into the behavior, needs, and preferences of exempt organizations.[42] This work is very important, as the National Taxpayer Advocate noted in 2007 and 2009, and it is not mutually exclusive with the pre-determination oversight we recommend. In fact, the approaches work hand in hand.

37 TE/GE response to TAS information request (June 11, 2015).

38 TE/GE, *Form 1023-EZ First Year Report* 9, EO Response to TAS information request (Oct. 29, 2015).

39 IRC § 6033(j).

40 In FY 2014, EO Exam received 19 referrals from EO Determinations employees for all IRC § 501(c)(3) organizations, without distinction between Form 1023 and Form 1023-EZ filers. For FY 2015, EO Exam received 184 such referrals, an almost ninefold increase. TE/GE responses to TAS information request (June 11, 2015; Nov. 25, 2015).

41 TE/GE response to TAS information request (June 11, 2015).

42 *See, e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 197, 209 (recommending that the IRS conduct an exempt organization Taxpayer Assistance Blueprint (TAB) to study exempt organizations' service needs and preferences (by size and type of organization) and develop a plan to improve service to these organizations, followed by further research of the tax exempt sector, and that it "[d]edicate a group of employees, from both outreach and compliance functions, entirely to small EOs. Such entities have very different needs from mid-sized and large EOs and require a different approach."). *See also* National Taxpayer Advocate 2009 Annual Report to Congress 287, 299 (reiterating the recommendation that the IRS design and implement an exempt organization TAB in order to formulate a targeted outreach plan based on research).

CONCLUSION

By adopting Form 1023-EZ to address inventory backlogs, the IRS relinquished its power to effectively determine whether applicants qualify as IRC § 501(c)(3) organizations. The IRS's own analysis shows a significant discrepancy between the rate at which Form 1023-EZ filers obtain exempt status and the rate of approval when the IRS subjects their applications to a slight amount of scrutiny. TAS's review of Form 1023-EZ filers that obtained exempt status confirms there is a significant level of erroneous approvals. Rather than auditing its way out of the noncompliance it helped create, the IRS should reconsider its decision to use Form 1023-EZ in its present form.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Revise Form 1023-EZ to require applicants, other than corporations in states that make articles of incorporation publicly available online at no cost, to submit their organizing documents.
2. Revise Form 1023-EZ to require applicants to provide a description of their actual or planned activities and submit summary financial information such as past and projected revenues and expenses.
3. Make a determination only after reviewing the Form 1023-EZ application, the applicant's organizing documents, its description of actual or planned activities, and its financial information.
4. Where there is a deficiency in an organizing document, require an applicant to submit a copy of an amendment to its organizing document that corrects the deficiency and has been approved by the state, even where the documents are available online at no cost, before conferring exempt status.

MSP #4 REVENUE PROTECTION: Hundreds of Thousands of Taxpayers File Legitimate Tax Returns That Are Incorrectly Flagged and Experience Substantial Delays in Receiving Their Refunds Because of an Increasing Rate of "False Positives" Within the IRS's Pre-Refund Wage Verification Program

RESPONSIBLE OFFICIAL

Debra Holland, Commissioner, Wage & Investment Division
Ken Corbin, Director, Return Integrity & Compliance Services

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF THE PROBLEM

In general, the IRS uses the Pre-Refund Wage Verification Program (hereinafter - Income Wage Verification or IWV) to temporarily freeze an individual's refund (also called "refund holds") when it detects potentially false wages and withholding. The National Taxpayer Advocate first expressed concerns with the IRS's inability to properly identify, process, and timely release refund freezes in 2003.[2] Despite certain improvements, such as technological advances, and procedural and policy changes, the IRS's screening processes in this program continue to harm taxpayers with legitimate returns. For example:

- TAS's analysis of the population of taxpayers filing for tax year (TY) 2014, whose returns the Electronic Fraud Detection System (EFDS) selected for review in 2015 (through October), showed that nearly 180,000 such taxpayers who finally received their refunds experienced delays of nearly 18 weeks on average.
- EFDS had a "false positive" rate of almost 35 percent in fiscal year (FY) 2015.[3]
- In 2015, the IRS moved potential identity theft returns identified by EFDS from the IWV to the Taxpayer Protection Program (TPP) for processing. The TPP's false positive rate jumped from 19.8 percent in calendar year (CY) 2014 to 36.2 percent in CY 2015, while the Level of Service

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

2 The National Taxpayer Advocate initially expressed concerns regarding the increase in Criminal Investigation (CI) control, or "freeze," by the IRS's CI Fraud Detection Units in her 2003 Annual Report to Congress. See National Taxpayer Advocate 2003 Annual Report to Congress 175 (Most Serious Problem: *Criminal Investigation Freezes*). This program preceded the current IWV Program operated by the IRS's Integrity & Verification Operation unit.

3 A false positive occurs when a system selects a legitimate return and delays the refund past the prescribed review period. IRS response to TAS information request (Oct. 20, 2015). The IRS did not track the false positive rates, also called detection rates, for EFDS. However, in FY 2015, it began tracking the false positive rate for EFDS related to the TPP.

(LOS) for taxpayers trying to contact the IRS to verify their identity plummeted. At one point during the peak of the filing season, only one out of ten calls got through to a live assistor.[4]

- The IRS also increased the testing of another application it uses to detect identity theft or fraud, the Return Review Program (RRP), which experienced an over 500 percent increase in stopping legitimate tax returns this year.

The workload in the Integrity & Verification Operation (IVO) unit, which operates the IWV program, decreased by 47 percent in CY 2015. Yet TAS received 36,752 IWV cases in the first nine months of CY 2015, or nearly 15 percent more as compared to the prior year, making it the second most common reason taxpayers came to TAS. TAS provided full or partial relief for almost four out of five taxpayers who contacted TAS about delayed refunds flagged under the IWV program and IWV holds, spending an average of 8.2 weeks to resolve these cases.[5]

The National Taxpayer Advocate acknowledges that any effective screening method will result in false positives, no matter how well designed. However, the high false positive rates in all of these programs are unnecessarily high; moreover, she remains concerned that:

- The IRS does not track the false positive rates for the IWV program, and thus, is unable to determine the precise filters or screens stopping legitimate refunds;
- The IRS does not have adequate procedures to promptly review and adjust its fraud detection filters, rules, and models; and
- Taxpayers whose refunds are frozen by the IWV program cannot reach a live assistor in the IVO unit.

These shortcomings burden taxpayers whose legitimate refunds are substantially delayed. As a result, the taxpayers' *rights to be informed*, *to quality service*, *to challenge the IRS's position and be heard*, *to privacy*, and *to a fair and just tax system* are jeopardized.

ANALYSIS OF PROBLEM

Background

The return integrity program, a process critical to the IRS's strategy to address identity theft and detect and prevent improper fraudulent refunds, is complex and multifaceted.[6] The Return Integrity & Compliance Services (RICS) IVO — a part of the Wage & Investment (W&I) Division — uses filters, rules, data mining models, and manual reviews to identify potentially false returns, usually through wages or withholding reported on the returns, to stop fraudulent refunds before the IRS issues them.[7] It electronically screens tax returns using three independent systems: the Dependent Database (DDb), the RRP, and the EFDS. If one of the systems flags a return as potentially fraudulent, the return goes to the TPP or the IWV program. Figure 1.4.1 provides a simplified flow chart of the complicated processes IVO uses to screen returns claiming refunds.

4 See Most Serious Problem: *Identity Theft (IDT): The IRS's Procedures for Assisting Victims of IDT, While Improved, Still Impose Excessive Burden and Delay Refunds for Too Long, infra*.

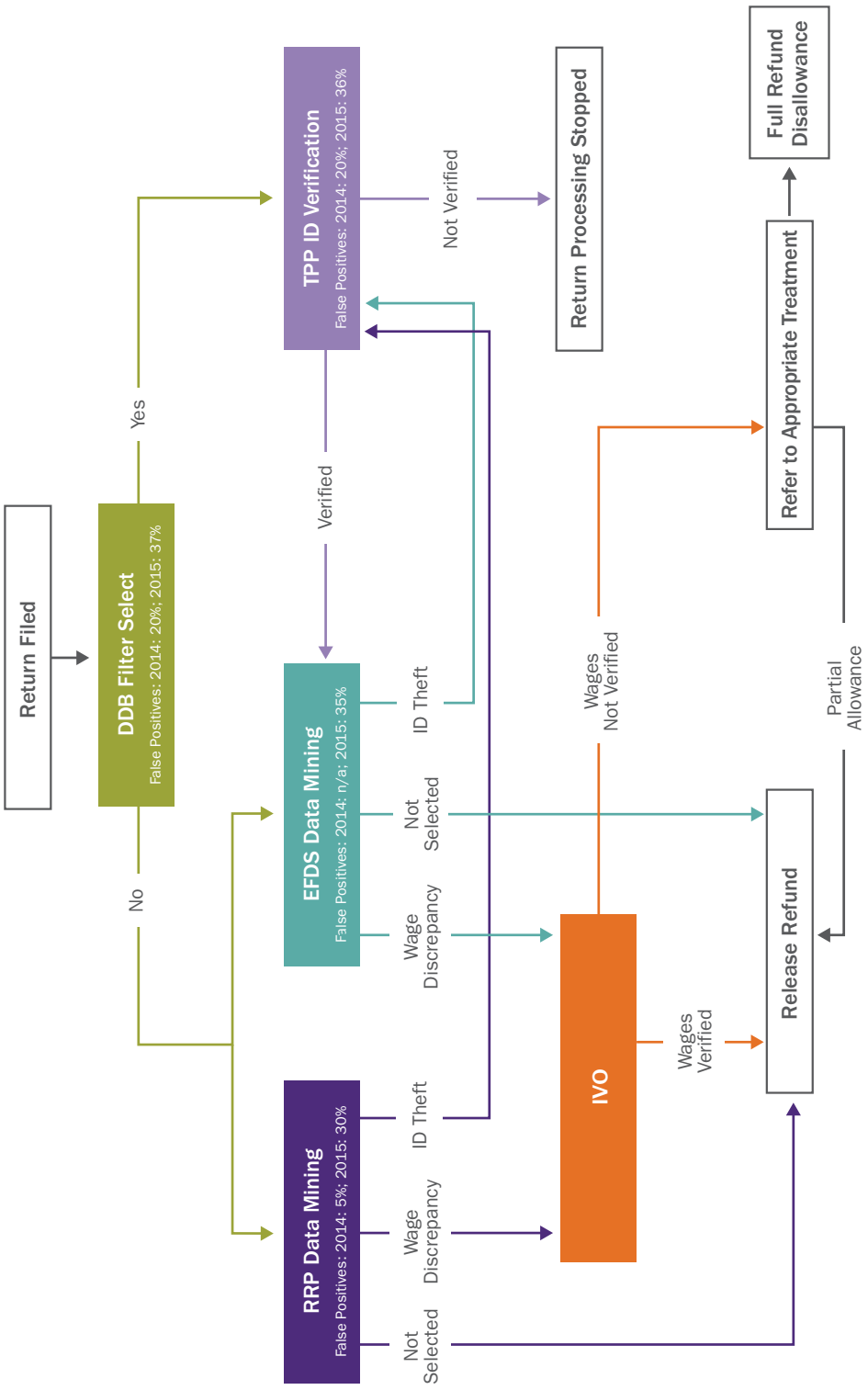
5 Data obtained from the Taxpayer Advocate Management Information System (TAMIS) (Oct. 6, 2015). Closed IVO refund holds cases through Sept. 30, 2015 were open an average of 58.33 days. TAS Case Assistance by Issue Code (CABIC) 045.

6 IRM 25.25.1.1 (Feb. 19, 2015).

7 IRM 25.25.2.1(1) (Aug. 20, 2015).

FIGURE 1.4.1

Flow Chart of Refund Return Processing in IVO



Taxpayer Protection Program

The TPP uses the DDb to look for returns that exhibit characteristics of identity theft. When it deems a taxpayer's return suspicious, the TPP freezes the return and advises the taxpayer via letter he or she must authenticate his or her identity by calling the TPP toll-free number or self-authenticate through the TPP's Out of Wallet website.[8] If the taxpayer is unable to authenticate, the IRS does not process his or her return, and the taxpayer may have to provide additional information, including a paper copy of the return filed.[9] In addition to the DDb, IRS analysts manually select returns using pattern-matching techniques to detect potential identity theft returns in mass batches. TPP has had a significant increase in its false positive rates, from 19.8 percent in CY 2014 to 36.2 percent in CY 2015 (year to date).[10] According to the IRS, the TPP stopped almost two million refunds in CY 2015, compared to almost 1.6 million refunds stopped in CY 2014.[11]

IWV Program

Next, the IRS processes returns claiming refunds, and it sends them through the EFDS. EFDS uses data mining models to score each Form W-2 and 1099 on refund returns for fraud potential based on business rules that consider return and filing characteristics.[12] For returns that score high enough on the EFDS, the IRS places an indicator on the account and delays posting for two weeks.[13] It sends potential identity theft returns back to the TPP and potentially fraudulent income/withholding returns to IVO for income verification. If the EFDS does not select returns, it posts and releases them for continued processing and does not include them in its false positive computation.[14]

When the IRS flags a refund return as having questionable income or withholding, it freezes the taxpayer's refund for a minimum of 11 weeks[15] while IVO employees attempt to contact the taxpayer's employers

8 IRM 25.25.6.1 (May 26, 2015). Out of Wallet questions are knowledge-based questions about private information not readily available that only the user will know.

9 IRM 25.25.6.5.1 (May 5, 2015).

10 *See* W&I Business Performance Review (May 15, 2015); IRS RICS, Update of the Taxpayer Protection Program (TPP) (Dec. 2, 2015).

11 Data obtained from IRS Global ID Theft Report (Sept. 30, 2015). The IRS stopped 1,987,714 refunds in year to date (YTD) 2015 and 1,593,457 cases in YTD 2014. For a full discussion of the National Taxpayer Advocate's concerns about identity theft, see Most Serious Problem: *Identity Theft (IDT): The IRS's Procedures for Assisting Victims of IDT, While Improved, Still Impose Excessive Burden and Delay Refunds for Too Long, infra.*

12 IRS response to TAS information request (Aug. 20, 2015). IRM 25.25.2.1 (Aug. 20, 2015).

13 The two-week hold allows IVO to screen the tax returns and look for fraud or potential identity theft issues.

14 Posting occurs when the tax return is posted to the customer account to reflect the filing of the return and includes tax computation to determine the tax obligation for this period.

15 IRM 25.25.2.4 (Aug. 20, 2015). The initial suspense period is ten days to allow for the IRS to send a letter to the taxpayer, which advises the taxpayer of the 60-day review period. The IRS sends Notice CP05, *Information Regarding Your Refund,* or Letter 4464C, *Questionable Refund 3rd Party Notification Letter. See* IRS response to TAS information request (Aug. 20, 2015). This 11-week "soft-hold" was negotiated by the National Taxpayer Advocate and the IRS post-2005 after the National Taxpayer Advocate showed in the 2005 Annual Report to Congress that the IRS was permanently freezing legitimate taxpayer refunds without reviewing them, resulting in an egregious abridgement of taxpayer rights and leading to the removal of the Questionable Refund Program (QRP) from CI to W&I, resulting in the creation of IVO. Although the initial hold is 11 weeks by default there are instances when a refund is released earlier. *See* National Taxpayer Advocate 2005 Annual Report to Congress 25 (Most Serious Problem: *Criminal Investigation Refund Freezes*); National Taxpayer Advocate 2005 Annual Report to Congress vol. 2 (*Criminal Investigation Refund Freeze Study*); National Taxpayer Advocate 2011 Annual Report to Congress 41 (Most Serious Problem: *The IRS's Wage and Withholding Verification Procedures May Encroach on Taxpayer Rights and Delay Refund Processing*).

to verify wages and withholdings reported.[16] If the employer verifies the information and IVO is satisfied the return is valid, the IRS will release the refund. If IVO cannot verify the return information through the Individual Master File (IMF) or employer contact, the IRS sends a letter to the taxpayer requesting documentation to substantiate the information.[17] It is unknown how long this process takes because the IRS does not track this information.[18] EFDS had a false positive rate of almost 35 percent in FY 2015 for returns the IRS sent to IVO for a determination.[19]

Return Review Program Models

The RRP application enhances the IRS's capabilities to detect, resolve, and prevent criminal and civil noncompliance, thereby reducing the issuance of fraudulent tax refunds.[20] RRP selects all potential issues related to identity theft or fraud on the return through initial processing and routes it to the proper treatment stream in pre-refund status. It then generates 15 scores that relate to the predictive value of possible identity theft or fraud.[21] The IRS planned for RRP to replace EFDS but is currently using both systems, which leads to more taxpayers experiencing refund delays because their refund returns have a higher chance of the filters stopping them. The Treasury Inspector General for Tax Administration (TIGTA) noted in a September 2015 report that the failure by the IRS to retire the EFDS program could result in an estimated $18.2 million in additional operation and maintenance costs. TIGTA recommended that the IRS retire EFDS, and the IRS agreed.[22] In FY 2014, the RRP false positive rate was five percent, which increased to 30.4 percent for FY 2015, an increase of over 500 percent.[23] One benefit of RRP over EFDS is that the IRS can adjust the RRP rules and models in real-time if systemic issues are identified, so improvements in this system will be essential to meet its objectives.

The IRS Does Not Track the False Positive Rates for the Pre-Refund Verification Program and Thus Is Unable to Determine What Stops Legitimate Refunds

As stated earlier, TAS considers any legitimate refund return that an IRS system selects and delays past the programs predetermined review period as false positive. The IRS fraud prevention units only track the false positive rates associated with identity theft. This includes programs such as TPP, EFDS, RRP, Manual Analyst, and DDb.[24] Somehow, the IRS has false positive data for TPP, EFDS, and RRP; however, false positive rates are not tracked for returns forwarded to the IWV program. False positive data, if monitored and analyzed in real-time, can be used by the IRS to improve its fraud prevention and IWV programs, minimize harm to taxpayers making legitimate refund claims, and preserve IRS resources.

16 IRM 25.25.3.1 (May 21, 2015). The IRS employs several methods to contact employers for verification of wages based on the information listed on the verification of income documents attached to the IMF returns, adhering to the employer preference if one exists. The IRS sends letters annually to certain large employers requesting they provide wage information on a computer disc. Requests for verification are automatically generated by fax; phone calls are made based on employer preference. The IRS employee makes three attempts to verify the information. IRS response to TAS information request (Aug. 20, 2015).

17 The IRS sends Notice CP05A, *Information Regarding Your Refund - Refund Being Held Pending More Thorough Review*.

18 IRS response to TAS information request (Aug. 20, 2015).

19 IRS response to TAS information request (Oct. 20, 2015). The IRS did not track the false positive rates for EFDS prior to FY 2015. However, in FY 2015, it began tracking the false positive rate for EFDS related to the TPP.

20 Privacy Impact Assessment (PIA) 1067 (Jan. 23, 2015), *available at* http://www.irs.gov/pub/irs-utl/RRP_TS_pia.pdf. A PIA is a process for examining the risks and ramifications of using information technology to collect, maintain, and disseminate information in identifiable forms about members of the public and agency employees.

21 *See* TIGTA, Ref. No. 2015-20-060, *The Return Review Program Enhances the Identification of Fraud; However, System Security Needs Improvement* (July 2, 2015).

22 *See* TIGTA, Ref. No. 2015-20-093, *Review of the Electronic Fraud Detection System* (Sept. 29, 2015).

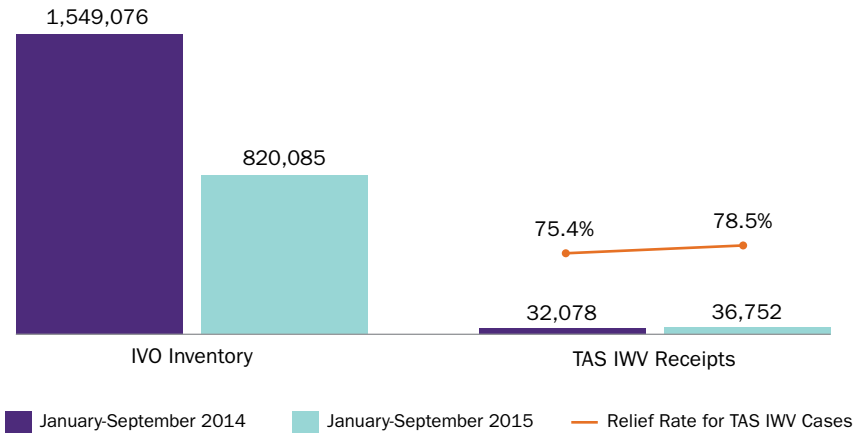
23 IRS response to TAS information request (Oct. 20, 2015).

24 IRS response to TAS information request (Aug. 20, 2015).

In 2015 (January through September), TAS provided full or partial relief in about 78.5 percent of cases closed for taxpayers who contacted TAS about delayed refunds flagged under the IWV Program. IWV cases constituted 19.3 percent of all TAS cases, or the second most common reason that taxpayers came to TAS for assistance.[25] TAS receipts of IWV cases have increased over 14.6 percent while the volume of the IRS's IWV holds has decreased over 47 percent, comparing the January through September periods from 2014 to 2015, as shown in Figure 1.4.2.[26]

FIGURE 1.4.2

TAS IWV Cases Increased Even Though IVO Inventory Decreased, January-September 2014-2015



The increase in the number of taxpayers seeking TAS assistance with IWV holds combined with the high relief rate of almost 80 percent is an indicator of serious problems with the IWV program. In other words, the IRS delayed, and, in some cases stopped, legitimate refunds to taxpayers because of over-inclusive filters or cross-competing rules.

Inexplicably, the IRS does not track the false positive rates for IWV holds, and thus is unable to determine what is causing the greater percentage of stopped legitimate refunds.[27] By applying findings from analysis of false positive returns, the IRS could prioritize identification of legitimate refunds at the earliest stage possible and develop better filters and models in real time.

Investing in tracking the IVO false positive rates by model or filter during the filing season, performing regular global reviews, and quickly adapting filters, rules, and models based on levels of confidence in each, would result in a more efficient utilization of resources and fewer delays for taxpayers with legitimate returns, thereby reducing taxpayer burden. The IRS should also establish target false positive rates for

25 Data obtained from TAMIS (Jan. 1, 2014; Oct. 1, 2014; Jan. 1, 2015; and Oct. 1, 2015).

26 *Id*. Data obtained from IRS Global ID Theft Report (Sept. 30, 2015). TAS received 32,078 cases in CY 2014 (January through September) and 36,752 cases in CY 2015. The IRS identified 1,549,076 cases in IVO for CY 2014 and 820,085 cases in CY 2015. This decrease in IRS IVO volume is significant because it may be an indicator that the IRS is not clearing cases in a timely manner.

27 IRS responses to TAS information requests (Aug. 20, 2015; Sept. 14, 2015). The IRS does track the false positive rates for TPP.

each process and filter in addition to creating a process to adjust selection rates so that the false positive rates do not exceed target level.

By applying findings from analysis of false positive returns, the IRS could prioritize identification of legitimate refunds at the earliest stage possible and develop better filters and models in real time.

In CY 2014, RICS adjusted its filters and rules, which increased returns in TPP, flagged for identity theft and decreased refund returns sent to the Pre-Refund Wage Verification Program.[28] These adjustments did not resolve the substantial delays of legitimate taxpayer refunds.[29] For example, taxpayers whose returns were flagged and sent to TPP experienced the worst LOS on the TPP phone line in recent history — at one point during the peak of the filing season the LOS was ten percent.[30] Moreover, the sequential processing of returns through various filters resulted in taxpayers being subjected to multiple reviews of the same return. Recent submissions to TAS's Systemic Advocacy Management System (SAMS) indicate the IRS cleared some returns from identity theft via TPP but then selected the same returns via the IWV program, which extended the refund hold resulting in unnecessary taxpayer callbacks.[31]

IVO Does Not Have Adequate Procedures to Promptly Review and Adjust Its Fraud Detection Filters, Rules, and Models

Recently Congress acted on the National Taxpayer Advocate's legislative recommendation to accelerate information reporting, and passed legislation requiring that returns and statements related to employee wage information and nonemployee compensation be filed on or before January 31.[32] The IRS should collaborate with TAS on implementing this legal requirement that will improve the screening and matching of third-party reporting with the information on taxpayers' returns.

Currently, IVO has no procedures or safeguards in place to promptly review and adjust its filters, rules, and models. For instance, the RRP erroneously flagged a group of returns and froze refunds that had previously cleared two systems and had historical data verifying their legitimacy.[33] At the time, RRP lacked access to the historical data and was unable to verify the results of prior screenings. Although the IRS can update RRP in real time, it needs approval from the Business Rules and Requirements Management

28 TAS believes that although the TPP is flagging more returns for identity theft, these refunds may still end up requiring wage verification treatment. The IRS is not flagging fewer returns overall in wage verification, rather it is flagging them with a different program.

29 Teleconference between the National Taxpayer Advocate and the RICS Director (Feb. 2, 2015). Discussion about the spike in IWV holds and the changing of TPP filters.

30 *See* Most Serious Problem: *Identity Theft (IDT): The IRS's Procedures for Assisting Victims of IDT, While Improved, Still Impose Excessive Burden and Delay Refunds for Too Long, infra.*

31 SAMS is a database of issues submitted to the TAS Office of Systemic Advocacy and the advocacy projects developed from some of these submissions. The issues come from a variety of sources. These include TAS, other IRS employees, and external stakeholders, including individual and business taxpayers, practitioners, research and professional organizations. *See* SAMS submission, Issue 32977 (May 18, 2015).

32 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 201 (2015). *See also* National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 86-8 (*Fundamental Changes: Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*); 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*).

33 SAMS submission 32694 (Mar. 26, 2015).

(BRRM) office.[34] BRRM does not meet regularly; therefore, any change request that needs immediate attention must go through a time-consuming approval process resulting in more refund delays. Creating a sub-approval group authorized to implement real-time modifications to screening rules and filters would allow a quicker resolution of systemic issues and minimization of taxpayer harm. The sub-group should include a TAS representative, since TAS often sees cases that are early-warning indicators of problems with filters.

At the end of FY 2012, the IRS eliminated the Pre-Refund Program Executive Steering Committee (ESC), leaving no overarching governance of the implementation of new filters, rules, and models or coordination of work involving multiple IRS functions. With the elimination of the ESC, the IRS cannot discuss problems associated with fraud detection data mining rules and filters at a servicewide level, resulting in additional delays for any necessary changes in screening rules and filters. In 2013, the National Taxpayer Advocate recommended that the IRS reinstate the ESC.[35] However, the IRS refused, stating, "The FY 2013 Return Integrity and Correspondence Service (RICS) reorganization established a centralized structure for the refund fraud program, and eliminated the need for an Executive Steering Committee (ESC)."[36]

If the IRS were to add staff to review returns on the front-end and answer taxpayer calls in the Integrity Verification Operation (IVO) unit, then more returns with legitimate refunds would be processed with fewer delays and less burden to the taxpayer, saving both the IRS and TAS resources from reworking these cases on the back-end.

The high rate of false positives in the IWV program in the absence of a forum to discuss potential flaws in filters and models suggests that the IRS's decision to eliminate the ESC was not well-founded. The IRS should reinstate the pre-refund program ESC as a forum for the exchange of information about systemic issues among IRS functions and for ideas about how to resolve these issues, as well as include TAS as a chartered voting member of the ESC.

Taxpayers Whose Refunds Are Frozen by the IWV Program Cannot Reach a Live Person in IVO

Unlike the TPP, IWV program does not have a dedicated phone number for taxpayers to call. As a result, taxpayers whose refunds are frozen face lengthy hold times and courtesy disconnects trying to reach IRS Customer Service representatives (CSRs) on a general line.[37] The CSR LOS for FY 2015 was 38.10 percent, compared to the FY 2014 LOS of 64.39 percent, representing a 40.8 percent decline.[38] If a taxpayer tries to get information from *Where's My Refund,* he or she will receive a generic message prompting a call to the IRS. Even if the taxpayer does reach a CSR, he or she will find the CSR

34 IRM 1.1.13.5.3.4 (Oct. 7, 2013). The office is responsible for the coordination and execution of the activities required to define, develop, maintain, and control business requirements and rules.

35 National Taxpayer Advocate 2013 Annual Report to Congress 173 (Most Serious Problem: *Revenue Protection: Ongoing Problems with IRS Refund Fraud Programs Harm Taxpayers by Delaying Valid Refunds*).

36 Email from Chief of Staff, Office of the Commissioner of Internal Revenue (May 23, 2014) (on file with the National Taxpayer Advocate). Although the IRS does have a Revenue Protection Technology Governance Board which provides input and recommendations to the IRS Revenue Protection Technology ESC neither appear to have the overreaching governance and implementation power of the Pre-Refund Program Executive Steering Committee.

37 A courtesy disconnect is when the IRS phone line is overloaded and the caller is disconnected after a certain amount of time. For a full discussion of the National Taxpayer Advocate's concerns regarding taxpayer account access, see Most Serious Problem: *Taxpayer Access to Online Account System: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak with an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues that Are Not Conducive to Resolution Online, infra*.

38 See IRS, Accounts Management (AM) (Sept. 30, 2015).

does not have access to the EFDS or RRP histories and cannot give specific responses to taxpayer inquiries.[39] CSRs take down information and route it to the IWV group in IVO. IVO, however, does not call back or correspond with a taxpayer based on referral from a CSR. If the information forwarded by the CSR is not verifiable, IVO will simply close out the referral on Account Management Services (AMS) application.[40]

Taxpayers Whose Refunds Are Frozen by the IWV Program Suffer From Delays and Inaction

Taxpayers with frozen refunds experience significant delays of 18 weeks on average while IVO employees attempt to verify wages and withholding.[41] TAS's analysis of the population of taxpayers filing for TY 2014, whose returns were selected by EFDS for review in 2015 (through October), showed that nearly 180,000 such taxpayers who finally received their refunds, experienced delays of nearly 18 weeks on average. Several examples illustrate the frustrations of taxpayers with legitimate refunds who were unable to reach a live assistor with access to their IVO accounts:[42]

- Taxpayers, who successfully authenticated their identity after their returns were stopped by the identity theft filters, were under the impression their refunds would be released. They were not notified by the IRS that there would be a second delay to their refunds, as their returns were then selected by the IWV program due to the IRS subsequently questioning reported wages and withholdings. A programming problem in IVO prevented the issuance of a Notice CP05, *Information Regarding Your Refund – We Have Received Your Income Tax Return and Are Holding Your Refund*. Multiple taxpayers contacted TAS after being unable to reach the IRS or to receive an explanation of the delay. TAS Office of Systemic Advocacy elevated this systemic issue, and the IRS committed to resolving this issue for the 2016 filing season.[43]
- In several instances, taxpayers were also subject to additional refund delays when IVO verified their wages and withholding but did not correctly input closing actions to release the refund. To release the refund, an employee must input the closing action into two separate IRS systems. If employees only input the action into one system, the IRS continues to hold the refund. IVO was not monitoring its inventory to ensure refunds were correctly and timely issued once verification took place. Taxpayers had to contact the IRS to inquire why they had not received their refund or request TAS assistance.
- In one instance, the IWV hold languished over a year without any contact from the IRS or action by IVO. It was only when an inquiry was referred to TAS that the hold was resolved in seven days.[44]

39 IRM 21.5.6.4.35.3 (Nov. 2, 2015).

40 IVO does not correspond with a taxpayer based on a referral from a CSR. To the contrary, if it is just a refund status inquiry not associated with any verifiable information, IVO employees will just close out the referral on AMS. IRM 25.25.5.2 (July 27, 2015); IRM 25.25.5.4 (July 27, 2015); IRM 25.25.5.4.1 (July 27, 2015).

41 "Significant delay" was quantified by TAS by analyzing the population of taxpayers filing for TY 2014 selected using EFDS for review in 2015. Through October, we found nearly 180,000 such taxpayers who finally received their refunds but were delayed on average nearly 18 weeks (median of 19 weeks). Additional taxpayers may still face delays, and future analysis will show how many taxpayers were affected and for how much longer. IRS CDW, TY 2014 filings received from January through October of 2015. Results quantify time elapsed between selection for review and receipt of refund (Dec. 2015).

42 These examples are compilation of facts from several SAMS submissions. SAMS issues 32694 (Mar. 26, 2015), 32900 (May 1, 2015), 33183 (July 9, 2015), and 33239 (July 22, 2015).

43 SAMS submission 32694 (Mar. 26, 2015).

44 SAMS submission 32900 (May 1, 2015), 33183 (July 9, 2015), and 33239 (July 22, 2015).

Even though IVO staffing has consistently increased, it appears the growth has not had a positive impact on the expedited screening and verification of the volume of cases the IVO program selects.[45] In CY 2015, the IRS selected 43 percent fewer returns for IWV, compared to CY 2014,[46] while the IVO staffing increased by over 12 percent from FY 2014 to FY 2015.[47] As stated above, IVO does not have a direct phone number for taxpayers to respond to IWV inquiries. Thus, the increase in staffing is not allocated to speeding up the verification process by accepting direct calls from affected taxpayers. Moreover, the increase in staffing did not result in a reduction of taxpayer burden as evidenced by the 14.6 percent increase in TAS cases during the same period.[48]

As stated earlier, the IRS has a period of time within which to look at a return before the grace period expires and the refund return is frozen for further review. If the IRS were to add staff to review returns on the front-end and answer taxpayer calls in the IVO unit, then more returns with legitimate refunds would be processed with fewer delays and less burden to the taxpayer, saving both the IRS and TAS resources from reworking these cases on the back-end. Implementing a front-end communication strategy, including live taxpayer assistance in the IVO unit, would reduce refund hold times and free more employees for further examination of fraudulent returns.

CONCLUSION

The National Taxpayer Advocate recognizes the importance of revenue protection screening techniques in protecting the tax system and the rights of taxpayers. Over the past 12 years, she has reported problems facing taxpayers whose legitimate refunds were frozen by the IRS and she has recommended improvements to reduce taxpayer burden while preventing refund fraud. Despite certain improvements, the IRS has not adopted several recommendations.[49] The IRS needs to balance its need to detect refund fraud with the taxpayers' *rights to be informed*, *to quality service*, *to privacy*, and *to fair and just tax system*.

45 IRS response to TAS information request (Oct. 20, 2015). For a full discussion of the National Taxpayer Advocate's concerns about third-party acceleration, see National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 67-96 (*Fundamental Changes: Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

46 IRS response to TAS information request (Oct. 20, 2015). In CY 2014, the IRS selected 1,925,671 items and the amount decreased in CY 2015 to 1,091,512 items selected. Even with the volume decrease, the IRS is still unable to manage the volume despite the increase in staff.

47 IRS response to TAS information request (Oct. 20, 2015). In FY 2014, the staffing level was 546, and in FY 2015 the staffing level was 612.

48 Data obtained from TAMIS (Jan. 1, 2014; Oct. 1, 2014, Jan. 1, 2015, and Oct. 1, 2015).

49 See National Taxpayer Advocate 2014 Annual Report to Congress 536 (*TAS Case Advocacy*); National Taxpayer Advocate FY 2015 Objectives Report to Congress 143-45 (*TAS Receipts Suggest the IRS Needs to Enhance Efforts to Detect and Prevent Refund Fraud*); National Taxpayer Advocate 2013 Annual Report to Congress 173 (Most Serious Problem: *Revenue Protection: Ongoing Problems with IRS Refund Fraud Programs Harm Taxpayers by Delaying Valid Refunds*); 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 41 (Most Serious Problem: *The IRS's Wage and Withholding Verification Procedures May Encroach on Taxpayer Rights and Delay Refund Processing*); National Taxpayer Advocate 2006 Annual Report to Congress 408 (Status Update: *Major Improvements in the Questionable Refund Program and Some Continuing Concerns*); National Taxpayer Advocate 2005 Annual Report to Congress 25 (Most Serious Problem: *Criminal Investigation Refund Freezes*); National Taxpayer Advocate 2005 Annual Report to Congress vol. 2 (*Criminal Investigation Refund Freeze Study*); National Taxpayer Advocate 2003 Annual Report to Congress 175 (Most Serious Problem: *Criminal Investigation Freezes*).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Begin tracking the IVO false positive rates by model or filter during the filing season, perform regular global reviews, and quickly adapt filters, rules, and models based on levels of confidence in each similar to the TPP.
2. Establish target false positive rates for each process and filter and create a process to adjust selection rates so that the false positive rates do not exceed target level.
3. Collaborate with TAS on implementing the new legal requirement to file returns and statements related to employee wage information and nonemployee compensation on or before January 31 of the year following the calendar year to which such returns relate.
4. Reinstate the Pre-Refund Program Executive Steering Committee to coordinate policy and other servicewide processes and business rules and include TAS in the steering committees as a charter voting member.
5. Create a sub-committee under the Business Rules and Requirements Management office with the authority to implement real-time modifications to screening rules and filters pertaining to tax fraud detection, resolution, and prevention, which directly affect RRP systems development; include a TAS representative as a member of this sub-committee.
6. Create a Taxpayer Call Area in IVO, which will include front-end outgoing verification calls to taxpayers from the IVO unit and the answering of direct taxpayer calls about refunds.

MSP #5 TAXPAYER ACCESS TO ONLINE ACCOUNT SYSTEM: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak With an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online

RESPONSIBLE OFFICIALS

Terry Milholland, Chief Technology Officer
Edward Killen, Director, Privacy, Governmental Liaison and Disclosure
Debra Holland, Commissioner, Wage and Investment Division
Rene Schwartzman, Business Modernization Executive, Wage and Investment Division
Rajive Mathur, Director, Office of Online Services

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

The National Taxpayer Advocate has advocated for years that the Internal Revenue Service (IRS) develop an online account system for taxpayers.[2] In fact, the IRS is now planning an online account system and even identified taxpayer online account access as one of the key capabilities to achieve its compliance vision.[3] We are pleased that the IRS is moving forward with plans to develop such a system, due to the benefits to both taxpayers and the IRS. Taxpayers with access to the system will be more informed about their tax accounts and have the tools to interact with the IRS in a convenient manner. The IRS, in turn, may benefit from both reduced and more fruitful phone calls because many of the callers will be more prepared to discuss relevant issues or ask pointed questions due to the information available on the online account system.[4] However, the IRS cannot ignore the service needs of a significant portion of the taxpayer population who still require more personalized service options, such as face-to-face or telephone services, due to preference or lack of access to the Internet. In addition, even the most technologically savvy taxpayers may at times need to use personal services because the issue they have is not conducive to resolve online. While in the current budget environment it may be tempting to move taxpayer service toward superficially lower-cost self-assistance options, any efforts to significantly reduce personal service

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

2 *See, e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

3 IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5 (July 28, 2015) (on file with the National Taxpayer Advocate).

4 As of May 2, 2015, approximately 83.2 million taxpayers contacted the IRS by calling the various Customer Account Services function toll-free telephone assistance lines. IRS assistors have answered approximately 8.3 million calls and provided a 37.6 percent Level of Service with a 23.5 minute Average Speed of Answer. Treasury Inspector General for Tax Administration, Ref. No. 2015-40-080, *Results of the 2015 Filing Season* 17 (Aug. 31, 2015).

options may ultimately impair voluntary compliance and undermine the taxpayers' *right to quality service*, *right to be informed*, and *right to pay no more than the correct amount of tax*.[5]

While in the current budget environment it may be tempting to move taxpayer service toward superficially lower-cost self-assistance options, any efforts to significantly reduce personal service options may ultimately impair voluntary compliance and undermine the taxpayers' *right to quality service*, *right to be informed*, and *right to pay no more than the correct amount of tax*.

Research has shown individuals and businesses prefer multi-channel service delivery for government services. For example, a survey of German taxpayers showed that even those who ordinarily demand online services prefer to interact in person when they need more individualized services.[6] While the delivery of online services may appear cost-effective at first glance, focusing solely on one method of service delivery is short-sighted, because it does not properly address the actual service needs of taxpayers. Ignoring the service needs of a significant segment of the population will likely impact voluntary compliance and have far more costly downstream consequences for the IRS.

Finally, the National Taxpayer Advocate remains concerned about the scope of the self-correction authority set forth in the draft Concept of Operations (CONOPS). It is unclear whether the self-corrections could address adjustments made pursuant to the agency's math error authority or whether they will extend beyond math error so that they constitute an abbreviated audit.[7] More importantly, it is unclear if these corrections will constitute an amended return or if the original return remains unprocessed until corrected. All of these options have legal consequences to the taxpayer with potential negative impacts on taxpayer rights.

ANALYSIS OF PROBLEM

Background

The IRS's Enterprise CONOPS is a formal servicewide plan developed to define the future direction of the agency and identify the capabilities it needs to achieve this vision.[8] One of the main themes of the CONOPS is to empower taxpayers with the tools they need to facilitate compliance. In order to achieve this goal, the IRS has identified digital taxpayer account management and self-correction as key capabilities.[9] According to the IRS draft CONOPS, online account access would enable taxpayers, preparers, and authorized third parties to securely interact with the IRS to obtain return information, submit payments, and receive status updates. It would also enable them to perform "self-correction" functions such as verifying return changes made by the IRS, updating or amending returns, and providing additional documents.[10]

5 For a detailed discussion of the Taxpayer Bill of Rights, see http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights.

6 Julia Klier, Regina Pfleger & Lea Thiel, *Just Digital or Multi-Channel? The Preferences of E-Government Service Adoption by Citizens and Business Users*, Wirtschaftsinformatik Proceedings 2015 180, 190 (2015), *available at* http://aisel.aisnet.org/cgi/viewcontent.cgi?article=1012&context=wi2015.

7 See IRC §§ 6213(b)(1),(g)(2).

8 See Most Serious Problem: *Taxpayer Service: The IRS Has Developed a Comprehensive "Future State" Plan That Aims to Transform the Way It Interacts with Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet, supra*.

9 IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5 (July 28, 2015) (on file with the National Taxpayer Advocate).

10 Draft IRS Compliance Concept of Operations (CONOPS) 3, 19-22 (June 8, 2014) (on file with TAS).

The IRS Cannot Drastically Reduce Both Face-to-Face and Telephone Services As It Focuses on Online Services Because Taxpayers Will Still Continue to Require Personal Services

Based on a 2014 survey, Forrester Research concluded that the public still uses non-digital channels more than digital ones. In fact, 37 percent of these survey participants indicated they do not trust the federal government to secure their personal data. Based on the survey findings, Forrester concluded that "[f]ederal agencies must act more strategically. They can win trust by perfecting existing [channels] before expanding and explaining the benefits of new channels as they roll out."[11] The recent security breaches pertaining to the IRS's "Get Transcript" online application and the Office of Personnel Management's (OPM) breach of federal employee records will only serve to undermine taxpayers' trust in communicating with the IRS and government online.[12]

Furthermore, additional research has shown individuals and businesses prefer multi-channel service delivery for government services.[13] Individuals prefer online services for information services, because they can gather and receive information or data on their own schedule and without a need for further discussion. However, they prefer to interact in-person when they need more individualized services. This multi-channel preference even exists for younger and well-educated individuals who typically have greater preferences for online services.[14] As for businesses, the medium to large companies prefer online services more than small businesses.[15]

It is not surprising that taxpayers continue to demand more personalized services considering the complexity of the tax law.[16] For those taxpayers comfortable using self-service options online, they must still struggle with understanding the substance of the tax law and how it applies to their unique circumstances. While the IRS official website is helpful and extensive, it currently has approximately 140,000 pages which can be overwhelming to taxpayers unfamiliar with the tax law.[17] Moreover, the website is not currently easy to navigate when using a mobile device, which could be a serious access issue for the increasing taxpayer population using smartphones.[18]

11 Rick Parrish, Forrester Research, *Washington Must Work Harder to Spur the Public's Interest in Digital Government: Federal Agencies Are Spending Millions on Digital CX That Customers May Not Want* (Apr. 28, 2015) (in response to the survey question "In which of the following ways do you interact with US federal government agencies?" respondents chose the following digital methods: 41 percent indicated website, 16 percent indicated email, four percent chose Facebook, three percent chose mobile app, three percent chose online chat (text), two percent chose online chat (video), two percent chose Twitter, one percent chose Instagram, and one percent chose other social media. Respondents chose the following nondigital methods: 37 percent chose in person, 33 percent chose postal mail, and 32 percent chose phone).

12 IRS, IRS *Statement on the "Get Transcript" Application* (June 2, 2015); OPM, Announcements, *Information About the Recent Cybersecurity Incidents* (June 23, 2015).

13 As noted above, this was a survey of German taxpayers published in 2015. *See* Julia Klier, Regina Pfleger & Lea Thiel, *Just Digital or Multi-Channel? The Preferences of E-Government Service Adoption by Citizens and Business Users*, Wirtschaftsinformatik Proceedings 2015, 180, 190 (2015), *available at* http://aisel.aisnet.org/cgi/viewcontent.cgi?article=1012&context=wi2015.

14 In fact, the 2013 Taxpayer Experience Survey conducted by IRS W&I Research and Analysis (WIRA) found that for all age categories of taxpayers (not just the elderly), only 34 percent felt secure sharing personal financial information over the Internet. IRS, W&I, *Use of Technology among Elderly and Low-income Taxpayers, Research Support for Fiscal Year (FY) 2015 Services Approach Efforts* 34 (May 2015).

15 Julia Klier, Regina Pfleger & Lea Thiel, *Just Digital or Multi-Channel? The Preferences of E-Government Service Adoption by Citizens and Business Users*, Wirtschaftsinformatik Proceedings 2015, 180, 190 (2015), *available at* http://aisel.aisnet.org/cgi/viewcontent.cgi?article=1012&context=wi2015.

16 For a discussion of tax law complexity, see National Taxpayer Advocate 2012 Annual Report to Congress 3-23.

17 Information provided from IRS Office of Online Services, Online Engagement, Operations and Media (Sept. 25, 2015).

18 Aaron Smith, Pew Research Center, *U.S. Smartphone Use in 2015* 1 (April 1, 2015).

The IRS can partially address the demand for more individualized service by offering personalized digital services, such as live chat. Live chat has been found to successfully meet the needs of those who need immediate answers to simple questions.[19] However, a recent survey found demand for live chat falls short of demand for telephone services when addressing complex financial questions.[20]

The IRS Must Balance the Added Convenience of Expanding Online Services Against the Inherent Security Risks

The IRS is planning to expand its online service offerings to include more convenient methods for taxpayers to interact with the tax agency.[21] However, there is a risk involved in expanding online services, given the sensitive nature of the information entrusted with the IRS. The recent unauthorized access by cybercriminals of the IRS's "Get Transcript" application and resulting theft of the confidential tax return information of more than three hundred thousand taxpayers highlights the importance of cybersecurity considerations.[22] The OPM announcement earlier in the year concerning the hacking of its database, making vulnerable the personal information, and in some cases the fingerprints, of an estimated 21.5 million current and former federal employees, applicants, and their families has further undermined public trust in government online applications.[23] The continuing discovery of the depth of the breach will likely erode taxpayer confidence in using online services offered by the government.

Individuals prefer online services for information services, because they can gather and receive information or data on their own schedule and without a need for further discussion. However, they prefer to interact in-person when they need more individualized services.

In the wake of these recent cybersecurity breaches, the IRS should take time to investigate how taxpayers will respond to the necessary cybersecurity-related barriers to entry. Most taxpayers are fully aware that IRS systems contain extremely confidential tax return information and may be willing to tolerate extra security measures to access their accounts. In fact, the IRS has one of the most important and valuable stores of information in the world. Because the information it stores is a major asset of the United States and the stakes are high if the system is compromised, the IRS needs to take significant measures to protect its data. However, it is unclear at what point taxpayers decide the extra security precautions are too burdensome and avoid online account access as a result.

Further, the IRS should conduct a biennial nationwide survey of taxpayers to gauge what specific types of transactions or other activities they would be willing to conduct with the IRS digitally. By conducting the survey every other year, the IRS will have the ability to identify trends in IRS-specific digital needs and respond accordingly. In addition, the survey should include oversamples of low

19 The IRS has researched taxpayer demand for a potential secure online chat feature or "live chat" and a 2014 IRS study shows that taxpayers are interested in using this feature for the following transactions: submitting documentation, obtaining the status of a case, and discussing case details. IRS, WIRA, *Compliance TDC Conjoint: Findings and Recommendations* (Sept. 2014).

20 A survey conducted by Software Advice found 74 percent of respondents prefer telephone for complex financial questions. Craig Borowski, *The Impact of Demographics on Live Chat Customer Service*, Software Advice (Jan. 6, 2015).

21 IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5 (July 28, 2015) (on file with the National Taxpayer Advocate).

22 IRS, *Additional IRS Statement on the "Get Transcript" Incident* (Aug. 17, 2015).

23 OPM Statement, *Statement by OPM Press Secretary Sam Schumach on Background Investigations Incident* (Sept. 23, 2015); Devlin Barrett and Damian Paletta, *Officials Masked Severity of Hack*, Wall St. J., June 24, 2015, *available at* http://www.wsj.com/articles/hack-defined-as-two-distinct-breaches-1435158334; Ellen Nakashima, *Chinese Breach Data of 4 Million Federal Workers*, Wash. Post, June 4, 2015, *available at* http://www.washingtonpost.com/world/national-security/chinese-hackers-breach-federal-governments-personnel-office/2015/06/04/889c0e52-0af7-11e5-95fd-d580f1c5d44e_story.html.

income, Spanish-speaking and small business taxpayers to ensure that the IRS tracks the needs of these populations.[24]

Comprehensive Studies Demonstrate Low Income and Other Vulnerable Taxpayer Populations Need Person-to-Person Assistance to Comply with Their Federal Tax Obligations

In 2014, TAS, which oversees and administers the Low Income Taxpayer Clinic (LITC) grant program for the IRS,[25] commissioned a survey by Russell Research to better understand the needs and circumstances of taxpayers eligible to use the clinics. The survey found 15 percent of LITC-eligible taxpayers reported receiving notices from the IRS. In response, 55 percent called the IRS, 29 percent replied by letter, 24 percent contacted their preparers, and nearly 20 percent did nothing (the survey allowed more than one response).[26]

Further, Pew Research Center periodically conducts surveys to determine Internet usage by American adults. While the survey results clearly show a steady rise in Internet usage among all populations, some populations adopt at a slower pace than others. Significant percentages of certain populations still fall behind and will need to use methods that do not involve Internet usage to interact with the IRS. The following figure shows categories of taxpayers with lower Internet usage rates, as of May 2015:[27]

FIGURE 1.5.1, 2015 Pew Research Center Survey Results of Internet Use Among Different Categories of Taxpayers

Category	Percent
Overall American adult population	84%
Age: American adults 65+	58%
Education Attainment: Less than high school degree	66%
Household Income: Less than $30,000	74%
Race or Ethnicity: African Americans	78%
Race or Ethnicity: Hispanics	81%
Community Type: Rural	78%

24 This recommended survey is envisioned to be more comprehensive than the Compliance TDC Conjoint study conducted by the IRS in 2014. It should specifically address the reasons why taxpayers would or would not use a particular service channel for each type of transaction conducted with the IRS, with a particular focus on low income and small business taxpayers. IRS, WIRA, *Compliance TDC Conjoint: Findings and Recommendations* (Sept. 2014). "Low income taxpayer" is generally defined as a taxpayer who has a household income that does not exceed 250% of the federal poverty level (FPL), based on the annual poverty guidelines published by the Department of Health and Human Services.

25 The IRS awards matching grants to organizations that provide representation to low income individuals who need help resolving tax problems with the IRS. *See* IRC § 7526. At least 90 percent of the taxpayers represented by an LITC must have incomes that do not exceed 250 percent of the federal poverty level. *See* IRC § 7526(b)(1)(B)(i). The U.S. Department of Health and Human Services publishes yearly poverty guidelines in the Federal Register, which the IRS uses to establish the 250 percent threshold for LITC representation. For the 2015 poverty guidelines, see 80 F.R. 3236-3237 (Jan. 22, 2015).

26 This Random-Digit Dialed (RDD) telephone survey utilized both cell phone numbers and landline numbers to reach participants. This approach was used to make sure all groups of the LITC-eligible taxpayers were represented in the survey. The survey included more than 1,100 individuals and gathered information on eligible taxpayers' awareness and use of LITC services, the types of issues for which they would consider using clinic services, and other items including demographic information. *See* 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*).

27 Andrew Perrin and Maeve Duggan, Pew Research Center, *Americans' Internet Access: 2000–2015* (June 26, 2015).

A 2015 online survey by Forrester Research explored the use of certain devices to conduct various transactions online. While this study was conducted online and thus excluded responses from offline individuals or those with limited online capabilities, it produced some noteworthy findings:[28]

- On average, only 19 percent of adults search for government services and policies with a personal computer or laptop. This rate drops to 11 percent when using personal tablets and to seven percent when using a mobile phone.
- With few exceptions, those in lower income brackets used all devices to conduct online financial transactions less frequently than the national average.
- On average, 22 percent of adults use their mobile phones to check financial statements. Only 16 percent use their mobile phones to pay bills and 16 percent used their mobile phones to transfer money between accounts.

In fiscal year (FY) 2015, the Wage and Investment (W&I) Operating Division compiled existing research on American technology usage to determine the impact reductions in the Taxpayer Assistance Center (TAC) budget and IRS printed forms and publications would have on the elderly, low income, and rural communities.[29] The research found that, while each community saw a steady increase in Internet usage, these communities had lower computer ownership and Internet usage rates. Interestingly, the research also found that southern states are more likely to have lower percentage of households that own a computer. The research emphasized that offline taxpayers are equally as likely to access face-to-face services at TACs as they are to use irs.gov, and that they are more likely to use the IRS toll-free line compared to TACs and irs.gov.[30] The research also noted that the 2013 Taxpayer Experience Survey conducted by IRS W&I Research and Analysis (WIRA) found that for all age categories of taxpayers (not just the elderly), only 34 percent of taxpayers felt secure sharing personal financial information over the Internet.[31]

While the IRS official website is helpful and extensive, it currently has approximately 140,000 pages which can be overwhelming to taxpayers unfamiliar with the tax law. Moreover, the website is not currently easy to navigate when using a mobile device, which could be a serious access issue for the increasing taxpayer population using smartphones.

Finally, the IRS conducted a survey in 2014 to determine taxpayer usage of existing service channels as well as planned future service channels for different types of transactions. The findings showed migration for each type of transaction toward future service channels, including secure message, secure online chat, the online account program, smartphone applications, and automatic email or text notifications. However, the results showed that some taxpayers prefer to stay with existing service channels. The following figure illustrates the percentages of taxpayers who would prefer to use existing service channels, when compared with a potential future state service configuration, by type of transaction.[32]

28 Because this survey was conducted online, the reported usage rates may be higher than for the general population. Forrester Research, *North American Consumer Technographics Online Benchmark Survey*, Part 1 (2015) (on file with TAS).

29 IRS, Wage & Investment, *Use of Technology among Elderly and Low-income Taxpayers, Research Support for Fiscal Year (FY) 2015 Services Approach Efforts* (May 2015).

30 *Id*. at 23.

31 *Id*. at 13.

32 IRS, W&I Research & Analysis, *Compliance TDC Conjoint: Findings and Recommendations* (Sept. 2014).

FIGURE 1.5.2, Percentage of Taxpayers Choosing to Remain with Existing Service Channels Despite the Introduction of New Channels, By Type of Transaction

Type of Transaction	Percentage of Taxpayers Choosing to Stay With Existing Service Channel
Status of Case	Phone (Customer Service Representative (CSR)): 11%
Sign a Document	Phone (CSR): 13% Fax: 15% Regular Mail: 16%
Discuss Case Details	Phone (CSR): 43% Regular Mail: 15%
Request an Extension	Phone (CSR): 30% Regular Mail: 23%

The LITC-eligible taxpayer survey, the Pew and Forrester findings, as well as the IRS's own research support the need for the IRS to design a taxpayer service strategy based on the actual requirements of the taxpayer population rather than focusing on initially attractive but ultimately short-term resource savings. The survey findings and studies show a significant portion of taxpayers may not use online or self-assistance services. While online self-help tools certainly have significant benefits in that they address the needs of an increasing portion of the population in a lower-cost manner, the IRS is harming offline taxpayers when it significantly decreases the face-to-face and person-to-person telephone services. The IRS has already begun to reduce the amount of full-time equivalent employee (FTE) resources to the phones and to the TACs. Figure 1.5.3 illustrates the budgeted FTE for both types of services between FY 2013 to FY 2015.[33]

FIGURE 1.5.3, W&I Full-Time Equivalent Employee Expenditures for Toll-Free and Field Assistance

	FY 2013	FY 2014	FY 2015	FYs 2013 to 2015 % Change
Toll-Free	7,726	6,915	4,591	-40.6%
Field Assistance	1,892	1,927	1,868	-1.3%

Questions Remain Concerning the Legal Implications of Self-Correction Authority

The National Taxpayer Advocate remains concerned about the scope of the self-correction authority set forth in the draft CONOPS. For example, it is unclear whether the self-corrections could address adjustments made pursuant to the agency's math error authority or whether they will extend beyond math error so that they constitute an abbreviated audit.[34] More importantly, it is unclear what these corrections will constitute. If the taxpayer corrects the return pursuant to the new self-correction authority, will the correction constitute an amended return or is the return still an original return that the IRS has not yet completely processed? All of these possible options have legal consequences to the taxpayer and all have potential negative impacts on taxpayer rights.

33 IRS, W&I Division response to TAS information request (Sept. 22, 2015) (Field Assistance numbers include management and headquarters; for FY 2015, Field Assistance FTE is projected and Toll-free is through Aug. 15, 2015).

34 The IRS is currently authorized to correct mathematical or clerical errors — arithmetic mistakes and the like — and assess any tax increase using summary assessment procedures that do not provide the taxpayer an opportunity to challenge the proposed deficiency in the United States Tax Court before the tax is assessed. See IRC §§ 6213(b)(1),(g)(2). Consequently, the use of math error bypasses critical procedural taxpayer rights protections.

Even more disturbing is the Administration's proposed legislation to give the IRS more flexibility to address "correctable errors" (by regulation); this new category of "correctable errors" would give the IRS the authority to make adjustments not covered by existing math error authority.[35] It is unclear if the IRS will give preparers and third parties the authority to address these correctable errors.[36] The National Taxpayer Advocate will seek a Counsel opinion to determine the boundaries and corresponding legal implications of such authority.

CONCLUSION

As the IRS migrates toward more digital interactions with the taxpayers, it is essential that it continues to offer personal services to those taxpayers who either (1) do not have the ability to use digital services, (2) have a strong preference to conduct certain transactions by phone or face-to-face, or (3) have an issue that is not conducive for resolution through digital means. The various studies discussed herein show that a significant segment of the taxpayer base may not be ready to interact with the IRS digitally. Furthermore, recent cybersecurity attacks on both IRS applications and OPM databases highlight the need to balance security risks with any online benefits applicable to both taxpayers and the IRS.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Conduct a biennial nationwide survey of taxpayers to identify trends and determine the types of transactions or other activities taxpayers would be willing to conduct with the IRS digitally. The survey should include oversamples of low income, Spanish-speaking, and small business taxpayers to ensure that the IRS tracks their needs.
2. Conduct research to identify the taxpayer base who will utilize the online taxpayer account system as well as other online service offerings. For those taxpayers likely to use the online services, the research should break it down by specific types of transaction or interaction with the IRS. Further, if a taxpayer has indicated that he or she will not use the program, the research should address the reasons for not using the program.
3. Incorporate into the CONOPS, budget initiatives, and in the strategic plan a recognition and plan for meeting the service needs of those taxpayers who are not likely to use online service offerings. Such plan should take into account the reasons for the taxpayer's behavior and potentially tailor the personal services to meet those needs.
4. Research taxpayer response to the necessary online account system cybersecurity and authentication measures to determine the percentage of taxpayers who decide the necessary barriers to entry are too burdensome and avoid online account access as a result.

35 The proposed correctable error authority would enable the IRS to assess tax without using the deficiency procedures in the following situations: (1) the information provided by the taxpayer does not match the information 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 required by statute. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals* 245-46 (Feb. 2015), *available at* http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx.

36 For more detail on the National Taxpayer Advocate's position on the proposed correctable error legislation, see *The National Taxpayer Advocate's 2014 Annual Report to Congress: Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 114th Cong. 34-35 (2015) (written testimony of Nina E. Olson, National Taxpayer Advocate).

MSP #6 PREPARER ACCESS TO ONLINE ACCOUNTS: Granting Uncredentialed Preparers Access to an Online Taxpayer Account System Could Create Security Risks and Harm Taxpayers

RESPONSIBLE OFFICIALS

Terry Milholland, Chief, Technology Officer
Edward Killen, Director, Privacy, Governmental Liaison and Disclosure
Debra Holland, Commissioner, Wage and Investment Division
Rene Schwartzman, Business Modernization Executive, Wage and Investment Division
Rajive Mathur, Director, Office of Online Services
Carol Campbell, Director, Return Preparer Office
Stephen Whitlock, Director, Office of Professional Responsibility

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

The National Taxpayer Advocate has advocated for years that the IRS develop an online account system for taxpayers.[2] A recent draft of the IRS Compliance Concept of Operations (CONOPS) identified online account access as one of the top ten initatives needed to achieve its compliance vision.[3] Pursuant to the draft CONOPS, online account access would enable taxpayers, preparers, and authorized third parties to securely interact with the IRS to obtain return information, submit payments, and receive status updates.[4] Accordingly, the National Taxpayer Advocate has the following concerns regarding preparer access to taxpayers' online accounts:

- Only preparers who are subject to IRS oversight should have access to taxpayers' online accounts;
- The IRS should clearly define the scope of preparers' access to online accounts;

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

2 *See, e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*); Most Serious Problem: *Taxpayer Access to Online Account System: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak with an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues that Are Not Conducive to Resolution Online, supra*.

3 IRS, *IRS Enterprise Concept of Operations (CONOPS): Overview of SB/SE and W&I, LB&I, and TE/GE CONOPS 25* (Jan. 15, 2015); *See* Most Serious Problem: *Taxpayer Service: The IRS Has Developed a Comprehensive "Future State" Plan That Aims to Transform the Way It Interacts with Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*, *supra*.

4 IRS, *Compliance Capabilities Initiative: Draft Blueprint for the Vision* 10-2, 21-30 (June 19, 2014); IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5, 10-2 (July 28, 2015) (on file with the National Taxpayer Advocate).

- The online account system should enable the taxpayer to maintain strict control over preparer authorizations, including approved actions; and
- The IRS should develop and implement procedures to ensure that preparers do not exceed their authority when accessing taxpayers' online accounts.

We are also concerned that the IRS plans to expand the third-party designee authorization on Form 1040 to include e-file software providers and Electronic Return Originators (EROs). By checking off the box, taxpayers would give these entities broad authorizations to perform actions that are likely beyond what most taxpayers realize.

ANALYSIS OF PROBLEM

Background

A recent draft of the IRS Compliance CONOPS envisions that the IRS will develop an online account system that enables taxpayers, preparers, and authorized third parties to securely interact with the IRS to obtain return information, submit payments, and receive status updates. It will also enable those taxpayers and authorized preparers to perform "self-correction" functions such as verifying return changes the IRS made, updating or amending returns, and providing additional documents.[5]

The IRS Should Permit Online Account Access to Only Preparers Subject to IRS Oversight

The IRS currently plans to enable the taxpayer to maintain control over whom can gain access to the account.[6] However, the IRS does not have any plans currently in development to restrict preparer access to the online account system by type of preparer. The National Taxpayer Advocate is concerned that the IRS will expose taxpayers to potential harm due to preparer incompetence or misconduct if it does not restrict access to only those preparers subject to IRS oversight pursuant to Circular 230.[7]

Preparers subject to IRS oversight under Circular 230 include attorneys, certified public accountants, enrolled agents, enrolled actuaries, and enrolled retirement plan agents.[8] In addition, pursuant to Revenue Procedure 2014-42, preparers who have obtained the voluntary Annual Filing Season Program (AFSP) Record of Completion can represent taxpayers before the IRS during an examination of a tax return or claim for refund they prepared. Preparers can voluntarily obtain an AFSP Record of Completion each calendar year if they successfully complete 18 hours of continuing education (CE) from IRS-approved CE providers, which includes a six-hour Annual Federal Tax Refresher (AFTR) course, obtain a score of at least 70 percent in the associated AFTR examination,[9] and agree to be subject to the duties and restrictions relating to practice before the IRS in Subpart B and § 10.51 of Circular 230 for the entire period covered by the AFSP Record of Completion.[10] After December 31, 2015, the IRS will no longer allow non-credentialed preparers without the AFSP Record of Completion to engage in limited practice on

5 IRS, *IRS Enterprise Concept of Operations (CONOPS): Overview of SB/SE and W&I, LB&I, and TE/GE CONOPS* 25 (Jan. 15, 2015); IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5, 10-12 (July 28, 2015) (on file with the National Taxpayer Advocate).

6 IRS, *Compliance Capabilities Initiative: Draft Blueprint for the Vision* 19 (June 19, 2014); IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5, 10-2 (July 28, 2015) (on file with the National Taxpayer Advocate).

7 31 U.S.C.§ 10.3.

8 *Id*.

9 Rev. Proc. 2014–42, § 4.05(2)(a), I.R.B. 2014-29 (July 14, 2014).

10 *Id*.

If the IRS does not limit online account access to only preparers subject to Circular 230 oversight, it could harm taxpayers and consequently, increase compliance issues.

returns they prepare after that date. Accordingly, the National Taxpayer Advocate believes that the IRS should restrict access to the online account to only preparers subject to Circular 230 oversight. As set forth below, the IRS has the ability to monitor and enforce this requirement because it has preparer tax identification numbers (PTINs) for these individuals. If the IRS does not limit online account access to only preparers subject to Circular 230 oversight, it could harm taxpayers and consequently, increase compliance issues. Without instituting safeguards on access to the system, the IRS could inadvertently facilitate or perpetuate preparer misconduct. Uncredentialed preparers could gain access, interact with the IRS on the taxpayer's behalf, and potentially address notices, proposed adjustments, or even proposed correctable errors without the taxpayer's consent or knowledge.[11] Although the vast majority of return preparers are conscientious and ethical, the IRS has ample evidence and experience to show that there are some return preparers who are committing refund fraud[12] or are negligent, and that certain payroll service providers who have access to employer accounts also embezzle funds and cover their tracks by changing account information.[13]

Further, in 2014, TAS commissioned a survey by Russell Research to better understand the needs and circumstances of taxpayers eligible to use the low income taxpayer clinics (LITCs).[14] The survey findings raise fundamental questions about the appropriateness of relying on preparers as intermediaries for the low income population, especially the Spanish speakers in this category, and particularly with the unregulated return preparer population. Nearly half of all LITC-eligible taxpayers used return preparers, as did approximately 75 percent of Spanish-speaking eligible taxpayers. However, the survey participants reported that a significant percentage of these preparers did not satisfy the very basic statutory requirements

11 For more detail on the National Taxpayer Advocate's position on the proposed correctable error legislation, see *The National Taxpayer Advocate's 2014 Annual Report to Congress: Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 114th Cong. 34-5 (2015) (written testimony of Nina E. Olson, National Taxpayer Advocate).

12 *Id.*; *see* National Taxpayer Advocate 2014 Annual Report to Congress 543-44; National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 71-8; and National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined from Continuing Its Efforts to Effectively Regulate Return Preparers*).

13 *The National Taxpayer Advocate's 2014 Annual Report to Congress: Hearing Before the H.R. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 114th Cong. 20-3 (Apr. 15, 2015) (written testimony of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate 2014 Annual Report to Congress 218-24 (Most Serious Problem: *Offers in Compromise: The IRS Needs to Do More to Comply With the Law Regarding Victims of Payroll Service Provider Failures*); National Taxpayer Advocate 2012 Annual Report to Congress 426-44 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*); National Taxpayer Advocate 2012 Annual Report to Congress 553-59 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 337-54 (Most Serious Problem: *Third Party Payers*); National Taxpayer Advocate 2007 Annual Report to Congress 538-44 (Legislative Recommendation: *Taxpayer Protection From Third Party Payer Failures*); National Taxpayer Advocate 2004 Annual Report to Congress 394-99 (Legislative Recommendation: *Protection from Payroll Service Provider Misappropriation*).

14 Russell Research, *Topline Findings from a Taxpayer Advocate Service Survey of Taxpayers Who Are Eligible to Use IRS's Low Income Taxpayer Clinics (LITC)* 5 (July 2014). TAS oversees and administers the LITC grant program for the IRS. The IRS awards matching grants to organizations that provide representation to low income individuals who need help resolving tax problems with the IRS. *See* IRC § 7526. At least 90 percent of the taxpayers represented by an LITC must have incomes that do not exceed 250 percent of the federal poverty level. *See* IRC § 7526(b)(1)(B)(i). The U.S. Department of Health and Human Services publishes yearly poverty guidelines in the *Federal Register*, which the IRS uses to establish the 250 percent threshold for LITC representation. For the 2015 poverty guidelines, see 80 Fed. Reg. 3236-3237 (Jan. 22, 2015).

under IRC §§ 6695(a) and (b).[15] For example, the participants reported that the preparer did not sign the return or did not give the taxpayer a copy more than 15 percent of the time. This percentage rose to more than 30 percent for Spanish-speaking eligible taxpayers.[16] Accordingly, TAS will continue to advocate to protect taxpayers from any harm imposed by giving third parties access to taxpayers' online accounts.

The IRS Should Clearly Define the Scope of Preparers' Access to Online Accounts

The IRS has not yet defined exactly what a preparer can do on behalf of the taxpayer upon gaining access to the taxpayer's online account. According to the CONOPS, preparers would be able to securely interact with the IRS to obtain return information, submit payments, and receive status updates. Authorized preparers would also be able to perform "self-correction" functions such as verifying return changes made by the IRS, updating or amending returns, and providing additional documents.[17] TAS remains concerned about the scope of this self-correction authority. For example, it is unclear whether these self-correction actions could include addressing adjustments made pursuant to the agency's math error authority.[18] Of particular concern is the planned ability of preparers to verify return changes made by the IRS as well as update or amend returns on behalf of the taxpayer, especially if the IRS does not limit access only to those preparers subject to IRS oversight.

Without any restrictions on type of preparer, there is a greater chance that vulnerable taxpayers could be harmed by preparers who prey upon the elderly, low income, and taxpayers with disabilities. Consider the possibility that preparers will develop a boilerplate form for the taxpayer to sign to authorize the preparer to conduct the above-referenced actions. If the preparer either fraudulently or negligently prepares an inaccurate return, the IRS may have just given the preparer the ability to cover his or her tracks. It is also possible that the taxpayer will not become aware of the problem for a long time. Finally, the preparer's actions could severely prejudice the taxpayer's procedural rights. For example, if the preparer accepts math error adjustments without the taxpayer's knowledge, the taxpayer may lose the right to contest the change in the U.S. Tax Court.[19]

The Online Account System Should Enable the Taxpayer to Maintain Strict Control Over Preparer Authorizations

TAS believes that the IRS should give the taxpayer strict and detailed control over preparer authorizations and develop procedures for the taxpayer to fine-tune them on the online account. While some

15 IRC § 6695(a) imposes a penalty on a tax return preparer for failure to provide a copy of the return to the taxpayer, unless the failure is due to reasonable cause and not to willful neglect. IRC § 6695(b) imposes a penalty on a tax return preparer for failure to sign a return when required by regulation to do so, unless the failure is due to reasonable cause and not to willful neglect.

16 Russell Research, *Topline Findings from a Taxpayer Advocate Service Survey of Taxpayers Who Are Eligible to Use IRS's Low Income Taxpayer Clinics (LITC)* 5 (July 2014). For more information on the LITC-eligible taxpayer study, see 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*).

17 IRS, *IRS Enterprise Concept of Operations (CONOPS): Overview of SB/SE and W&I, LB&I, and TE/GE CONOPS* 25 (Jan. 15, 2015); IRS, *Compliance Capabilities Initiative: Draft Blueprint for the Vision* 10-2, 21-30 (June 19, 2014); IRS, *IRS Enterprise Concept of Operations (CONOPS): Taxpayer Advocate Service Briefing* 5, 10-2 (July 28, 2015) (on file with the National Taxpayer Advocate).

18 The National Taxpayer Advocate has written extensively about her various concerns regarding the expansion of math error authority under IRC § 6213(g). *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 163-71 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*).

19 IRC § 6213(b)(1) provides that a taxpayer has no right to petition the Tax Court upon receiving a math error notice. IRM 21.5.4.1, *General Math Error Procedures Overview* (Oct. 1, 2014). In math or clerical error cases, the service may assess and send a notice of assessment of additional tax without using deficiency procedures.

taxpayers may not have close relationships with their preparers, others have long-term relationships and completely trust their preparer to interact with the IRS on their behalf. A taxpayer can decide the limits of the authority he or she wants to convey to a preparer but must avoid signing boilerplate forms giving the preparer broad access to the online account system with minimal restrictions. The IRS should bring IRS Form 2848, *Power of Attorney and Declaration of Representative*, into the 21st century by building the online account system to provide specific checkboxes addressing authorizations for each type of action a preparer could take on behalf of the taxpayer on the online account system. For example, the checkboxes could include some of the following actions:[20]

- Provide the IRS any information that is missing from the taxpayer's return;
- Obtain from the IRS information about the processing of the taxpayer's return or the status of the taxpayer's refund or payment(s);
- Receive copies of notices or transcripts related to the taxpayer's return, upon request; and
- Respond to certain IRS notices about math errors, offsets, and return preparation.

TAS believes that the IRS should give the taxpayer strict and detailed control over preparer authorizations and develop procedures for the taxpayer to fine-tune them on the online account.

These proposed checkboxes are also relevant to the current plans of the IRS to expand the third-party designee authorization on Form 1040 to include e-file software providers and EROs. By checking off one box, the taxpayer would give the software provider or ERO, whichever is applicable, the blanket authority to perform any or all of the actions included in the four bullets above. The rationale for this expansion is to enable the parties to obtain refund status information from the IRS, so that they can inform the taxpayer and subsequently, the IRS will receive fewer calls from the taxpayers seeking this information. However, there is no reason the software provider or ERO should have the authority to perform all of the actions listed. In fact, the taxpayer, if given the choice, probably would not agree to provide the authority to these parties to perform most of the actions listed.

The IRS Should Develop and Implement Procedures to Track Preparer Access and Restrict Unauthorized Activities

Once the taxpayer specifies the preparer's authorities for the online account system, the IRS must develop a method to track preparer access and restrict all unauthorized activities. The IRS should build the system to prevent unauthorized activities from happening in the first place. As discussed above, the system should first restrict access to only those preparers subject to IRS oversight pursuant to Circular 230. It also should build the online account system so it validates the preparer's PTIN information. If the system determines the preparer is unregulated and did not take part in the voluntary AFSP, then it could automatically block certain authorization checkboxes. The checkboxes ensure that everyone involved in a transaction knows exactly what the taxpayer has authorized the preparer to do.

Under agency law, the preparer is acting as the taxpayer's agent. Accordingly, pursuant to the Doctrine of Apparent Authority (sometimes referred to as the Doctrine of Ostensible Authority), any reasonable third party is allowed to rely on the agent's actions, unless the third party has reason to know that the agent's

20 The four bullets listed are the actions for which the taxpayer designates a third party after Line 79 of tax year 2014 Form 1040, *U.S. Individual Income Tax Return*. IRS Form 1040 Instructions 2014. However, ideally, the check boxes should have plain language explanations that have been reviewed by members of the Taxpayer Advocacy Panel (TAP) and LITCs, who have experience communicating with vulnerable populations and also represent them in situations where preparers have taken unauthorized actions.

actions are unauthorized. Therefore, the IRS is allowed to rely on the preparer's actions, unless it has reason to know that the taxpayer did not grant the preparer authority to conduct certain transactions. In fact, under agency law and the Doctrine of Apparent Authority, the taxpayer may be liable for any of the preparer's unauthorized actions if he or she granted a blanket authorization on the online account system, even if the taxpayer had an agreement with the preparer to conduct only one specific type of transaction.[21] The taxpayer would then have to seek recourse against the preparer and may be left to correct those errors, made by the preparer's unauthorized transaction conducted by the preparer, on his or her own.

The Doctrine of Apparent Authority assumes that the third party, the IRS, did not have reason to know that the agent, the preparer, was conducting an unauthorized action. However, the significant occurrence of return preparer fraud may be enough to give the IRS reason to know or appreciate the potential risk for unauthorized actions by unscrupulous preparers.[22] Therefore, there is a possibility that the taxpayer will not be liable for the unauthorized actions of the preparer if the IRS has reason to know of the potential risk. Further, if the IRS creates the online account system with blanket authorizations as the only available option, the IRS may have difficulty holding the taxpayer liable because it is not making an effort to protect its interests by mitigating the known risk of unauthorized actions.[23] The IRS should give serious consideration to this issue as it develops the process for taxpayer authorizations on the system.

Because the taxpayer may be held responsible for the preparer's actions, whether authorized or not, it is crucial that the taxpayer is aware of *all* the actions taken by the preparer on the taxpayer's online account.

Because the taxpayer may be held responsible for the preparer's actions, whether authorized or not, it is crucial that the taxpayer is aware of *all* the actions taken by the preparer on the taxpayer's online account. Therefore, whenever a preparer takes any type of action on the online account system, including merely accessing the account, the system should alert the taxpayer, in a manner specified by the taxpayer, such as by email or text. Though TAS anticipates IRS hesitation to bombard the taxpayer with messages from the system, it believes the taxpayer needs to know when the preparer accesses the system and exactly what type of transaction the preparer conducted. If the taxpayer feels uncomfortable with the action taken, he or she should then have the ability to report a grievance based on information provided in each system alert communication. Most importantly, this alert system would provide notice to the taxpayer of unauthorized actions and enable the taxpayer to take immediate steps to undo them.

In addition, if the system does not prevent unauthorized actions, the IRS could violate IRC § 6103 if it inappropriately discloses taxpayer information to an unauthorized preparer accessing the system. Unauthorized access also infringes upon the taxpayer's *right to confidentiality*.[24] While the IRC provides civil and criminal penalties for inappropriate uses and disclosures by preparers of tax return information, the IRS should issue guidance specifically applying the provisions to unauthorized access to the online

21 Restatement (Third) of Agency § 2.03 (2006).

22 For a recent discussion on return preparer fraud issues, see National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 34-7 (Area of Focus: *The IRS Agrees It Should Issue Refunds to Victims of Return Preparer Fraud, But It Has Been Slow to Develop Necessary Procedures*). At the end of FY 2015, TAS had 272 return preparer fraud cases in total inventory. Data obtained from TAMIS for FY 2015 (Nov. 1, 2015) (Data represents open cases with Special Case Code PF). The current inventory of return preparer fraud cases includes unresolved cases received in prior FYs.

23 Restatement (Second) of Torts § 918 (1979) ("One is not prevented from recovering damages for a particular harm resulting from a tort if the tortfeasor intended the harm or was aware of it and was recklessly disregardful of it, unless the injured person with knowledge of the danger of the harm intentionally or heedlessly failed to protect his own interests.").

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

account system.[25] In addition, the IRS should revise Circular 230 sanctions to include sanctions for those preparers who conduct, or attempt to conduct, unauthorized transactions on the online account system.

The IRS should develop procedures to enable the taxpayer to undo any unauthorized transactions conducted by the preparer. For example, if the preparer accepts a math error adjustment without the authorization of the taxpayer, the taxpayer could lose the opportunity to seek independent review by the U.S. Tax Court. The IRS should develop procedures to reverse the unauthorized acceptance of the math error adjustment and institute deficiency procedures.[26]

CONCLUSION

As the IRS develops a new online account system for taxpayers, the National Taxpayer Advocate has concerns about preparer access to such system. First, due to the potential for incompetent or unscrupulous preparers to use the system to impose significant harm on taxpayers, it is prudent to restrict access to only those preparers who are already subject to IRS oversight. If the IRS does not restrict access to preparers subject to Circular 230 oversight, it should evaluate the actions preparers can take on the system to protect taxpayers from harm imposed by preparer misconduct. Furthermore, taxpayers are the best equipped to determine the boundaries of the preparer's online access and should have the ability to maintain strict control over preparer authorizations. Finally, such safeguards are meaningless unless the IRS can ensure that preparers do not go beyond those specific authorized activities.

25 IRC §§ 7216, 6713.

26 Treasury should revise Circular 230 to include a sanction for unauthorized access to the online account system. We recommend Treasury revise § 10.51, *Incompetence and Disreputable Conduct*, 31 C.F.R. Part 10, to include specific reference to unauthorized access to the online account system. However, such sanctions may not be applicable to preparers who are not subject to IRS oversight under Circular 230.

RECOMMENDATIONS

The National Taxpayer Advocate recommends the IRS:

1. Limit preparer access to the taxpayer online account system to only those preparers subject to IRS oversight under Circular 230.
2. Develop the online account system so it validates the preparer's PTIN information. If the preparer is not subject to Circular 230 oversight, the system should block certain authorization checkboxes automatically.
3. Develop the online account system so that the taxpayer can adjust preparer authorizations by checking a separate box for each type of action the designated preparer can take on the taxpayer's behalf. The checkboxes should use plain language explanations that Taxpayer Advocacy Panel members and Low Income Taxpayer Clinics have reviewed.
4. Develop procedures to track preparer access to the taxpayer's online account and verify the taxpayer authorized the actions taken.
5. Develop procedures to automatically alert the taxpayer of any preparer activities on the online account system and provide information to the taxpayer on how to report unauthorized access.
6. Work with the Department of Treasury to issue guidance specifically applying the provisions of IRC §§ 6713 and 7216 to unauthorized access to the online account system.[27] In addition, the IRS should work with Treasury to revise Circular 230 sanctions to include sanctions for preparers who conduct, or attempt to conduct, unauthorized transactions on the online account system.

27 IRC §§ 7216, 6713.

MSP #7 INTERNATIONAL TAXPAYER SERVICE: The IRS's Strategy for Service on Demand Fails to Compensate for the Closure of International Tax Attaché Offices and Does Not Sufficiently Address the Unique Needs of International Taxpayers

RESPONSIBLE OFFICIALS

Douglas W. O'Donnell, Commissioner, Large Business & International Division
Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

Despite an increase in the number of international taxpayers, the IRS has significantly decreased its overseas taxpayer service presence in recent years.[2] While it has plans to expand international criminal investigation locations,[3] during late 2014 and 2015, the IRS eliminated the last four tax attaché posts abroad, citing a multi-year decrease in its appropriations.[4] Taxpayers who benefitted from these offices now must either call an overwhelmed, tolled IRS telephone number in the United States or obtain information from the irs.gov website.

Apart from the attachés, the only free option[5] for taxpayers to ask a specific question and receive a response from an IRS employee was the Electronic Tax Law Assistance Program (ETLA), which the IRS terminated in October 2015. ETLA allowed the IRS to learn directly from taxpayers what problems and questions they had, and how it needed to update its webpages and publications to provide the necessary information. In conjunction with terminating ETLA, the IRS also discontinued R-mail, a system that allowed customer service representatives to refer taxpayer questions to employees with specific expertise. By eliminating ETLA and R-mail, the IRS has shut itself off from taxpayers with no way of knowing (unless the taxpayer makes a mistake or the IRS selects his or her return for audit) whether it is providing the

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

2 National Taxpayer Advocate 2011 Annual Report to Congress 156, fn. 39. *See also* National Taxpayer Advocate 2009 Annual Report to Congress 134-54.

3 See Internal Revenue Service FY 2016 President's Budget 81 (Feb. 2, 2015), *available at* http://www.treasury.gov/about/budget-performance/CJ16/02-06.%20IRS%20FY%202016%20CJ.pdf.

4 There were originally fifteen foreign tax attaché posts. *See id*. On November 30, 2014, the IRS closed its Beijing office. Memorandum from Acting Deputy Commissioner, International (LB&I) to LB&I, Commissioner; SB/SE, Commissioner; W&I, Commissioner; Director, IBC; Director, IIC; Director, PGLD; Director Taxpayer Advocate Services; Office of the Chief Technology Officer; Chief Criminal Investigations; Chief Financial Officer (Oct. 16, 2014). The IRS closed tax attaché offices in Frankfurt, Germany, London, UK, and Paris, France, on June 26, 2015, Sept. 19, 2015, and Dec. 26, 2015, respectively. Memorandum from Acting Deputy Commissioner, International (LB&I), *Post Closures of Frankfurt, London and Paris* (Feb. 18, 2015).

5 Because taxpayers calling abroad may have to pay long distance toll charges, the international taxpayer assistance line is not considered a free option.

service taxpayers need. The net effect is a reversion back to a "push" approach to taxpayer information, as opposed to a dialogue.

The National Taxpayer Advocate has repeatedly written about the unique needs of international taxpayers, which the IRS has been slow to address.[6] Given the overwhelming complexity of international tax rules and reporting requirements and the potentially devastating penalties for even inadvertent noncompliance,[7] the IRS's withdrawal of dialogue makes it more likely taxpayers will get it wrong. The IRS creates an endless cycle of more noncompliance breeding more enforcement, without more proactive taxpayer service through education and interaction, which would help avoid these problems. In addition to the closure of the attachés and the termination of ETLA, the National Taxpayer Advocate remains concerned that:

- Telephone and correspondence service for international taxpayers is inadequate;
- The IRS's plans for expanding self-service options, which although having the potential to benefit international taxpayers, cannot fully replace personal service options, either by phone, face-to-face, or an online chat function; and
- The IRS has no permanent servicewide team focused on service for taxpayers abroad.

With its international taxpayer service strategy, the IRS is limiting the opportunity for interaction and will no longer be able to learn firsthand what taxpayers need. Without a two-way dialogue, information will be filtered and the IRS will decide what it thinks taxpayers need to hear, instead of hearing what information taxpayers want and need. This interaction is vital, and any system of taxpayer service worthy of that name must have avenues for learning from its participants, instead of just telling them.

ANALYSIS OF PROBLEM

International Taxpayers Comprise a Significant Group With Unique Needs and Burdens

The number of U.S. citizens abroad continues to grow, while the numbers of other international taxpayers remain steady. In mid-2015, approximately 8.7 million U.S. citizens lived abroad, compared with about 7.6 million in mid-2014.[8] The number of U.S. military service personnel and dependents stationed overseas as of June 2015 was 174,100 compared to 149,600 in 2014, an increase of over 16 percent.[9] There were also many international U.S. taxpayers who were neither residents nor citizens of the United States,

6 *See, e.g.*, National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 77-82 (Area of Focus: *International Local Taxpayer Advocates Would Provide Valuable Assistance to Taxpayers and Protect Their Rights*); National Taxpayer Advocate 2012 Annual Report to Congress 262-80 (Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs*); National Taxpayer Advocate 2013 Annual Report to Congress 205-13 (Most Serious Problem: *International Taxpayer Service: The IRS Is Taking Important Steps to Improve International Taxpayer Service Initiatives, But Sustained Effort Will Be Required to Maintain Recent Gains*).

7 *See* 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*).

8 *See* U.S. Department of State, Bureau of Consular Affairs, *Who We Are and What We Do: Consular Affairs by the Numbers* (May 2014), *available at* http://travel.state.gov/content/dam/travel/CA%20Fact%20Sheet%202014.pdf; U.S. Department of State, Bureau of Consular Affairs, *Who We Are and What We Do: Consular Affairs by the Numbers* (Apr. 2015), *available at* http://travel.state.gov/content/dam/travel/CA%20by%20the%20Numbers-%20May%202015.pdf.

9 U.S. Department of Defense, *Active Duty Military Personnel, Strength by Regional Area and by Country* (Mar. 31, 2015); U.S. Department of Defense, Active Duty Military Personnel, Strength by Regional Area and by Country (Mar. 31, 2014), *available at* https://www.dmdc.osd.mil/appj/dwp/dwp_reports.jsp; U.S. Department of Defense, Active Duty Military Personnel, Strength by Regional Area and by Country (Mar. 31, 2013), *available at* https://www.dmdc.osd.mil/appj/dwp/dwp_reports.jsp.

evidenced by the approximately 231,000 U.S. individual tax returns filed by nonresident aliens in 2014, compared to 214,000 in 2013.[10]

International taxpayers face unique filing burdens. For example, taxpayers who are not U.S. citizens must apply for an Individual Taxpayer Identification Number (ITIN), an arduous process that often requires mailing original identification documents.[11] U.S citizens, resident aliens, and certain non-resident aliens that have an interest in specified foreign financial assets and meet the reporting threshold, must report their foreign financial assets under the Foreign Account Tax Compliance Act (FATCA).[12] Furthermore, all U.S. persons, that have an interest of $10,000 or more in foreign financial accounts, must file Financial Crime Enforcement Network Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR).[13]

Without a two-way dialogue, information will be filtered and the IRS will decide what it thinks taxpayers need to hear, instead of hearing what information taxpayers want and need. This interaction is vital, and any system of taxpayer service worthy of that name must have avenues for learning from its participants, instead of just telling them.

The Closure of Tax Attaché Offices Abroad, Concurrent With the Expansion of the IRS's International Enforcement Presence, Harms Taxpayers and Fails to Provide the Assistance They Need

The closure of the last four overseas tax attachés deprives taxpayers abroad of valuable and necessary services.[14] In 2014 and 2015, the attachés collectively held 19 formal outreach events, with approximately 1,500 attendees.[15] These events focused on topics such as filing requirements, the foreign tax credit, FBAR, and tax law changes; and they included a question and answer portion with the opportunity for one-on-one questions after. In fiscal year (FY) 2014, approximately 5,442 taxpayers walked-in to the London attaché office to seek assistance or ask questions, and the Frankfurt office had over three thousand phone contacts.[16] By providing accessible information about what international taxpayers need to do to comply with the tax laws, the attachés supported taxpayers' *rights to be informed* and *to quality service*.

The interaction between the attachés and taxpayers created a perfect feedback loop: taxpayers came to the attachés for help, and in addition to providing assistance, the attachés learned about issues taxpayers found confusing or about systemic problems. The attachés then incorporated this information into their future presentations and shared it with other IRS employees who were

10 TAS Research & Analysis query of Compliance Data Warehouse (Dec. 15, 2015).

11 See Most Serious Problem: *Individual Taxpayer Identification Numbers (ITINs): IRS Processes Create Barriers to Filing and Paying for Taxpayers Who Cannot Obtain Social Security Numbers*, *infra*.

12 For more information about the burdens on taxpayers associated with FATCA, see National Taxpayer Advocate FY 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*).

13 See 31 C.F.R. §§ 1010.350(a), 1010.306(c). All U.S. persons includes U.S. citizens, resident aliens, trusts, estates, and domestic entities.

14 In 1993, the IRS had staff members attached to or located at more than a dozen U.S. embassies abroad. See David Kocieniewski, IRS Will Shut Last Overseas Taxpayer Assistance Centers (Jan. 14, 2015), *available at* http://www.bloomberg.com/news/articles/2015-01-14/irs-will-shut-last-overseas-taxpayer-assistance-centers. The Commissioner listed growing the attaché presence as one of the many actions the IRS could take if provided with additional funding of $40.7 million in order to address offshore tax evasion. See FY 16 *Treasury Department Budget: Hearing Before the Senate Appropriations Committee, Subcommittee on Financial Services and General Government*, 113th Cong. (2015) (statement of John A. Koskinen, Commissioner, IRS).

15 IRS response to TAS information request (July 22, 2015).

16 *Id*.

responsible for content on irs.gov, or who might be in a position to influence policies or procedures. The following examples illustrate this:

- The Paris attaché received numerous questions about renunciation, so it posted information on this issue on the embassy website and in its brochures.
- The Paris attaché wrote letters to IRS service centers to resolve systemic problems.
- The Beijing attaché reached out to the Affordable Care Office to recommend it add a Frequently Asked Question to its website, which it did, based on recurring questions from international taxpayers.
- The Beijing attaché elevated to the IRS the issue of taxpayers with foreign addresses being unable to use the online transcript request.
- Upon noticing a large number of returns filed that appeared to be part of a fraudulent scheme, the London attaché elevated the issue to Deputy Large Business & International (LB&I) Commissioner, International, and it was referred to the appropriate office.[17]

The attachés also sent monthly reports to IRS headquarters, reporting on trends and the prevailing issues.[18] In this way, the attachés were highly efficient and cost effective because they likely benefited many more taxpayers than just the ones who contacted them.

The interaction between the attachés and taxpayers created a perfect feedback loop: taxpayers came to the attachés for help, and in addition to providing assistance, the attachés learned about issues taxpayers found confusing or about systemic problems.

The attachés also acted as a liaison to community organizations, professional associations, financial institutions, and the embassy and consulate offices in the surrounding region.[19] The Paris attaché reported meeting with practitioners annually to hear about their issues and problems, and incorporated this information into its annual taxpayer service plan. The attachés also had relationships with treaty partners and spent ample time on exchange of information issues. The attachés used their expertise to provide information about laws and overseas procedures to other IRS offices.[20]

Unique to the attachés activities was the direct, two-way interaction between them and taxpayers or stakeholders. Although virtual outreach may be beneficial in the future, and the Paris attaché successfully held two virtual outreach events for expatriates in Nairobi and Barcelona during 2015, these did not provide the opportunity for one-on-one interaction. Furthermore, the IRS relied on the partnership of the Department of State in conducting these events, and has recently cited rejections by the Department of State as reasons for stalled progress on plans to conduct similar outreach events during the next filing season.[21] Even if the IRS is able to orchestrate future virtual sessions without the attachés, providing a one-time brief window will not replace the dialogue that taxpayers had with the attachés throughout the year.

17 TAS conference call with IRS tax attachés (Sept. 24, 2015).

18 *Id*.

19 For example, the Paris office had collaborative relationships with the Organization of Economic Cooperation and Development (OECD) and traveled to meet with treaty partners, embassy officials, and consulates to see what their needs were. *See Id*. The London office had active relationships with a number of expatriate community organizations, as well as professional groups such as the Entertainment Industry Workshop Group and the British-American Business Roundtable. *See* IRS response to TAS information request (July 22, 2015).

20 TAS conference call with IRS tax attachés (Sept. 24, 2015).

21 *Id*.

The National Taxpayer Advocate is concerned that the IRS did not analyze the impact of closing the attachés prior to making its decision. The IRS stated "these closures have relatively little impact on taxpayers and treaty partners;" however, the IRS did not conduct any impact studies to determine the potential effects on taxpayers, compliance, or revenue. The IRS estimated the closures would save $4 million per year.[22] However, at the same time, the IRS has asked for $8.4 million to expand offshore criminal investigations, including opening two additional posts.[23] Impact studies may have considered the effects on voluntary compliance, especially encouraging voluntary payments.[24] Instead of closing the existing attachés, the IRS should analyze the impact of reopening additional attaché offices. In addition, each IRS office abroad should include a Local Taxpayer Advocate (LTA) to provide international taxpayers with better access to TAS, foster increased communication and information sharing, and encourage reporting of systemic issues.[25] Increases in voluntary compliance resulting from better service for taxpayers abroad would more than offset the additional costs.[26]

Shutting Down the Electronic Tax Law Assistance Program Removed the Only Free Option for International Taxpayers to Meaningfully Interact With the IRS

On October 1, 2015, the IRS shut down the ETLA program, 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.[27] An internal email indicates that a drop in usage since its initiation drove the IRS's decision.[28] However, low usage was by design, as the irs.gov website includes little mention of ETLA.[29] Furthermore, ETLA inquiries have actually increased in recent years, with an average of almost 32,000 inquiries per year during the last four years, compared with an average of only about 13,500 inquiries per year during the prior four years.[30] Inquiries from aliens and U.S. citizens living abroad have grown substantially, up 39 percent since FY 2013.[31]

22 *See* David Kocieniewski, IRS Will Shut Last Overseas Taxpayer Assistance Centers (Jan. 14, 2015), *available at* http://www.bloomberg.com/news/articles/2015-01-14/irs-will-shut-last-overseas-taxpayer-assistance-centers. The IRS requested $283 million for international enforcement resources for FY 2014, and only about $8.5 million for all field assistance for the LB&I Operating Division, which includes a Headquarters office and one other domestic office. IRS response to TAS information request (July 10, 2015).

23 IRS FY 2016 President's Budget 81 (Feb. 2, 2015), *available at* http://www.treasury.gov/about/budget-performance/CJ16/02-06.%20IRS%20FY%202016%20CJ.pdf. Currently, the IRS maintains ten criminal investigation offices overseas. IRS, Criminal Investigation, Fiscal Year 2014 National Operations Annual Business Report, 27, *available at* http://www.irs.gov/pub/foia/ig/ci/REPORT-FY2014-IRS-CI-Annual-Report.pdf.

24 As an example, taxpayer remittances received by the London attaché in FY 2014 totaled almost $27 million. IRS response to TAS information request (July 22, 2015).

25 For a detailed discussion of the need for LTAs abroad, see National Taxpayer Advocate FY 16 Objectives Report to Congress 77-82 (Area of Focus: *International Local Taxpayer Advocates Would Provide Valuable Assistance to Taxpayers and Protect Their Rights*). *See also* National Taxpayer Advocate 2013 Annual Report to Congress 213; National Taxpayer Advocate 2011 Annual Report to Congress 190.

26 More than 98 percent of all tax revenue collected by the IRS is paid voluntarily and timely. In FY 2014, the IRS collected total tax revenue of about $3.1 trillion. Of that amount, it collected $57.1 billion through enforcement actions. Government Accountability Office (GAO), GAO-15-173, *Financial Audit: IRS's Fiscal Years 2014 and 2013 Financial Statements* 29 (Nov. 2014), *available at* http://www.gao.gov/assets/670/666863.pdf.

27 *See* SERP Alert 15A0387 (Aug. 18, 2015).

28 *See* email from Chief, Electronic Services and Programs, SE:W:CAS:AM:ESP (Aug. 13, 2015).

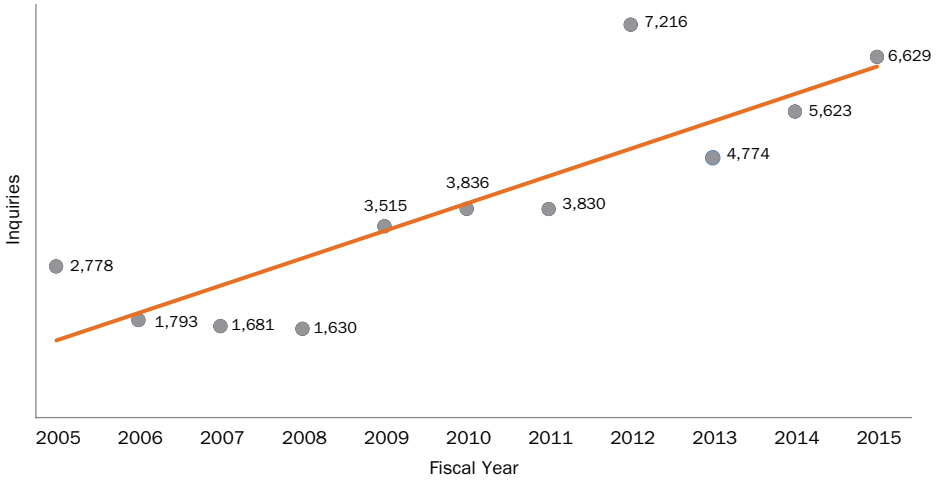
29 A search on irs.gov on August 18, 2015, for "ETLA" or "Electronic Tax Law Assistance" turned up only two web pages on irs.gov, neither of which actually had a link that taxpayers could use to access the ETLA system.

30 ETLA Fiscal Year Reports, FY 2008-2015.

31 *Id*.

FIGURE 1.7.1[32]

Growth in ETLA Inquiries Received From Aliens and U.S. Citizens Living Abroad



Although some ETLA inquires resulted in long wait times for taxpayers,[33] the average response time during FY 2015 for questions related to aliens and U.S. citizens living abroad was only 3.9 days,[34] meaning the IRS was able to manage its resources in a way to efficiently answer these questions. In addition to the superficially low usage rate, the IRS also cites cost as a reason for discontinuing ETLA, comparing the cost per contact of $116 with the cost per contact for toll free assisted calls of $42.[35] However, one ETLA submission is not equal to one telephone call. ETLA questions are usually those that are not covered in online applications or are difficult to understand or interpret in the context of a taxpayer's specific circumstances, meaning they are inherently likely to be more difficult and thus more expensive to answer. Taxpayers could also ask questions 24 hours a day, which is crucial for taxpayers in international time zones.

In conjunction with terminating ETLA, the IRS also discontinued its R-mail program, which was an automated system used to refer specific tax law questions received through ETLA to headquarters employees to clarify confusing issues or instructions. The IRS cited low usage for this program, which is a self-fulfilling proposition, a result of the IRS not answering "out of scope" questions, precisely the type of question that might require a referral.[36] R-mail could have provided a valuable feedback loop between international taxpayers who are experiencing confusion regarding an issue or instruction, and the IRS employee receiving the referral, who can recommend changes to the instructions or procedures based on what the taxpayer identifies as confusing.

32 ETLA Fiscal Year Reports, FY 2005-2015.

33 For example, questions involving the Child Care Credit and Other Credits handled by the Dallas office had an average wait time of nearly 30.1 days for inquiries worked during FY 2015. ETLA Fiscal Year 2015 Report. The IRS has a goal of answering all ETLA inquiries within three business days. Internal Revenue Manual (IRM) 21.3.2.1, *Electronic Tax Law Assistance Overview* (Dec. 10, 2014).

34 ETLA Fiscal Year Reports for inquiries received between October 1, 2014 and September 30, 2015.

35 *See* Briefing Document, *Retiring Electronic Tax Law Assistant (ETLA) and Referral Mail (R-Mail)* (sent by email from Wage and Investment Senior Advisor to TAS, Aug. 31, 2015).

36 IRM 21.2.1.57.2, *Procedures* (Mar. 15, 2012), provides procedures for R-mail telephone referrals and states: "Depending on the complexity of the message, you may determine that a question is outside the scope of the service. IRM 21.2.1.57.2.2.7, "Out of Scope" Procedures."

None of the alternatives to ETLA provide real interaction. The IRS cites various tools on its website,[37] but even the so called "interactive" tools only provide canned responses to questions the IRS has come up with, leaving taxpayers unable to ask their actual questions and the IRS oblivious as to what issues taxpayers have. Contingent on funding, the IRS has proposed two options for virtual webcasts to assist taxpayers abroad who no longer have the benefit of ETLA or virtual outreach conducted by the attachés. The first option includes a live webcast with up to 20,000 attendees where questions can be asked and answered during the webcast. The second option is for a PowerPoint slide webcast with audio that is envisioned to accommodate at least 2,000 attendees and can be recorded for subsequent viewing, but without audience interaction and the capability to respond to audience questions.[38] Even if the IRS is able to achieve the first option, it would provide only a single opportunity for dialogue with a limited number of taxpayers at a time that may not be convenient or when taxpayers even have questions. Given the reliance on ETLA by taxpayers abroad, terminating ETLA as a whole reflects poor decision-making and disregard for international taxpayers' needs.

Telephone and Correspondence Service for International Taxpayers Is Inadequate

Although an increasing number of international taxpayers prefer online services over telephone, non-filers were significantly more likely than filers to want more IRS resources devoted to telephone service as opposed to online service improvements, according to a 2012 IRS survey.[39] This may be because only 58 percent of non-filers surveyed reported having Internet access at home, and 35 percent reported having no Internet access at all.[40] Foreign taxpayers face burdens in calling the IRS, primarily because they must call a domestic IRS office, which may be many time zones away, and pay significant tolls depending on the length of the call. This is especially problematic given the decline in phone service over 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.[41] Furthermore, the average level of service on the international phone line in FY 2015 was only 55 percent.[42]

The IRS could accommodate the international taxpayer service need driven by the increase in international enforcement by allocating additional funding for international taxpayer phone lines. Using Voice over Internet Protocol (VOIP) technology could potentially allow the IRS to reduce its phone costs and provide toll-free service to overseas taxpayers. When asked about barriers to using this technology, the IRS response was based solely on its experience as a tenant of the U.S. embassy in London, where the Department of State used such technology, reflecting that the IRS has not researched this possibility.[43]

37 The IRS cites Tax Topics, Tax Trails, and the Interactive Tax Assistant as alternatives, although additions to the Interactive Tax Assistant are contingent on funding. *See* IRS Briefing Document, *Retiring Electronic Tax Law Assistance and Referral Mail* (sent by email from Wage and Investment Senior Advisor to TAS on Aug. 31, 2015).

38 *See* IRS Briefing Document, *Retiring Electronic Tax Law Assistance and Referral Mail* (sent by email from Wage and Investment Senior Advisor to TAS on Aug. 31, 2015).

39 Forty-six percent of nonfilers favored improving telephone service over online service, as opposed to only 30 percent of filers who favored telephone service. IRS, Wage and Investment Research and Analysis, *2012 Taxpayer Experience of Individuals Living Abroad: Service Awareness, Use, Preferences, and Filing Behaviors* 10 (Aug. 2012).

40 IRS, Wage and Investment Research and Analysis, *2012 Taxpayer Experience of Individuals Living Abroad: Service Awareness, Use, Preferences, and Filing Behaviors* 10 (Aug. 2012).

41 IRS, JOC Snapshot Reports for weeks ending Sept. 30, 2013 and Sept. 30, 2015.

42 IRS, JOC Snapshot Report for week ending Sept. 30, 2015.

43 *See* IRS response to TAS information request (July 22, 2015).

Although many questions can be answered from an online article or the Interactive Tax Assistant (ITA), questions about a taxpayer's account or requests for a manager to explain an employee's handling of their case must be answered over the phone. Furthermore, the term "interactive" in describing the ITA is misleading because the taxpayer only receives one of a number of canned answers to questions the IRS has created on its own.

Although many questions can be answered from an online article or the Interactive Tax Assistant (ITA),[44] questions about a taxpayer's account or requests for a manager to explain an employee's handling of their case must be answered over the phone. Furthermore, the term "interactive" in describing the ITA is misleading because the taxpayer only receives one of a number of canned answers to questions the IRS has created on its own. There is no two-way interaction between the taxpayer and an employee where the taxpayer could receive a specific answer to his or her question and the IRS could learn about how to improve its taxpayer resources based on the taxpayer's question.

The lack of phone service is especially critical given barriers to receiving correspondence abroad. The Treasury Inspector General for Tax Administration (TIGTA) recently found that typographical errors and systemic address limitations lead to undeliverable international mail and registered mail may not be delivered to its intended recipients abroad.[45] TIGTA noted that approximately 855,000 notices and letters were sent to U.S. taxpayers abroad during 2014, but the IRS could not determine how many taxpayers responded.[46] Without effective correspondence or accessible phone service, the IRS infringes a taxpayer's *right to be informed.* Taxpayers abroad may not receive crucial information about their accounts, as well as learn when they need to take actions to exercise their rights. For example, without receiving a Statutory Notice of Deficiency, a taxpayer abroad may not know he or she must petition Tax Court within 150 days to challenge the deficiency in court.[47]

The IRS's Plans for Expanding Self-Service Options, Which Although Having the Potential to Benefit International Taxpayers, Cannot Fully Replace Personal Service Options, Either by Phone, Face-to-Face, or an Online Chat Function

The IRS has improved some self-service resources for international taxpayers; however, most only provide static information, with no way for taxpayers to interact with an IRS employee. In June 2015, the IRS released three YouTube videos for international taxpayers on the topics of filing requirements, the foreign earned income tax exclusion, and ITINs.[48] It also added two new international "Tax Trails," which are a series of "interactive" questions that allow a taxpayer to find canned answers to tax law and tax filing questions chosen by the IRS.[49] The IRS also expanded its coverage of international issues on its "Tax Map," which now includes an index of international issues and provides links to various IRS online articles about specific topics, such as tax treaties or FATCA. In FY 2015, the international pages received 15,484 total

44 The Interactive Tax Assistant is a tax law resource that takes a taxpayer through a series of questions on a limited number of topics and provides responses. *See* http://www.irs.gov/uac/Interactive-Tax-Assistant-(ITA)-1. The term "interactive" is misleading, as the taxpayer only receives one of a number of canned answers to questions the IRS has created on its own, as opposed to interacting with an employee who could answer the taxpayer's specific question.

45 *See* TIGTA, Ref. No. 2015-30-072, *Planned Improvements Have Not Been Made to Manage and Track Correspondence With International Taxpayers* (Sept. 8, 2015).

46 *Id*.

47 IRC § 6213 provides that within 90 days (or 150 days if the notice is addressed to a person outside the United States) after a notice of deficiency is mailed, a taxpayer can petition Tax Court to challenge the deficiency.

48 *See* IRS, IR 2015-85, *New YouTube Videos, Online Resources Help Taxpayers Abroad* (June 4, 2015), *available at* http://www.irs.gov/uac/Newsroom/New-YouTube-Videos,-Online-Resources-Help-Taxpayers-Abroad.

49 *See id*.

hits through June 29, 2015, with the top five non-U.S. visitor countries of origin being: China, UK, Canada, Germany, and Spain.[50]

TAS asked the IRS about its progress during the last two fiscal years on expanding online resources for international taxpayers, including secure messaging portals, Free File fillable forms, e-filing, and improvements to irs.gov. The IRS response reflected the main actions were improvements to irs.gov, which primarily consisted of updating informational webpages. The only significant action was to develop a registration page allowing foreign financial institutions to register with the IRS regarding their participation in FATCA and obtain a Global Intermediary ID Number to use for FATCA reporting.[51]

The IRS should invest in catching up with technology already developed by the private sector to create a secure internet connection for taxpayers abroad so they could communicate with the IRS via an "e-chat" system. The IRS can also pilot the Virtual Service Delivery (VSD) technology it successfully uses for in-person interaction with taxpayers domestically.[52] To avoid security concerns involving foreign Internet Protocol addresses, the IRS could partner with the U.S. Department of State to install VSD terminals at U.S. embassies and consulates. However, before the IRS develops alternatives for taxpayers abroad to interact with IRS employees virtually, it is vital for the IRS to reinstate and maintain the services offered by the tax attachés.[53]

Furthermore, the IRS should not focus its entire international taxpayer service strategy on web-based self-service options. Currently, some taxpayers do not have access to several existing online services. For example, the Get Transcript application cannot be used by taxpayers with ITINs, which are used by individuals not eligible for Social Security numbers. Nonresident alien taxpayers cannot file Form 1040-NR or Form W-7, *Application for IRS Individual Taxpayer Identification Number*, electronically. As explained above, a significant number of taxpayers abroad who did not file returns lack internet access.

The IRS Needs a Permanent Servicewide Team Focused on the Unique Service Needs of International Taxpayers

To specifically address the needs of international taxpayers, in 2012 the IRS created the International Individual Taxpayer Assistance (IITA) team with representatives from the LB&I, the Wage & Investment Division (W&I), the Office of Online Services (OLS) and TAS. Although the team was initially instrumental in updating and streamlining various international IRS webpages, the team's efforts have flagged in recent years. The IRS declined to adopt the National Taxpayer Advocate's 2012 recommendations to make the team permanent with a formal charter and required periodic reporting,[54] and not surprisingly, the team has been largely inactive recently. The team's main actions during the last two fiscal years have been limited to adding content to international taxpayer web pages, with the exceptions of preparing a 2015 filing season information document for U.S. embassies and convening an ad-hoc team in 2015 to

50 *See* IRS response to TAS information request (July 22, 2015).

51 IRS response to TAS information request (July 10, 2015).

52 Virtual service delivery enables taxpayers to interact directly with IRS employees using videoconferencing equipment and allows taxpayers to transmit and discuss documents in real time. Currently, the IRS employs VSD technology at only brick and mortar locations, as opposed to allowing taxpayers to use their own technology equipment at home. The National Taxpayer Advocate has made numerous recommendations over the years to expand the IRS's use of VSD. *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 152-62 (Most Serious Problem: *Virtual Service Delivery: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services*).

53 The National Taxpayer Advocate has also advocated for LTAs to be placed at each international tax attaché office to better serve taxpayers abroad. *See* National Taxpayer Advocate FY 2016 Objectives Report to Congress 77-82 (Area of Focus: *International Local Taxpayer Advocates Would Provide Valuable Assistance to Taxpayers and Protect Their Rights).*

54 *See* National Taxpayer Advocate 2012 Annual Report to Congress 280.

work on virtual outreach sessions.[55] Without formalizing and making permanent the IITA team, taxpayer service for international taxpayers will dissipate further.

CONCLUSION

International taxpayers are a growing population who face declining taxpayer service resources and increased filing and reporting requirements, along with substantial penalties for noncompliance. The closure of the overseas tax attaché offices exacerbates this problem by eliminating a key means of providing outreach and technical assistance, identifying issues with IRS processes and procedures, and learning about current challenges and the needs of international taxpayers. Furthermore, by terminating ETLA and R-mail, the IRS has shut itself off from taxpayers, preventing taxpayers from asking their own questions and preventing the IRS from learning how to better serve taxpayers and prevent problems. The IRS's planned focus on web-based self-service for international taxpayers will not replace the services lost. While in the current budget environment it may be tempting to migrate taxpayer service toward superficially lower-cost self-assistance options, significantly reducing personal service options may ultimately impair voluntary compliance and undermine taxpayers' *rights to be informed* and *to quality service.*[56]

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Reopen the four international tax attaché offices and provide funding for TAS to establish one LTA position at each office.
2. Conduct impact studies to determine the effects on taxpayer service, compliance, and revenue by opening additional tax attaché offices around the world.
3. Reestablish the ETLA (or a similar program) with timeframes for responses and create a process for using the information from ETLA inquiries in updates to IRS internal and external materials, including the irs.gov website.
4. Allocate funding for staffing additional telephone service to accommodate the need created by the expansion of international enforcement activities.
5. Create a task force to analyze and provide a report within one year on the barriers to VOIP usage and partnering with the U.S. Department of State to employ VSD technology for taxpayers at U.S. embassies and consulates.
6. Reinstate the IITA Team, with a formal charter, regular meetings, objectives, and measurable results.

55 See IRS response to TAS information request (July 22, 2015).

56 For a detailed discussion of the Taxpayer Bill of Rights, see http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights.

MSP #8 APPEALS: The Appeals Judicial Approach and Culture Project Is Reducing the Quality and Extent of Substantive Administrative Appeals Available to Taxpayers

RESPONSIBLE OFFICIALS

Kirsten B. Wielobob, Chief, Appeals
Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

An independent and effective Office of Appeals (Appeals) within the IRS is essential for quality tax administration and meaningful protection of taxpayer rights. Appeals' mission is to resolve tax controversies on a basis that is fair and impartial to both the government and the taxpayer and in a manner that will enhance public confidence in the integrity and efficiency of the IRS.[2] Appeals attempts to accomplish these goals and to improve voluntary compliance by providing a prompt, high-quality decision in each case, and by reasonably resolving the maximum number of tax controversies without recourse to litigation.[3]

Appeals recently implemented the Appeals Judicial Approach and Culture (AJAC) project in hopes of enhancing "internal and external customer perceptions of a fair, impartial and independent Office of Appeals."[4] AJAC's stated intent is to reinforce Appeals' mission of administrative dispute resolution by clarifying and separating the negotiation and decision-making role of Appeals from the factual investigations and case development allocated to the Examination and Collection functions.[5] For example, under AJAC, Appeals now will generally treat a Collection information statement (CIS) as verified by Collection, and whenever taxpayers in Examination-based cases raise new issues or present additional

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

2 IRM 8.1.1.1(1), *Accomplishing the Appeals Mission* (Feb. 10, 2012).

3 *Id.*

4 IRS, Internal Guidance Memorandum (IGM) AP-08-0714-0005, *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project, Collection – Phase 2* (July 10, 2014).

5 IRS, *Reinforcing Appeals' Philosophy: Appeals Judicial Approach and Culture (AJAC) Talking Points* (July 2, 2014), *available at* http://appeals.web.irs.gov/about/ajac.htm. Appeals states that AJAC is intended to emphasize its "quasi-judicial" nature. According to Black's Law Dictionary, "quasi-judicial" is a term not easily definable, but generally connoting "[o]f, relating to, or involving an executive or administrative official's adjudicative acts." Black's Law Dictionary (10th ed. 2014), *available at* http://westlaw.com. Appeals' use of the term "quasi-judicial" is apparently intended to distinguish factual investigations allocated to the Examination or Collection functions from dispute resolution activities on which Appeals would like to focus.

evidence requiring further investigation, Appeals will send the matter back to Compliance for development and evaluation.[6]

Although AJAC's aspirations are commendable, its practical implementation is eroding the very perceptions of fairness and objectivity that it claims to bolster. One commentator stated, "[t]here seems to be something problematic in the procedure for just about everyone involved."[7] Further, non-docketed Examination-based Appeals receipts have steadily fallen and TAS has observed that AJAC cases, at least in some circumstances, may be generating less thorough review than pre-AJAC cases.[8]

The National Taxpayer Advocate has long been a proponent of an independent and effective Appeals process within the IRS.[9] Nevertheless, she is concerned that, in application, AJAC is:

- Being used to intimidate taxpayers and deny their right to an administrative appeal;
- Causing cases to bounce back and forth between Appeals and Compliance; and
- Resulting in curtailed review by Appeals Hearing Officers (Hearing Officers) of IRS Examination and Collection actions.[10]

ANALYSIS OF PROBLEM

AJAC Is Sometimes Being Used to Intimidate Taxpayers and Deny Their Right to an Administrative Appeal

The IRS recently affirmed its commitment to a number of fundamental taxpayer rights, including *the right to appeal an IRS decision in an independent forum.*[11] A meaningful and efficient appeals process is a core element of this taxpayer right, which is also a goal of AJAC. Nevertheless, while striving to operate more efficiently is laudable, the course the IRS is currently pursuing is imperiling taxpayers' access to Appeals.

6 IRM 8.22.7.1.1(2), *Collection Information Statement (CIS)* (Sept. 23, 2013); IRM 8.6.1.6.2, *General Guidelines* (Nov. 14, 2013). "Compliance" will be used hereafter as a collective term to refer to the Examination and Collection functions within the Small Business/Self-Employed Division (SB/SE) and the Wage & Investment Division (W&I). To the extent a portion of the discussion is limited to a particular IRS operating division, that division will be specifically referenced.

7 Diane Freda, *Estate Taxes: Estates Grapple With New Dispute Timelines Under IRS Appeals Procedure*, Daily Tax Rep. (BNA) No. 4, at G-3 (Jan. 7, 2015). *See* her profile at http://www.bna.com/diane-freda-h2147483829/.

8 *See* figure entitled *Comparison of Appeals' Workload by Fiscal Year*, *infra*; Appeals response to TAS information request (May 29, 2015), as supplemented by fiscal year (FY) 2015 data provided by Appeals (Nov. 3, 2015). *See also* anecdotal comments from tax practitioners, *infra*, regarding the diminishing extent and quality of Appeals' review under AJAC.

9 *See* National Taxpayer Advocate 2014 Annual Report to Congress 185; National Taxpayer Advocate 2010 Annual Report to Congress 210; National Taxpayer Advocate 2009 Annual Report to Congress 70.

10 This term refers to any Settlement Officer, Appeals Officer, Appeals Account Resolution Specialist, or other employee holding hearings, conferences, or who otherwise resolves open case issues in Appeals. It further encompasses individuals who conduct or review administrative hearings or who supervise hearing officers. IRS, AJAC FAQs, *available at* http://appeals.web.irs.gov/about/ajac-faq.htm#General (updated July 7, 2014).

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

An effective and available Appeals function is crucial for a variety of reasons, including Appeals' ability to:

- Accept affidavits and weigh oral testimony;
- Consider hazards of litigation; and
- Apply the *Cohan* rule as a means of negotiating a case resolution.[12]

In conjunction with AJAC, Compliance started enforcing a more stringent policy with respect to Information Document Requests (IDRs) and to close cases and bypass Appeals prior to issuing the Statutory Notice of Deficiency (SNOD) unless a taxpayer provides all requested documentation or certifies that no additional information is available.[13] For example, Letter 5262 was originally revised over TAS's objections to read:

> If you don't provide the information requested on the enclosed Form 4564 or contact me to confirm you have no additional information to provide by the response due date listed above, we will close your examination based on the information we have now. If you don't agree, you won't be able to appeal within the IRS before we issue a notice of deficiency.[14]

Nevertheless, a telephone call from a taxpayer confirming that no additional information is available leaves the IRS identically situated to where it would be if the same taxpayer failed to respond to the IDR at all.[15] Yet the outcomes are fundamentally different: in the first scenario, the taxpayer will be able to exercise his or her right to go to Appeals, while in the second scenario, the same taxpayer will be barred from exercising that right.

Although Appeals Judicial Approach and Culture Project's (AJAC) aspirations are commendable, its practical implementation is eroding the very perceptions of fairness and objectivity that it claims to bolster.

When TAS objected to this policy, Compliance initially replied that mistakes would be made and the approach was subject to a learning curve, but the policy was consistent with AJAC.[16] The creation of additional obstacles and absolute prohibitions to an appeal within the IRS under the guise of AJAC has many troubling aspects. Compliance should not stand as the gatekeeper to Appeals. Appeals, not Compliance, should determine its own jurisdiction. Compliance cannot be allowed to sit as both judge and jury in deciding whether IRS information requests are reasonable and whether some lesser degree of information or alternative form of substantiation might be sufficient to allow taxpayers to establish their cases. In fact, that is the "quasi-judicial" role of Appeals — to review Compliance's determinations.

12 The *Cohan* rule was developed under federal case law as a means of allowing the fact finder to estimate deductible expenses where the fact of those expenses, although not their amount, can be substantiated. *See Cohan v. Comm'r*, 39 F.2d 540 (2d Cir. 1930). Note, these various settlement tools can sometimes be used by Compliance (*e.g.*, in the process of resolving coordinated issues, IRM 4.46.5.6.1, *Scope of Settlement Authority* (Mar. 1, 2006)). These resolution mechanisms, however, are not as widely available and commonly applied in Compliance as they are in the Appeals context.

13 TAS is primarily aware of this practice arising within the SB/SE Field Examination function. TAS elevated issue conference with SB/SE (July 30, 2014).

14 Letter 5262, *Examination Report Transmittal-Additional Information Due (Straight Deficiency)* (Aug. 2014); IRM 4.10.8.11, *Eligibility for Appeals Conference and Preliminary Letters (SB/SE Field and Office Examiners only)* (Sept. 12, 2014). The referenced SNOD would allow the taxpayer 90 days to appeal the IRS determination to the U.S. Tax Court.

15 In many situations, this failure to respond could be attributable to circumstances beyond taxpayers' control, such as mail failures, health issues, or extended travel. Further, the required affirmation that the requested information does not exist ignores the possibility that taxpayers may possess the information but may have objections to the scope, relevance, or legality of some of the information sought by the IDR.

16 TAS elevated issue conference with SB/SE (July 30, 2014).

Compliance's approach, wrong in principle, has been made worse in practice by the compressed timelines it has imposed on taxpayers before issuing the SNOD. In the typical Small Business/Self-Employed (SB/SE) field examination, most taxpayers would receive an initial letter that included an information request. In the event that taxpayers did not respond, they soon were sent a second letter in the 5262 series demanding all requested information and threatening the loss of appeal rights if they did not provide that information or inform the IRS it was unavailable. If 15 days elapsed (ten days plus five days for mail handling), or if the IRS was unsatisfied with the taxpayer's response, the SNOD would be issued and Appeals temporarily or permanently bypassed.[17]

TAS received comments from some tax practitioners who believed that they were working with Compliance to provide information and resolve a case, only to be surprised by the unexpected arrival of a SNOD, effectively ending all current administrative dialogue with the IRS.[18] In an op-ed piece from *The New York Times*, a tax practitioner observed that if the compressed timeframes were not adhered to, "the consequences may be dire" and that "I could return home from a vacation or a stay in the hospital to find not only that I am being audited, but that my audit has already been closed and sent to the notice of deficiency unit."[19] Core taxpayer rights — such as *the right to appeal an IRS decision in an independent forum, the right to a fair and just tax system,* and *the right to pay no more than the correct amount of tax* — mean little if the IRS implements policies impairing those rights.[20]

After the National Taxpayer Advocate brought the issue to the attention of senior leadership, the IRS agreed to discontinue the use of the Letter 5262 series on a provisional basis. SB/SE issued a June 9, 2015 memorandum temporarily suspending use of the Letter 5262 series.[21] TAS understands that SB/SE is contemplating reversing itself and reinstituting its previous policy with minor modifications regarding the issuance of SNODs in cases where all requested information is not provided and the taxpayer does not call to confirm the lack of such information.[22] Thus, not only would SB/SE continue to refuse relief to those who already have been denied access to Appeals by the premature issuance of SNODs, but all taxpayers would once again become subject to this risk. The National Taxpayer Advocate urges SB/SE to abandon its attempts to place obstacles between taxpayers and Appeals. SB/SE should permanently discontinue use of the Letter 5262 series and the policies that led to its development.

17 IRM 4.10.8.11(5), *Eligibility for Appeals Conference and Preliminary Letters (SB/SE Field and Office Examiners only)* (Sept. 12, 2014). As previously noted, taxpayers are provided with 90 days in which to file a petition with the U.S. Tax Court. In many of these cases, the issue will then be sent back to Appeals by the Tax Court if the matter has not been previously considered by Appeals. This additional procedural step, however, subjects taxpayers to unnecessary delays, expenses, complexities, and pitfalls for the unwary.

18 TAS conference call with Low Income Taxpayer Clinic practitioners (Apr. 22, 2015). The information gleaned from this and other similar TAS conference calls is anecdotal and cannot be taken as systemic proof or statistical evidence. Nevertheless, it is consistent with broader impressions formed by TAS from widespread interactions with taxpayers and their representatives.

19 David DuVal, *Beware the I.R.S.'s Speeded-Up Audit*, N.Y. Times (Apr. 29, 2015), *available at* http://www.nytimes.com/2015/04/30/opinion/beware-the-irss-speeded-up-audit.html?emc=eta1&_r=0.

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

21 The impacted letters include Letter 5262, *Examination Report Transmittal - Additional Information Due (Straight Deficiency)*; Letter 5261, *Examination Report Transmittal - Additional Information Due (Claims for Refund)*; Letter 5441, *Response to Letter 5262 - Straight Deficiency, and Office Examination's Use of Letter 950, 30 Day Letter-Straight Deficiency*. See SB/SE Memo from Scott Irick, Director, Examination/AUR Policy, *Temporary Suspension of Letters 5262, 5261, 5441, and Office Examination's Use of Letter 950* (June 9, 2015), *available at* http://lmsb.irs.gov/international/dir_compliance/foreign_resident/downloads/Letter%20Suspension%20Memo%202015-0609.pdf.

22 SB/SE response to TAS fact check document (Nov. 16, 2015). While SB/SE does not directly address TAS's understanding, SB/SE's reply states, among other things, "[t]he AJAC 'Reassessment' [which is considering the Letter 5262 series] has developed recommendations that are being elevated for executive review and approval. The team is recommending additional IRM clarifications, letter updates, training, external communications and oversight." *Id*.

In focus groups conducted by TAS, several tax practitioners commented that in their experience, Revenue Agents (RAs) who examine cases in Compliance now often discourage taxpayers from going to Appeals.[23] One practitioner stated, "They (RAs) always try to send me to Tax Court straight from exam; they want me to skip Appeals."[24]

Further, according to some practitioners, Compliance also has been using AJAC as a tool for "bullying" taxpayers in other circumstances.[25] TAS has received some reports that Compliance, under the vague but broad cloak of AJAC, has aggressively demanded that taxpayers sign waivers of the statute of limitations on assessment, extending it for one to two years. These demands have occurred even in cases where taxpayers have only sought a slight extension of time from the IRS to provide requested documents and where sufficient time remained under the existing statutory period of limitations for the case to be transferred to Appeals.[26] The use of procedural leverage by the IRS to intimidate taxpayers, to threaten premature case closures, and to jeopardize taxpayers' access to Appeals is inconsistent with AJAC's avowed purpose.

AJAC has been promoted as having the goal of enhancing "external customer perceptions of a fair, impartial, and independent Office of Appeals."[27] However, in some situations AJAC has been used as an instrument for limiting taxpayers' access to Appeals or coercing them into taking steps not in their best interests.

AJAC Is Causing Cases to Bounce Back and Forth Between Appeals and Compliance

A core policy notion of AJAC is that cases should be fully worked in Compliance and not come to Appeals until the IRS and the taxpayer have reached an impasse.[28] AJAC resulted in the implementation of several directives instructing Hearing Officers to return cases to Compliance for the completion of required factual investigations.[29] If a taxpayer raises a new issue or presents additional evidence at Appeals, then the case is sent back to Compliance if, in the opinion of the Hearing Officer, it requires further investigation.[30] Even in cases where new theories or arguments relying on no additional facts are presented by the taxpayer, AJAC requires Compliance to be consulted for its recommendation.[31]

These strictures effectively narrow Appeals' jurisdiction. Cases where Appeals previously would have been actively involved and sought to negotiate settlements fair to both taxpayers and the government are now returned to Compliance. When implemented on a case-by-case basis, and when informed by the

23 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *Appeals – How Are AJAC and CAP Changes Working?*, 6, 7 (Oct. 2015).

24 *Id.* at 7.

25 TAS conference call with practitioners associated with the American Bar Association Section of Taxation (Mar. 17, 2015).

26 *Id.* Generally, 365 days must be remaining on the statute of limitations for Appeals to accept a proposed deficiency case. IRM 8.21.3.1.1, *New Receipts and Transfers* (Aug. 28, 2014).

27 IRS, IGM AP-08-0714-0004, *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project, Examination and General Matters – Phase 2* (July 2, 2014).

28 *Reinforcing Appeals' Philosophy: Appeals Judicial Approach and Culture (AJAC) Talking Points* (July 2, 2014), *available at* http://appeals.web.irs.gov/about/ajac.htm.

29 *See, e.g.*, IRS, IGM AP-08-0714-0004, *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project, Examination and General Matters – Phase 2* (July 2, 2014).

30 IRS, IGM AP-08-0714-0004, *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project, Examination and General Matters – Phase 2* (Projected as IRM 8.2.1.5(2)(i), (j), *Returning a Case to Examination – Appeals Hearing Officers*) (July 2, 2014).

31 IRS, IGM AP-08-0714-0004, *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project, Examination and General Matters – Phase 2* (Projected as IRM 8.6.1.6.6, *Taxpayer Raises New Theory or Legal Argument*) (July 2, 2014). This consultation is to be undertaken subject to existing *ex parte* requirements. *Id.*

judgment of the Hearing Officer, such an approach is reasonable and has merit. However, when mandated by means of an inflexible systemic policy, this approach is fraught with inequities and inefficiencies.

According to some tax practitioners, AJAC is being used by Appeals as an inventory control mechanism.[32] The more cases that are bounced back to Compliance, the fewer open cases remain in Appeals' inventory. Some practitioners have observed that Appeals is often quick to embrace this opportunity and return cases to Compliance.[33] Others have related that in the past, Appeals Officers were more open to having conversations and listening to taxpayers' positions, whereas now they are in more of a hurry to move the case along — often back to Compliance.[34] The National Taxpayer Advocate is concerned that Compliance, in turn, will respond to its own expanding inventory pressures by precipitously returning cases to Appeals or bypassing Appeals altogether through the issuance of SNODs.

Appeals' workload has decreased in recent years with overall and non-docketed Examination-based case receipts steadily falling between fiscal years (FY) 2011 and 2015. By contrast, Examination-based docketed cases in Appeals have remained relatively constant, resulting in a proportional increase in such cases. This trend will likely only increase if SB/SE reinstitutes the Letter 5262 series and resumes the practice of bypassing Appeals through the precipitous issuance of SNODs. Docketed cases are expensive and stressful for taxpayers and a resource drain for the IRS. The extent to which AJAC is exacerbating this proportionally increasing trend in docketed Appeals cases will become clearer over time, but, to this point at least, AJAC does not appear to be helping. These trends are shown in the following figure.

FIGURE 1.8.1, Comparison of Appeals' Workload by Fiscal Year[35]

	Nondocketed		Docketed		Overall Case Receipts
	Case Receipts	Percentage	Case Receipts	Percentage	
FY 2011	21,706	50%	22,101	50%	43,807
FY 2012	19,450	46%	23,004	54%	42,454
FY 2013	16,509	43%	21,797	57%	38,306
FY 2014	13,563	37%	23,356	63%	36,919
FY 2015	11,645	33%	23,785	67%	35,430

To further illustrate AJAC's troubling application, a tax practitioner participating in a TAS conference call provided the following example. A part of the factual record in an Appeals case included detailed bank records. The Hearing Officer indicated a willingness to sit down with the taxpayer, review the factual file together, and seek a resolution of the case based on the shared dialogue. However, the case was sent back to Compliance by the Hearing Officer's manager under the auspices of AJAC.[36] Everyone loses in this scenario including the Hearing Officer who was ready, willing, and able to resolve the case; the taxpayer who must incur the additional cost and effort of recommencing the dialogue with Compliance; and the tax system itself, which has placed needless burdens on taxpayers and strained the morale of its employees.

32 TAS conference call with practitioners associated with the American Bar Association Tax Section (Mar. 17, 2015).

33 *Id.*

34 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *Appeals – How Are AJAC and CAP Changes Working?*, 6 (Oct. 2015).

35 Data for this figure, which focuses on Examination-based cases, was drawn from the Appeals Response to TAS information request (May 29, 2015), as supplemented by FY 2015 data provided by Appeals (Nov. 3, 2015).

36 TAS conference call with practitioners associated with the American Bar Association Tax Section (Mar. 17, 2015).

Along with Hearing Officers whose ability to resolve cases has been limited, similar morale issues are reportedly being experienced by Compliance employees. According to some tax practitioners, certain Compliance personnel expressed the view that Compliance was not adequately consulted in the development and implementation of AJAC.[37] Some Compliance employees have articulated "feelings of anger" at AJAC's provisions and "resentment" when cases are returned from Appeals.[38] Taxpayers and their representatives are placed at an unfair and unnecessary disadvantage when forced to seek justice in such a discordant environment, particularly when the venue for resolution is perpetually in danger of changing.

AJAC Is Resulting in Curtailed Review by Appeals Hearing Officers of IRS Examination and Collection Actions

AJAC also appears to be diminishing the substantive quality of the Appeals' reviews that are taking place. Several participants in TAS focus groups described the Appeals environment under AJAC as having shifted from conversational to adversarial.[39] Another participant in a focus group commented, "My level of confidence in Appeals has declined…"[40]

Taxpayers who grow weary of the administrative hurdles established for case resolution or who lose access to Appeals because of premature case closures may be driven to seek justice beyond the IRS in the judiciary or might drop out of the dialogue and be denied due process altogether.

Where Examination actions are concerned, AJAC precludes taxpayers from raising issues at Appeals that are not first considered by Compliance.[41] According to practitioners, this change in practice by Appeals is significantly unfavorable for taxpayers and detracts from the fair and speedy resolution of cases.[42]

Manifestations of AJAC's attempt to limit Appeals' jurisdiction are also apparent in appeals arising out of Collection cases. For example, in cases involving offers in compromise (OIC) made outside of the collection due process context, Hearing Officers are only allowed to review the OIC in question. They are precluded from offering other collection alternatives as a means of resolving the case.[43] Thus, AJAC removes an important resolution tool from the hands of Hearing Officers, disadvantages taxpayers, and increases the burden on Collection, which, in most situations, will have the case added to its inventory.

Further, in appeals arising pursuant to the Collection Appeals Program (CAP), AJAC clarifies that Hearing Officers are to consider only the "appropriateness" of the decision under review.[44] The sense of tax practitioners interviewed by TAS is that Appeals is interpreting this review as purely procedural in nature.[45] One practitioner who is active in representing taxpayers in CAP reported being

37 TAS conference call with practitioners associated with the American Bar Association Tax Section (Mar. 17, 2015).

38 *Id.*

39 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *Appeals – How are AJAC and CAP Changes Working?*, 6 (Oct. 2015).

40 *Id*, at 5.

41 *Aggressive IRS Audit Techniques*, panel discussion, American Bar Association Section of Taxation 2015 Joint Fall CLE Meeting, 65 (Sept. 19, 2015).

42 *Id.*

43 IRM 8.23.3.12, *Alternative Resolutions for Offers* (Oct. 15, 2014).

44 IRM 8.24.1.1.1(9), *Administrative and Legislative History* (Dec. 2, 2014). For a more in-depth discussion of issues surrounding CAP and the ways in which these issues are being exacerbated by AJAC, see National Taxpayer Advocate 2015 Annual Report to Congress, Most Serious Problem: *Collection Appeals Program (CAP): The CAP Provides Inadequate Review and Insufficient Protections for Taxpayers Facing Collection Actions, infra*.

45 TAS conference call with practitioners associated with the American Bar Association Tax Section (Mar. 17, 2015).

told by a Hearing Officer that, "If all of the boxes were checked, then Appeals would sustain Collection's decision."[46]

The National Taxpayer Advocate is concerned that these restrictions on Hearing Officers' abilities to resolve controversies will result in the rubber-stamping of actions taken by Compliance, particularly in Collection cases. If Hearing Officers are limited in their ability to evaluate facts and circumstances and apply common sense and good judgment in their discussions with taxpayers, Appeals' core mission will be jeopardized. Hearing Officers should be empowered and encouraged to explore the broadest possible scope of settlement options in furtherance of their role of facilitating administrative dispute resolution. To the extent that this effort would, in the opinion of Hearing Officers, be assisted by the clarification or development of additional facts, they should have the ability to pursue such a course.[47]

To the extent that this ability is curtailed, as is currently occurring under AJAC implementation, both taxpayers and the voluntary tax system will suffer. The IRS Restructuring and Reform Act of 1998 strengthened Appeals in hopes of protecting taxpayers "caught in the IRS hall of mirrors" and providing them with an administrative appeals process that is "truly independent and structured to represent their concerns."[48] If this "hall of mirrors" is reinstituted by AJAC, taxpayers who grow weary of the administrative hurdles established for case resolution or who lose access to Appeals because of premature case closures may be driven to seek justice beyond the IRS in the judiciary or might drop out of the dialogue and be denied due process altogether. In the long run, such outcomes, which are currently being precipitated by AJAC, place extraordinary cost burdens on taxpayers, the government, and the judiciary. Moreover, the preservation of due process rights and the perception of fairness it brings are cornerstones of a successful voluntary tax compliance system, not just of the administrative appeals process.[49]

CONCLUSION

The AJAC project is intended to increase the efficiency and effectiveness of Appeals. While these goals are laudable, current observations indicate that AJAC cases may be taking longer to resolve and, at least in some circumstances, yielding a diminished level of substantive review. AJAC's implementation is eroding the very perceptions of fairness and objectivity that the project was instituted to bolster. In practice, AJAC is being used to limit taxpayer's access to Appeals, causing cases to be bounced back and forth between Appeals and Compliance, and resulting in curtailed review by Hearing Officers. Although AJAC's underlying premise that cases should be thoroughly worked by Compliance is reasonable enough, the manner in which AJAC has been implemented is neither in the best interests of taxpayers nor tax administration.

46 TAS conference call with practitioners associated with the American Bar Association Tax Section (Mar. 17, 2015).

47 This authority would be consistent with the independence of Appeals, as it would be exercised in conjunction with Appeals' administrative dispute resolution activities, and would be undertaken separate and apart from the influence of other operating divisions within the IRS.

48 144 Cong. Rec. S7622 (July 8, 1998) (Statement of Sen. Roth).

49 *Reinforcing Appeals' Philosophy: Appeals Judicial Approach and Culture (AJAC) Talking Points*, July 2, 2014, *available at* http://appeals.web.irs.gov/about/ajac.htm; National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 131, 134; National Taxpayer Advocate 2009 Annual Report to Congress 79.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Permanently discontinue the Letter 5262 series and preserve taxpayers' rights to an appeal even in cases where all requested information is not provided to Compliance.
2. Loosen AJAC restrictions to allow Hearing Officers to exercise more discretion regarding whether additional factual development or analysis within Appeals would materially assist case resolution.
3. Provide Hearing Officers with revised guidance and enhanced training emphasizing quality substantive review, rather than mere satisfaction of procedural requirements by expanding timeframes and retaining Appeals' jurisdiction where appropriate, as the best means of providing taxpayers with *the right to appeal an IRS decision in an independent forum*.
4. Develop and implement an outreach plan aimed at practitioners to help them understand what is needed for a successful appeal and to provide Appeals with information about the difficulties experienced by taxpayers and practitioners under AJAC.

MSP #9 COLLECTION APPEALS PROGRAM (CAP): The CAP Provides Inadequate Review and Insufficient Protections for Taxpayers Facing Collection Actions

RESPONSIBLE OFFICIAL

Kirsten B. Wielobob, Chief, Appeals

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

The IRS developed the Collection Appeals Program (CAP) in stages as a response to congressional concerns regarding the rights of taxpayers subject to collection activity relating to liens, levies, and installment agreements.[2] Congress also established collection due process (CDP) protections under Internal Revenue Code (IRC) § 6320 for liens and IRC § 6330 for levies.[3] Congress believed that the existence of "procedures designed to afford taxpayers due process in collections [would] increase fairness to taxpayers."[4]

Instead, this patchwork of protections has led to some overlapping Collection appeals procedures within the IRS Office of Appeals (Appeals) that are confusing and potentially problematic for taxpayers. CAP hearings do have some attractive aspects in comparison with CDP appeals that make CAP worth preserving, including expanded coverage of collection actions and an expedited timeframe. They remain severely limited, however, in the remedies and scope of review they offer taxpayers, providing no judicial oversight of the outcome and no consideration of collection alternatives.

From fiscal years (FY) 2012 through 2015, approximately 44,500 CDP appeals per year have been received by the IRS, while taxpayers have sought just 4,600 CAP hearings per year over this same period.[5] Approximately 22 percent of taxpayers emerged fully or partially victorious from CAP hearings during these years, while 68 percent of taxpayers were fully or partially victorious in CDP appeals.[6]

CAP would be fairer and more widely embraced if it offered taxpayers and their representatives an expedited resolution vehicle that was combined with a meaningful level of review and a reasonable

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

2 Internal Revenue Manual (IRM) 8.24.1.1.1(1), *Administrative and Legislative History* (Dec. 2, 2014). *See also* Taxpayer Bill of Rights 2 (TBOR 2), Pub. L. No. 104-168, 110 Stat. 1457 (1996).

3 The IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

4 S. Rep. No. 105-174, at 67 (1998).

5 Appeals' response to TAS information request (May 18, 2015), as supplemented by FY 2015 data provided by Appeals (Nov. 3, 2015).

6 *Id*. For a more detailed breakdown of this data and a discussion of the underlying assumptions, see figure entitled "Comparison of Outcome Percentages in CAP Hearings and CDP Appeals," *infra*.

opportunity for a negotiated settlement. CAP hearings that allowed for the consideration of collection alternatives and sought a quality outcome for both taxpayers and the government would provide a real benefit, even if that process required slightly expanded timeframes. The result would likely be more settlements, more balanced outcomes for participants, and a more attractive process for taxpayers.

Absent these improvements, the National Taxpayer Advocate is concerned that:

- Appeals adopts an unnecessarily narrow view of its role within CAP and needlessly restricts the scope of available review;
- CAP's emphasis on speed curtails the effectiveness and meaningfulness of Appeals' review;
- Procedures implemented by the Appeals Judicial Approach and Culture (AJAC) Project exacerbate CAP's shortcomings by adding to the inflexibility of an already limited mechanism;[7]
- Pursuit of a CAP hearing by a taxpayer can inadvertently cause the loss of all substantive administrative and judicial review of a collection action; and
- Taxpayers are underutilizing a potentially valuable Collection Appeals alternative.

ANALYSIS OF PROBLEM

CAP's Narrow Scope of Collection Actions and the Collection Vehicles Covered by It Are the Result of IRS Discretion, Not Congressional Intent

The IRS initially created CAP to provide review of lien, levy, or seizure actions taken or proposed by the Collection function. Only a few months after CAP's initiation, Congress enacted TBOR 2, which, among other things, added IRC § 6159(c) requiring the IRS to "establish procedures for an independent administrative review of terminations of installment agreements (IAs) under this section for taxpayers who request such a review."[8] Later, as part of Internal Revenue Restructuring and Reform Act of 1998 (RRA 98), Congress added appeal rights for rejected installment agreements in the same section relating to offers in compromise (OIC).[9] The treatment subsequently accorded these collection alternatives by the IRS, however, was substantially different.

Although the legislative history of RRA 98 made a passing reference to CAP, Congress defined neither the parameters of CAP nor the manner in which it should operate.[10] The IRS itself determined which Collection actions, now including rejected, modified, or terminated IAs, would be subject to CAP hearings, and then imposed an increasingly narrow scope of review available to taxpayers seeking protection of their rights within CAP.[11] Unlike actions taken or proposed regarding IAs, OICs were not placed

7 For an in-depth discussion of AJAC and its impact on taxpayers, see 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*.

8 TBOR 2, Pub. L. No. 104-168, 110 Stat. 1457 (1996). The text of IRC § 6159(c) has since been moved to IRC § 6159(e).

9 RRA 98, Pub. L. No. 105-206, Title III, Subtitle E, § 3462(c) (July 22, 1998). *See* IRC §§ 6159(e) and (f); 7122(e).

10 *See* S. Rep. No. 105-174, at 92 (1998); IRM 8.24.1.1.1(4), *Administrative and Legislative History* (Dec. 2, 2014).

11 Independent administrative reviews of terminated IAs are made available under IRC § 6159(e), while independent administrative reviews of rejected IAs are furnished by IRC § 7122(e)(1), and appeal rights with respect to such rejections are provided by IRC § 7122(e)(2). While Congress established these protections, the IRS determined that they would be exercised via CAP. IRM 8.24.1.1.1, *Administrative and Legislative History* (Dec. 2, 2014).

within CAP by the IRS and are subject to broader, more substantive Appeals oversight and resolution procedures.[12]

The legislative history indicates that, over the years, Congress has focused on expanding taxpayer rights through the creation of CDP appeals and the mandated review of adverse determinations regarding IAs and OICs. For the IRS to move IAs under CAP and then conduct CAP hearings in a way that potentially limits the protections afforded by CDP appeals and is less beneficial than OIC reviews is inconsistent with the spirit of TBOR 2, RRA 98, and the Taxpayer Bill of Rights recently adopted by the IRS.[13] More broadly, the restrictions placed on the availability and scope of CAP hearings jeopardize the fundamental rights of taxpayers *to appeal an IRS decision in an independent forum*, *to challenge the IRS's position and be heard*, *to a fair and just tax system*, and *to privacy.*

National Association of Enrolled Agents testimony submitted almost 20 years ago to the National Commission on Restructuring the IRS assessed the limitations of CAP hearings in terms that are as applicable now as they were then.

> The scope of this program is so circumscribed by the procedural limitations imposed that it really does not constitute a true appellate process… We believe the lack of taxpayer and practitioner use of this "appeals" process is ample evidence that this program is not perceived as a fair and independent appellate procedure and believe the Commission ought to examine its intent and practice.[14]

CAP's Emphasis on Speed Comes at the Unnecessary Cost of Meaningful Appeals Review

CAP hearings provide taxpayers with some distinct benefits in comparison to CDP Appeals. CAP hearings, even more so than CDP appeals, can be utilized to challenge a range of Collection actions and can be sought:

- Before or after the IRS files a Notice of Federal Tax Lien (NFTL);
- Before or after the IRS levies or seizes property;
- Before or after the IRS terminates or modifies an IA; or
- After the IRS initially rejects a proposed IA.[15]

On the other hand, CDP appeals can only be pursued after the filing of the *first* NFTL or issuance of the *first* levy with respect to any tax liability.[16] The rejection, modification, or termination of an IA or an OIC do not trigger the right to a CDP appeal, nor are CDP hearings available for *subsequent* liens or levies.[17]

12 IRM 8.23.1.3, *Conference and Settlement Practices* (Oct. 10, 2014). Note that an exception to the more robust protections generally granted to taxpayers under the OIC regime occurs if the IRS determines that the OIC was filed solely to delay collection, in which case the OIC will be rejected and collection activity recommenced. IRM 5.8.4.20, *Offer Submitted Solely to Delay Collection* (May 10, 2013).

13 For a more in-depth discussion regarding the potential ways in which CAP hearings can limit CDP rights, see the below section entitled *The Choice By a Taxpayer to Pursue a CAP Hearing Can Inadvertently Result In the Loss of All Substantive Administrative and Judicial Review of a Collection Action*.

14 Written testimony of Joseph F. Lane, Enrolled Agent on behalf of the National Association of Enrolled Agents, submitted to the National Commission on Restructuring the IRS (Feb. 26, 1997), *available at* http://www.house.gov/natcommirs/naea1.htm.

15 IRM 8.24.1.2(2), *Collection Appeals Program* (CAP) (Dec. 2, 2014).

16 IRC § 6320(a).

17 IRC § 6330(a). *See* IRM 8.22.4, *Collection Due Process Appeals Program* (Sept. 25, 2014). *See also* IRM 8.24.1.1.1, *Administrative and Legislative History* (Dec. 2, 2014).

An additional benefit of CAP hearings is that they are designed to provide taxpayers with an expedited response. Appeals attempts to move CAP proceedings forward quickly, ideally within five business days, with Hearing Officers generally directed to make CAP cases their first priority.[18] The average cycle time for resolution of a CAP proceeding during FYs 2012 through 2015 is 13 days.[19] By contrast, the average cycle time for a CDP appeal during the same period is approximately 196 days.[20]

These benefits under CAP as it is currently conducted come at a cost, however. Taxpayers are not allowed to challenge the underlying liability in a CAP hearing and cannot later seek judicial review of the CAP determination.[21] Further, Hearing Officers conducting a CAP proceeding undertake only a procedural review "of the action proposed or taken based on law, regulations, policy and procedures considering all the facts and circumstances."[22] As part of this inquiry, Appeals will not consider Collection alternatives (*e.g.*, IAs or OICs) to the issue under appeal or otherwise seek the "best" answer. By contrast, CDP appeals will weigh collection alternatives or challenges to the liability, and balance the proposed collection action with the taxpayer's legitimate concern regarding intrusiveness.[23]

Likely as a result of the limited review and remedies provided by the CAP process, taxpayers infrequently prevail in CAP hearings. The converse, however, is true in the case of CDP appeals. A comparison of these outcomes in contested proceedings is illustrated in the following figure.

FIGURE 1.9.1, Comparison of Outcome Percentages in CAP Hearings and CDP Appeals[24]

Outcome	Review Method	FY 2012	FY 2013	FY 2014	FY 2015
Percent of Cases IRS Fully Sustained	CAP	74%	76%	81%	80%
	CDP	34%	31%	32%	33%
Percent of Cases IRS Only Partially Sustained or Fully Overturned	CAP	26%	24%	19%	20%
	CDP	66%	69%	68%	67%

18 IRM 8.24.1.2.7, *Case Procedures Under CAP* (Dec. 2, 2014).

19 Appeals' response to TAS information request (May 18, 2015), as supplemented by FY 2015 data provided by Appeals (Nov. 3, 2015). Cycle time for non-docketed closed cases is measured from the point when a taxpayer's request for a hearing is filed with the IRS until a CAP proceeding is closed.

20 *Id.*

21 IRM 8.24.1.1.1(10), *Administrative and Legislative History* (Dec. 2, 2014); IRM 8.24.1.1.1(5), *Administrative and Legislative History* (Dec. 2, 2014). *See, e.g., Budish v. Comm'r*, T.C. Memo 2014-239.

22 IRM 8.24.1.1.1(9), *Administrative and Legislative History* (Dec. 2, 2014).

23 IRM 8.24.1.1.1, *Administrative and Legislative History* (Dec. 2, 2014); National Taxpayer Advocate 2014 Annual Report to Congress 185.

24 Where outcome percentages are concerned, the extent to which the IRS position is sustained by Appeals generally indicates that the taxpayer's position has been unsuccessful to the same degree. Data for this figure is drawn from the IRS response to TAS information request (May 18, 2015), as supplemented by FY 2015 data provided by Appeals (Nov. 3, 2015). The term "Percent Fully Sustained Cases" reflects closing code 14 data taken from the responses provided by Appeals. The term "Percent Partially Sustained or Fully Overturned Cases" reflects closing codes 15 and 16 data taken from the responses provided by Appeals. The comparisons are expressed as a percentage of the data furnished by Appeals under the category "Other Nondocketed Total" in Tab 1 and Tab 2 respectively, which category best captures the vast majority of contested cases. In order to reflect the different natures of CDP proceedings and CAP hearings, which have a five-day turnaround so few withdrawals take place, Appeals includes withdrawn cases under code 14 for CAPs and under code 16 for CDPs. CAP withdrawals have the same effect as CAP sustentions—that being no change to Collection's position. As a result, CAP withdrawals are included under closing code 14. *See* Appeals Clarification Response (June 19, 2015). For CAP closing codes, see IRM 8.24.1.3, *APS CAP Case Closing Procedures* (Dec. 2, 2014); for CDP and Equivalent Hearing closing codes, see IRM 8.22.9.8, *Closing Codes for CDP, EH, and RJ Hearings* (Nov. 13, 2013).

CAP hearings and CDP appeals have distinct reasons for existing and play different roles. Each review mechanism is valuable and should be preserved. Nevertheless, CAP hearings should more effectively protect taxpayer rights and serve the needs of taxpayers subject to a Collection action, which in turn will minimize IRS rework.

CAP's primary weakness is its inflexibility, expressed in terms of a lack of substantive review and a prohibition against the consideration of alternative Collection options. CAP's rigidity and limited parameters are partially explained by Appeals' laudable desire to hasten review and provide an expedited decision. Nevertheless, an incomplete or ill-considered decision is not made better for having been reached more quickly. While speed is an important priority, Appeals should also focus on allowing a robust review and dialogue with taxpayers so that CAP proceedings can reach the best decision for all concerned at the earliest possible stage.

CAP hearings and CDP appeals may, of necessity, involve different degrees of substantive review. Nevertheless, CAP hearings should still include a meaningful level of inquiry sufficient to allow for the consideration of Collection alternatives and a quality answer based on the existing facts after remand to Collection when the circumstances dictate.

For example, assume that Collection proposed filing an NFTL against a financial advisor who is concerned that the impact on his credit report would jeopardize his employment status.[25] As a result, the taxpayer filed for a CAP hearing. Currently, the Hearing Officer would undertake a review to determine only whether Collection followed the applicable procedures. The Hearing Officer would not consider Collection alternatives, which would involve an examination of whether Collection had reasonably balanced the government's need for efficient collection of taxes with the legitimate concerns of the taxpayer. Thus, the Hearing Officer would not necessarily examine the effect of the NFTL on the taxpayer's ability to maintain or find employment in the financial industry, thereby potentially imperiling the taxpayer's job and the government's ability to collect the taxes — a lose-lose situation for both parties.[26]

The taxpayer and the government would benefit considerably if the Hearing Officer reviewed the proposed NFTL to see if the taxpayer had offered reasonable collection alternatives and Collection had properly considered these alternatives and the intrusiveness of the proposed NFTL. If not, a remand for such consideration or for pursuit of an OIC would be highly desirable for all concerned, regardless of whether Collection had the legal authority to file the NFTL in the first instance. If this additional review requires a 14-day or 21-day, rather than a five-day, target for resolution, then the time would be well spent.

Procedures Implemented by the Appeals Judicial Approach and Culture (AJAC) Project Only Exacerbate CAP's Shortcomings

Unfortunately, under AJAC, the IRS appears to be moving precisely in the wrong direction. IRM changes implemented with respect to CAP hearings as part of AJAC clarify that "Appeals does NOT consider alternatives to the issue under appeal, but solely determines the appropriateness of the issue under

25 IRM 5.12.2.6(1), *NFTL Filing Criteria* (Oct. 14, 2013). In general, an NFTL will be filed if the aggregate unpaid balance of assessments is $10,000 or more.

26 IRM 5.12.2.4(6), *Determination Criteria for Do-Not-File or Deferring the NFTL Filing* (Jan. 1, 2015). The filing of an NFTL may be deferred where the Revenue Officer can substantiate with reasonable certainty, supported by documentation from the taxpayer, that filing the NFTL will hamper collection.

To be effective, the Collection Appeals Program (CAP) hearings should examine Collection alternatives, at least to the extent they shed light on the appropriateness and intrusiveness of the collection action, and the case should be remanded to Collection for consideration of those alternatives when necessary.

appeal."[27] Thus, Hearing Officers are directed only to sustain or not sustain Collection's position and are expressly admonished not to negotiate any Collection alternatives.[28]

This approach is bad for taxpayers and counterproductive for the IRS. For example, under the current guidance, if Compliance follows the applicable procedural rules in proposing an NFTL filing, even if the lien is inadvisable and there are other viable collection alternatives, the Hearing Officer will be required to approve the NFTL filing. This regime jeopardizes the taxpayer's *rights to privacy* and *to a fair and just tax system*, and will inevitably cause the IRS to do substantial downstream work to address harmful and unnecessary Collection actions. To be effective, CAP hearings should examine Collection alternatives, at least to the extent they shed light on the appropriateness and intrusiveness of the collection action, and the case should be remanded to Collection for consideration of those alternatives when necessary.

According to responses obtained from focus groups and TAS interviews with tax practitioners, these procedural clarifications made under AJAC have added to the inflexibility of an already limited review mechanism.[29] Some taxpayer representatives have reported that, prior to AJAC, they typically were able to obtain face-to-face conferences with Hearing Officers.[30] Nevertheless, the renewed emphasis on narrow scope and quick disposition of cases under AJAC has led to a general inability to engage in such conferences, even though practitioners view face-to-face conferences as an essential element of the accurate and equitable disposition of taxpayers' cases.

The rush to disposition is particularly problematic in CAP cases involving IAs which, according to tax practitioners interviewed by TAS, often require approximately 30 days for proper consideration and reasonable disposition.[31] This extra time occasionally is necessary for taxpayers to answer questions raised by Hearing Officers and to obtain and present requested documentation. Nevertheless, such cases, along with other CAP cases, now are rigorously subjected to the five-day rule, often to the detriment of taxpayers whose arguments may require considerably longer than five days for proper presentation or thorough consideration.[32]

Further, some taxpayer representatives have reported instances in which CAP Hearing Officers are simply "rubber stamping" Collection decisions after only a nominal review.[33] One practitioner who is active in representing taxpayers in CAP related a comment by a Hearing Officer that "[i]f all of the boxes were checked, then Appeals would sustain Collection's decision."[34] The lack of oversight by Appeals and its unwillingness to consider legitimate arguments are more troubling to these representatives than even an unfavorable outcome reached after an unbiased and comprehensively conducted proceeding.[35]

27 IRM 8.24.1.1.1(9), *Administrative and Legislative History* (Dec. 2, 2014).
28 *Id.*
29 TAS conference call with practitioners associated with the American Bar Association Tax Section (Mar. 17, 2015).
30 *Id.*
31 *Id.*
32 *Id.*
33 *Id.*
34 *Id.*
35 *Id.*

Pursuit of a CAP Hearing by a Taxpayer Can Inadvertently Cause the Loss of All Substantive Administrative and Judicial Review of a Collection Action

One of the dangers confronting taxpayers as they try to choose between their CAP and CDP options is the chance that an inopportune decision could cost them the possibility of a substantive review. If a taxpayer proceeds with a CAP hearing and if that proceeding concludes before a CDP appeal is lodged, then the issue raised and considered at the CAP hearing may be precluded from consideration in a subsequent CDP appeal.[36] This risk exists because the completed CAP hearing can be viewed as a "previous administrative proceeding" under IRC § 6330(c)(4).[37]

For example, assume that a taxpayer pursues a CAP hearing with respect to a proposed levy that is sustained by Appeals because Collection followed the requisite procedural steps. Thereafter, the taxpayer may be denied access to a CDP with respect to this initial levy based on the argument that the matter is now barred from review because the taxpayer is raising no new issues. In this event, the taxpayer would lose the additional benefits conferred in a CDP appeal such as substantive review, consideration of Collection alternatives, application of the balancing test, and judicial oversight of the outcome.

Even if the issue is not precluded from a subsequent decision in a CDP appeal because the CDP request was filed prior to, or concurrently with, the CAP hearing, the Hearing Officer conducting the CDP appeal still has the option of adopting the decision made in the CAP proceeding as part of the CDP determination.[38] Hearing Officers are allowed to take this approach as long as the taxpayer does not present any new information or arguments in the CDP appeal regarding the issue raised in CAP.[39] A CDP review would be appropriate if a taxpayer raised collection alternatives, but the risk remains in this uncertain environment that a Hearing Officer might mistakenly invoke issue preclusion or adopt the prior CAP decision in any event. Thus, under a variety of circumstances, taxpayers availing themselves of the attractive aspects of CAP could unwittingly forfeit their ability to seek a CDP appeal.[40]

These potentially binding effects of a CAP hearing on a CDP appeal would be less problematic if the scope of review conducted in these proceedings and the rights they confer were synonymous, but they are not.[41] The more searching inquiry required by a CDP appeal arguably should be construed as a "new issue" and thus should be separately pursued as part of the ensuing CDP appeal. Nevertheless, many taxpayers, particularly low income taxpayers, may lack the legal sophistication or legal representation to frame such nuanced arguments. As a result, such taxpayers may believe an adverse CAP decision automatically precludes any further consideration of the issue and may therefore not even raise the matter in a later occurring CDP appeal.

36 IRC § 6330(c)(4). IRS Office of Chief Counsel Memorandum, *Collection Appeal Program and I.R.C. § 6330(c)(4) Issue Preclusion*, PMTA 2012-14, 4 (May 3, 2012). For this issue preclusion to occur, the taxpayer must meaningfully have participated in the CAP appeal and the issue under consideration in the two proceedings must be identical. *Id*. Doubts are to be resolved in favor of the taxpayer. IRM 8.22.5.5.1(2), *Issues Excluded under IRC 6330(c)(2)(B) and I.R.C. 6330(c)(4)(A)* (Mar. 29, 2012). Nevertheless, this determination has few meaningful parameters, and taxpayers finding themselves in such a situation are left in a highly uncertain and vulnerable position.

37 *Id.*

38 *Id.*

39 *Id.*

40 Note that if a taxpayer requests both a CDP and a CAP regarding a proposed levy or NFTL filing, the taxpayer is required to choose one or the other. IRM 8.24.1.1.1(8), *Collection Appeals Program Overview* (Dec. 2, 2014). Some taxpayers, however, particularly low income taxpayers, may lack the sophistication or legal representation, to adequately understand the ramifications of their choices in the absence of a thorough explanation from the Hearing Officer, which may not be forthcoming.

41 IRM 8.24.1.1.1(5), *Collection Appeals Program Overview* (Dec. 2, 2014).

Moreover, Hearing Officers themselves may not be immune from confusion regarding the impact of a CAP decision. A request for CDP consideration of an issue previously included in a CAP hearing may erroneously be denied by Hearing Officers unaware that their exercise of the additional substantive review inherent in a CDP appeal generally would require a thorough reconsideration of the issue previously presented in a CAP proceeding. Alternatively, Hearing Officers, while not specifically invoking issue preclusion, may still adopt a prior CAP determination rather than providing taxpayers with the more in-depth substantive CDP analysis to which they are entitled.

In an effort to quantify the magnitude of this problem and analyze the extent to which taxpayers availing themselves of CAP hearings are being denied CDP appeals, TAS requested specific data from Appeals regarding issue preclusion and the adoption of CAP determinations in CDP cases. Appeals responded that it did not track such data.[42]

Taxpayers Are Underutilizing a Potentially Valuable Collection Appeals Alternative

The available data illustrates that CAP is used relatively infrequently by taxpayers and their representatives. From FY 2012 through 2015, approximately 44,500 CDP appeals per year have been received by the IRS.[43] On the other hand, taxpayers have sought only 4,600 CAP hearings per year over this same period.[44] Thus, CAP usage has represented barely ten percent of CDP utilization.

This relatively low use of CAP may, at least in part, be attributable to the circumstance that outcomes are comparatively unfavorable for taxpayers. Between FY 2012 and 2015, only 22 percent of taxpayers emerged fully or partially victorious from CAP hearings, while 68 percent of taxpayers were fully or partially victorious in CDP appeals during this same period.[45]

> The relatively few negotiated settlements in the Collection Appeals Program (CAP) hearings and the poor outcomes that CAP hearings generate for taxpayers when Appeals does reach a decision may well help explain why most taxpayers and their representatives decline to pursue this course.

Further, between FY 2012 and 2015, virtually no CAP proceedings were closed as "agreed" by Appeals.[46] By contrast, well over half of the CDP appeals filed during these years yielded a compromise between the IRS and taxpayers.[47] The relatively few negotiated settlements in CAP hearings and the poor outcomes that CAP hearings generate for taxpayers when Appeals does reach a decision may well help explain why most taxpayers and their representatives decline to pursue this course.

CAP would be more widely embraced if it offered taxpayers and their representatives an expedited resolution vehicle that was combined with a meaningful level of review and the reasonable opportunity for a negotiated settlement. CAP hearings that allowed for the consideration of collection alternatives and sought a quality outcome for both taxpayers and the government would provide a real benefit, even if that process required slightly expanded timeframes. The result likely would be more settlements, more balanced outcomes for participants, and a more attractive process for taxpayers. Failure to implement such improvements creates unnecessary downstream rework for the government and

42 Appeals' response to TAS information request (May 18, 2015).
43 *Id.*
44 *Id.*
45 *Id.* For a more detailed breakdown of this data and a discussion of the underlying assumptions, see figure entitled *Comparison of Outcome Percentages in CAP Hearings and CDP Appeals*, *supra*.
46 *Id.*
47 *Id.*

perpetuates an antagonistic environment because taxpayers have difficulty exercising their *right to challenge the IRS's position and be heard.*

Another cause for the underutilization of CAP appears to be the lack of awareness regarding its availability. Although CAP is mentioned on irs.gov, it is not readily apparent and could be easily overlooked. Moreover, some taxpayer representatives interviewed by TAS stated that no one in the IRS had ever mentioned CAP to them or the taxpayers they represented.[48] After implementing the improvements in CAP discussed above, the IRS should increase its efforts to publicize the benefits of CAP, both to taxpayers and their representatives. This enhanced publicity could begin by increasing the profile of CAP on irs.gov as a potential mechanism for contesting Collection actions. Further, the IRS should remind Hearing Officers and all IRS employees with taxpayer contact of the importance of verbally communicating this alternative Collection Appeals process to taxpayers.

CONCLUSION

The IRS created the restrictive regime currently applicable to CAP hearings and has the power to improve it. While preserving the concept of expedited review, the IRS should deemphasize speed as the defining principle of CAP hearings in favor of more meaningful review overall and issue resolution. As the quality and independence of CAP hearings improve, usage will expand, and both taxpayers and the IRS will benefit from increased resolution of Collection issues at an earlier stage in the administrative process.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Revise the policies and procedures governing CAP to allow Hearing Officers the expanded authority, and where necessary, the additional time to review Collection alternatives and remand cases to Collection for consideration of those alternatives.
2. Issue guidance specifying that taxpayers' use of CAP will no longer preclude them from receiving an independent reconsideration via a CDP appeal based on either issue preclusion or pro forma adoption of the prior CAP decision.
3. After implementing the improvements in CAP discussed above, make a concerted effort to publicize the benefits of CAP and ensure that Hearing Officers and all IRS employees with taxpayer contact more effectively inform taxpayers and their representatives about the availability of CAP hearings.

48 TAS conference call with Low Income Tax Clinics practitioners (Apr. 22, 2015).

MSP #10 LEVIES ON ASSETS IN RETIREMENT ACCOUNTS: Current IRS Guidance Regarding Levies on Retirement Accounts Does Not Adequately Protect Taxpayer Rights and Conflicts with Retirement Security Public Policy

RESPONSIBLE OFFICIALS

Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

- *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*

DEFINITION OF THE PROBLEM

Taxpayers rely on Individual Retirement Accounts (IRAs) or defined contribution plans, such as 401(k) plans, or Thrift Savings Plans (TSPs) for federal employees, to fund living and other expenses after retirement. With rising medical and hospice care costs, many retirees are struggling to cover their basic living expenses. The Employee Benefits Retirement Institute (EBRI) estimates only 56.7 percent to 58.5 percent of Baby Boomers and Gen Xers are sufficiently funded for life after retirement.[2] Social Security benefits account for only about 40 percent of retirees' total income, meaning Americans should be funding retirement plans to make up the shortfall.[3] Understanding the importance of Americans having sufficient retirement savings, Congress for years encouraged retirement savings and formulated policies to protect the rights of individuals to pensions.[4]

Congress has given the IRS broad powers to collect taxes, including the authority to levy on a taxpayer's property and rights to property.[5] This power to levy extends to funds held in retirement accounts. Given the long-term importance of retirement assets to individuals' future welfare, the IRS regards retirement levies as "special cases" that require additional scrutiny and managerial approval.[6] However, the IRS

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

2 Jack VanDerhei, *"Short" Falls: Who's Most Likely to Come Up Short in Retirement, and When?*, Employee Benefits Retirement Institute Notes, Vol. 35, No. 6, June 2014, *available at* http://www.ebri.org/pdf/notespdf/EBRI_Notes_06_June-14_ShrtFlls-HSAs.pdf. For purposes of this study, Baby Boomers are defined as the generation born between 1948 to 1964 and Gen Xers are the generation born between 1965 and 1974.

3 *See* Social Security Administration (SSA), *available at* http://www.ssa.gov/policy/docs/ssb/v65n3/v65n3p1.html (last visited Dec. 4, 2015); SSA, *Retirement Planner: Learn About Social Security Programs*, *available at* http://www.socialsecurity.gov/planners/retire/r&m6.html (last visited Dec. 4, 2015); Association for the Advancement of Retired Persons, Affording Retirement: Social Security Alone Isn't Enough, *available at* http://www.aarp.org/work/social-security/info_06_2010/ss_isnt_enough.html (last visited Dec. 4, 2015).

4 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).

5 *See* IRC § 6331.

6 Internal Revenue Manual (IRM) 5.11.6.2(3) (Sept. 26, 2014).

guidance that explains the steps required before a retirement account can be levied contains inadequate detail and is insufficient to protect taxpayer rights.[7]

The National Taxpayer Advocate has highlighted several concerns to show current guidance is not sufficient to protect taxpayer rights including the following:

- The guidance regarding flagrant conduct (a prerequisite for the levy) lacks definition and clarity;
- There is inadequate instruction for analyzing future retirement calculations and no requirement to provide those calculations to the taxpayer;
- The IRS does not educate the taxpayer about what to do to avoid a levy, or discuss alternative collection options with the taxpayer prior to a levy on a retirement account;
- The IRS does not conduct a risk analysis similar to the pre-seizure and pre-levy considerations;
- The IRS does not track levies that are issued against particular retirement accounts and therefore is unable to conduct quality reviews to ensure taxpayers are being treated uniformly and employees are following existing guidance; and
- The IRS proposed a TSP levy pilot program within its Automated Collection System (ACS) unit, which could automate much of the decision to levy on a TSP retirement account, and would result in disparate collection treatment of TSP accounts compared to other retirement accounts.

The current Internal Revenue Manual (IRM) procedures and the proposed ACS pilot undermine both taxpayer rights and retirement security policy.

ANALYSIS OF PROBLEM

Background

Internal Revenue Code (IRC) § 6331 gives the IRS the right to levy on a taxpayer's property and rights to property. This power allows the IRS to levy on funds held in retirement accounts.[8] Generally, the levy on a retirement account will only reach the funds 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).[9]

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

1. Determine what property (retirement assets and non-retirement assets) is available to collect the liability;
2. Determine whether the taxpayer's conduct has been flagrant; and
3. Determine whether the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.[10]

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

8 For information on what constitutes a retirement plan, see IRC § 4974(c). The IRS may also levy on retirement income or distributions once the taxpayer retires. IRM 5.11.6.1, *Retirement Income* (Jan. 22, 2010).

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

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

The Small Business/Self-Employed (SB/SE) Area Director, Field Collection, must approve the notice of levy by signing the form as the Service Representative or by following IRM 5.11.1.3.5.[11] However, any notice of levy that requires the approval of the SB/SE Collection Area Director must include a memorandum explaining the IRS employee's justification for the levy.[12] The written information provided to the manager must include:

1. A summary of any information the taxpayer has provided that may affect the decision to levy, *e.g.*, claims that the assessment is wrong;
2. If the taxpayer has submitted such information, an analysis of that information and why the notice of levy should still be served;
3. Verification that the amount is still owed, *e.g.*, IDRS confirms the amount is still unpaid;
4. An explanation that the notice of levy is appropriate in consideration of the amount owed and any circumstances that are known about the taxpayer and the liability; and
5. Other collection alternatives considered and rejected.[13]

When a distribution occurs as the result of a levy, the taxpayer will experience tax consequences. First, 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.[15]

Understanding the importance of Americans having sufficient retirement savings, Congress for years encouraged retirement savings and formulated policies to protect the rights of individuals to pensions.

The IRM Guidance Regarding Flagrant Conduct Lacks Definition and Clarity

According to IRM guidance, if the IRS determines that a taxpayer has engaged in flagrant conduct, it may levy on a retirement account.[16] However, the guidance also provides that if a taxpayer has *not* engaged in flagrant conduct, then the levy should not occur.[17] Thus, the determination of flagrant behavior is a prerequisite for determining to levy on a retirement account. IRS employees are instructed to make a determination of flagrancy on a case-by-case basis and may consider extenuating circumstances that mitigate otherwise flagrant behavior.[18]

However, there is no on-point definition of what constitutes "flagrant" behavior in the IRC, accompanying regulations, or the IRM. The IRS has addressed "flagrant" in regulations related to excise taxes on exempt organizations (EOs). That guidance provides that "a willful and flagrant act (or failure to act) is one which is voluntarily, consciously, and knowingly committed in violation of any

11 IRM 5.11.6.2(10) (Sept. 26, 2014).
12 IRM 5.11.1.3.5(6) (Aug. 1, 2014).
13 IRM 5.11.1.3.5(2) (Aug. 1, 2014).
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).
15 Generally, there is a ten percent additional tax on early distributions from a qualified retirement plan but this additional tax does not apply to distributions made from an account because of an IRS levy. IRC § 72(t)(2)(A)(vii).
16 IRM 5.11.6.2(5) (Sept. 26, 2014).
17 *Id*.
18 *Id*.

provision of chapter 42 (other than IRC §§ 4940 or 4948(a)) and which appears to a reasonable man to be a gross violation of any such provision."[19] The United States Tax Court applied this definition in determining that a trustee's actions were flagrant and therefore subject to a penalty assessment under IRC § 6684.[20] This language could provide an analytical framework for defining "flagrancy" in the IRM as it relates to retirement accounts. Without a clear definition of flagrant conduct, this vital element of the analysis cannot occur on a consistent and meaningful basis. The key elements for a flagrant act should be that it is committed in a willful and voluntary manner and that a reasonable person would view it as a gross violation.[21]

Without a definition of flagrant conduct, the IRS employee must make this determination based on examples in the IRM guidance. Several examples of flagrant conduct listed in the IRM include the following:

- 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.[22]

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.[23] 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.[24] Other employer plans adopt a similar "opt-out" approach to automatically enroll employees.[25] Thus, an employee may have been contributing to a retirement plan via automated payroll deductions for years before incurring an IRS debt and may not be aware the IRS views such contributions to be flagrant conduct. Indeed, if the IRS adopted an EO definition of flagrant conduct discussed above (*i.e.*, voluntary, conscious, and knowing), it is questionable whether their contributions would constitute flagrant conduct.

The examples described above are overly broad in terms of discouraging retirement savings for *any* taxpayer with an outstanding liability. The guidance goes against strong public policy that encourages saving

19 Treas. Reg. § 1.507-1(c)(2).

20 *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.

21 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 Right 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.

22 IRM 5.11.6.2(6) (Sept. 26, 2014). TAS is working with the IRS to revise this IRM section. However, no changes have been made at this time.

23 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/tspbk08.pdf (last visited Dec. 4, 2015).

24 *See* Thrift Savings Plan, *Summary of the Thrift Saving Plan* 2, *available at* https://www.tsp.gov/PDF/formspubs/tspbk08.pdf (last visited Dec. 4, 2015).

25 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).

for retirement.[26] Without a 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 involuntary or unknowing act.

Finally, these examples seem counterintuitive in light of the IRS's public guidance providing safe harbors related to automatic contribution features for retirement plans.[27] If voluntarily contributing to a retirement account remains an element of flagrancy, taxpayers should at least be notified and given the opportunity to cease voluntary contributions prior to a levy on their retirement account.

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."[28] This guidance does not contain any definitive deadlines and is based 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.

Additionally, while the IRM does address extenuating circumstances that may exist to mitigate a taxpayer's behavior, it does not contain any examples of such extenuating circumstances. Nor does the IRM require the IRS employee to identify the mitigating circumstances, which could include IRS delays and IRS failures to meet appointments or take promised actions. As a result, this IRM is a trap for unwary taxpayers who may experience significant and irreparable harm as a result of a subjective and non-uniform finding of flagrancy by an IRS employee.

There Is Inadequate Instruction for Analyzing Future Retirement Calculations and No Requirement to Provide Those Calculations to the Taxpayer

The last step in determining if a levy on a retirement account is appropriate is to determine if the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.[29] 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.[30]

26 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. (Sept. 16, 2014) (statement of Orrin Hatch, ranking member, Committee on Finance).

27 Rev. Proc. 2015-28. In response to the issuance of this published guidance, Senator Ron Wyden, Finance Committee ranking member, applauded administration efforts claiming, "[t]hese improvements from the Treasury and the IRS mark an important step in helping millions of Americans save for a secure retirement. Automatic enrollment in retirement plans is a promising method to increase retirement savings. The changes made today will make it easier for smaller businesses to set up a retirement plan with automatic enrollment features and help more middle-class Americans prepare for retirement." Senator Ron Wyden, *Wyden Applauds Administration Efforts to Improve Retirement Saving* (Apr. 2, 2015) *available at* http://www.finance.senate.gov/newsroom/ranking/release/?id=3daed452-120a-45ab-b5fd-a9a4e21c05f4.

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

29 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). *Id*.

30 IRM 5.11.6.2(7) (Sept. 26, 2014). When conducting this financial analysis, employees are reminded to consider special circumstances that may be present on a case-by-case review.

While the guidance refers the employee to IRM 5.15 to determine necessary living expenses, there is no discussion on determining the taxpayer's potential retirement income. 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, 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.

> **Example:** Assume a taxpayer is 50 years old, expects to retire at age 62, and has a $40,000 tax liability with $54,000 in his TSP account. Further assume the taxpayer will begin receiving $2,000 per month from his federal pension and another $1,200 per month from Social Security at age 62, with a life expectancy of 80. The $54,000 TSP corpus (the years from the taxpayer's retirement age of 62 to 80) divided by 18 years leaves an average of $3,000 per year, or $250 per month. Thus at age 62, the taxpayer expects to have $3,450 of monthly income from all sources ($2,000 pension, $1,200 Social Security, $250 TSP). The IRS estimates the taxpayer will have necessary living expenses of $3,300 per month at retirement. Based on this financial analysis, if the IRS were to levy the entire TSP corpus, the taxpayer's monthly retirement income would be reduced to $3,200, and he could not meet his necessary living expenses of $3,300. An IRS levy should be limited to 60 percent of the TSP corpus, or $32,400, based on the crude estimate that the taxpayer would need to rely on only 40 percent of his TSP to cover necessary living expenses ($100 out of an available $250 per month). However, there are currently no safeguards to prevent the IRS from levying the *entire* TSP corpus, regardless of whether it would leave the taxpayer unable to meet necessary living expenses upon retirement.

IRM 5.11.6.2(7) does not instruct employees to provide the basis of a decision or calculations to the taxpayer. Without this information, the taxpayer cannot substantively address the IRS's determination to proceed with the levy. The IRS should consider the impact of the levy on the taxpayer's retirement security, including estimating future retirement income if the account were levied. This could be done by utilizing the Social Security Administration (SSA) and TSP websites and online calculators.[31] Alternatively, the IRS could create its own calculators for this purpose.

The IRS Does Not Educate the Taxpayer About What to Do to Avoid a Levy, or Discuss Alternative Collection Options With the Taxpayer Prior to a Levy on the Retirement Account

The current IRM guidance does not require employees to educate the taxpayer as to what he or she needs to do to avoid a levy on their retirement account. Since this levy can cause irreparable harm to the taxpayer's future well-being, it is imperative that the IRS adheres to the taxpayer *right to be informed*. As stated above, an unsophisticated taxpayer who is unaware of the IRM examples regarding flagrant conduct may continue making voluntary contributions to a retirement account, risking his or her retirement assets. The IRS would not tell the taxpayer to stop or reduce contributions to avoid being deemed flagrant, even

31 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 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.

when contributions are automatically made as a part of employment. For the government to encourage retirement contributions, but also deem those contributions as flagrant conduct, without notice to the taxpayer, is a Catch-22 for the taxpayer.

Likewise, the IRS is not proactively informing taxpayers about the tax consequences of a distribution from the retirement account. Pursuant to IRC § 408(d), generally the entire amount paid from a retirement account or any distribution is considered gross income and subject to taxation. In the instance of a levy on a retirement account, the payor would generally be required to withhold ten percent for federal income taxes.[32] It is not guaranteed that the withheld amount will cover the full amount of federal tax liabilities associated with a distribution. No amount is required to be withheld for state income taxes, which could potentially subject the taxpayer to state tax penalties and enforcement activities. These tax consequences could exacerbate the taxpayer's existing financial difficulties by creating a new tax liability the taxpayer is unable to pay, creating a vicious circle of noncompliance.

Without a 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 involuntary or unknowing act.

Educating taxpayers about tax consequences of contributions to and distributions from a retirement account is necessary for fair and just tax administration given public policy to encourage retirement savings. Moreover, communication with the taxpayer about the consequences of a levy on a retirement account (including the loss of retirement savings) might be the one piece of information that could transform a heretofore unresponsive taxpayer into a responsive and cooperative one. Thus, communication can help collect revenue *and* protect retirement savings.

Finally, the IRM makes only minimal mention of collection alternatives. The pertinent section reads: "[i]f there is property other than retirement assets that can be used to collect the liability, or if a payment agreement can be reached, consider these alternatives before issuing a levy on retirement accounts. Also consider the expense of pursuing other assets as well as the amount to be collected."[33] This excerpt only minimally references installment agreements and does not mention currently not collectible status or offers in compromise.[34] Without this information, employees may be guided to focus on the retirement account levy without considering less intrusive alternatives, thereby compromising a taxpayer's *right to privacy*.

32 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).

33 IRM 5.11.6.2(4) (Sept. 26, 2014).

34 When a taxpayer has no assets or income which are, by law, subject to levy, or it is determined that levy action would create a hardship, the liability may be reported as currently not collectible. A hardship exists if the levy action prevents the taxpayer from meeting necessary living expenses. IRM 1.2.14.1.14, *Policy Statement 5-71* (Nov. 19, 1980). *See also* Treas. Reg. 301.6343-1(b)(4). An offer in compromise allows the IRS and the taxpayer to settle an outstanding liability for a reduced amount. IRC § 7122.

The IRS Does Not Conduct a Risk Analysis Similar to the Pre-Seizure and Pre-Levy Considerations

As mentioned above, levies on retirement accounts receive "special" consideration. However, the IRS must perform a general risk analysis prior to seizing a taxpayer's property.[35] A risk analysis should also be required for levies on retirement accounts. The guidance under IRM 5.11.6.2 should also make a cross-reference to IRM 5.11.1.3.1, in which IRS employees are instructed to consider the following prior to imposing a levy:

- The taxpayer's financial condition, including information discussed in IRM 5.1.12.20.1.1 related to economic hardship determinations;
- The taxpayer's responsiveness to attempts at contact and collection;
- The taxpayer's filing and paying compliance history;
- The taxpayer's effort to pay the tax; and
- Whether current taxes are being paid.[36]

This guidance includes a clear reference to economic hardship, which the guidance for retirement levies does not include. Consideration of the taxpayer's recent filing and payment compliance history could be a mitigating factor against a determination of flagrancy. Additionally, IRS employees are instructed to consider the timing of successive seizures to avoid undue hardship and collection alternatives in order to determine the feasibility of a seizure.[37] These considerations allow for greater protection of taxpayer rights and should be incorporated into guidance for retirement levies. Finally, the IRM should require that the levy take place within a reasonable amount of time (*e.g.*, 90 days) of when the risk analysis is completed to avoid a situation of changed circumstances.

The IRS Does Not Track Levies That Are Issued Against Particular Retirement Accounts and Therefore Is Unable to Conduct Quality Reviews to Ensure Taxpayers Are Being Treated Uniformly and That the Guidance Is Being Followed By Employees

The IRS does not have a system for tracking levies that are issued against particular retirement accounts.[38] This means that IRS management and other stakeholders are not able to conduct quality reviews or track retirement levies to ensure that taxpayers are being treated in a uniform manner and that the internal guidance is being followed by employees.[39]

35 IRM 5.10.1.3.2, *Alternative Methods of Collection* (Aug. 4, 2014). There is no legal distinction between a levy and a seizure. Generally, if the taxpayer is holding the property, or a third party is holding the property and it cannot be turned over by writing a check, the IRS will use seizure procedures. IRM 5.11.1.2.2, *Notice of Levy vs. Seizure* (Aug. 1, 2014). A levy is often used for things such as a taxpayer's bank account, wages, or other income. *Id*.

36 IRM 5.11.1.3.1, *Pre-levy Considerations* (Aug. 1, 2014).

37 IRM 5.10.1.1 (Aug. 4, 2014).

38 IRS response to a TAS information request (May 21, 2015).

39 For information about how the inconsistent use of Designated Payment Codes reduces the ability to assess Collection actions, see Most Serious Problem: *IRS Collection Effectiveness: The IRS's Failure to Accurately Input Designated Payment Codes for All Payments Compromises Its Ability to Evaluate Which Actions Are Most Effective in Generating Payments, infra.*

However, TAS conducted a review of cases from FY 2014 and FY 2015 that were most likely to contain TSP, IRA, or retirement account levies.[40] TAS reviewed 43 possible TSP levy cases and found that in 33 cases, Form 668A, *Notice of Levy*, was generated and issued to the TSP board. In 31 of those cases, the IRS employee did not document managerial approval, as required by the IRM. Additionally, flagrant conduct, a prerequisite for the levy determination, was only recorded in one case. No taxpayers were informed that making contributions could be deemed flagrant conduct. The total amount of levy funds received from these levies totaled approximately $49,000.

TAS also reviewed 128 possible IRA levy cases and found that in 72 cases, Form 668A, *Notice of Levy*, was generated and issued on an IRA account. In 52 of those cases (72 percent), the IRS employee did not document managerial approval, as required by the IRM. Flagrant conduct was documented in 18 cases and the IRS educated just one taxpayer on the effects of continuing to make IRA contributions. The total amount of levy funds received from these levies totaled approximately $2 million.

Last, TAS reviewed 176 possible retirement account levy cases and found that in 66 cases, Form 668A, *Notice of Levy*, was generated and issued on a retirement account. In 29 of those cases (44 percent), the IRS employee did not document managerial approval, as required by the IRM. The IRS documented flagrant conduct in 20 cases and the IRS informed only two taxpayers about the consequences of continued contributions. The total amount of levy funds received from these levies totaled approximately $7.6 million. It is important to make sure that each taxpayer's case receives proper analysis prior to levying on a retirement account, because proceeds from a levied retirement account cannot be returned to the retirement account, even in the event of an erroneous or wrongful levy.[41]

Even With Inadequate Guidance, the IRS Proposes a Pilot Project Within the Automated Collection System, Which Will Compound the Harm to Taxpayers

Considering all of the deficiencies discussed above, the National Taxpayer Advocate is especially concerned with the IRS's pilot program aimed at allowing its ACS to issue levies on TSP accounts.[42] This pilot will treat taxpayers with TSP accounts disparately from taxpayers who have other types of retirement accounts. If a taxpayer has a defined benefit plan and has no present right to withdraw the account balance, the IRS will have no corpus to levy upon at the present time. However, recent changes in the TSP regulations allow a levy on a TSP account to reach up to the entire vested account balance now without restrictions.[43] The IRS has not articulated a reason why it believes this pilot should single out TSP

40 TAS review completed November 17, 2015, on potential retirement account asset levy cases with levies issued between FY 2014 and FY 2015. Note: Because some taxpayers received more than one levy, the total number of cases could be slightly higher than the total number of taxpayers in the review. This review was based on a non-random sample so statistics based on this data may not project to the overall population; however the sample demonstrates that the IRS is not always following necessary procedures.

41 The National Taxpayer Advocate recommended legislative changes to IRC § 401 (for Qualified Pension, Profit Sharing, Keogh, and Stock Bonus Plans), IRC § 408 (for IRA 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 202-09. 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.

42 ACS is a computerized system that maintains balance-due accounts and return delinquency investigations. IRM 5.19.5.2, *What Is ACS?* (Aug. 20, 2013). TSP is a retirement plan for federal employees established under 5 U.S.C. § 8437.

43 5 U.S.C. § 8473(e)(3), 5 C.F.R. § 1653.35, and IRM 5.11.6.2.1, *Thrift Savings Plan* (July 17, 2015).

accounts.[44] As of December 31, 2014, there are approximately 4.7 million TSP participants, so the pool of taxpayers affected by this pilot could be quite large.[45]

TAS was not consulted during the process to create procedures for this pilot, but is providing comments to the draft procedures. As currently written, the procedures provide even fewer safeguards to taxpayer rights than the current IRM guidance for levying on retirement accounts generally.[46] For instance, the procedures treat taxpayers in ACS differently from taxpayers working with a revenue officer.[47] Under the pilot procedures, the IRS employee's financial analysis will be restricted to these two elements:

- Document if there is any information that retirement is impending and that the taxpayer will be relying on funds in the TSP for necessary living expenses. The employee is instructed to use available information to apply the standards in IRM 5.19.13.1.4 and Publication 590-A. If this documentation is present, do not issue the TSP levy; and
- Also, consider any special circumstances in the taxpayer's situation, such as extraordinary expenses, or additional sources of income, including spousal income and assets, other retirement accounts, etc. that will be available to pay expenses during retirement.[48]

There is no mention of reviewing IRM 5.15, *Financial Analysis*. Furthermore, these procedures introduce considerations not found in IRM 5.11.6.2(7), such as imputing spousal income into the financial analysis.[49] TAS is working actively to address the problems with the pilot.

Under ACS, cases are assigned to teams, functions, or units rather than individual employees.[50] It is a computer system that "analyzes for levy sources, undeliverable mail codes, telephone numbers, and other characteristics" in place of an employee. The computer system also "prints letters for mailing and assigns cases to the proper team, function, or units," while a "small percentage of cases meeting specific criteria" are researched by the ACS Support function.[51] ACS provides minimal contact with a taxpayer. For instance, ACS uses "predictive dialer" technology, which automatically makes outbound calls to taxpayers or representatives and if contact is made, the call is transferred to a waiting agent.[52] Last, correspondence

44 In response to an information request asking for the rationale of the pilot program, the IRS explained that "ACS has authority to issue levies on retirement accounts, however, it was not previously utilized. The pilot is an opportunity to determine if this means will be cost effective and meet sound tax administration." IRS response to TAS information request (July 9, 2015).

45 Thrift Savings Fund, *Financial Statements December 31, 2014 and 2013* 6, *available at* http://www.frtib.gov/ReadingRoom/FinStmts/TSP-FS-Dec2014.pdf.

46 IRS, *ACS Thrift Savings Plan Levy Pilot Procedures* (Dec. 9, 2015).

47 *Id*.

48 *Id*.

49 *Id*.

50 IRM 5.19.5.3, *Research on ACS* (Jan. 6, 2015).

51 *Id*.

52 IRM 5.19.5.4.1(1) (Feb. 20, 2015). An automated message is left if an answering machine answers and if there is no answer, the system "updates the account and reschedules the case to the predictive dialer queue for another attempt." *Id*.

submitted by a taxpayer to ACS is actually processed by ACS Support, a different unit.[53] The IRS has confirmed that the ACS pilot will work in a similar fashion.[54]

The taxpayer may struggle to navigate a system in which they receive automated phone contact, but cannot contact an assigned employee.[55] With no employee assigned to the case, each contact or piece of correspondence would be analyzed by a different employee. The National Taxpayer Advocate is concerned that under this system the ACS employee will not be able to make a determination of flagrancy under the proposed definition. As mentioned above, IRM 5.11.6.2.1(5) requires that the IRS employee prepare written analysis for the manager to approve prior to levy. This analysis requires that the employee consider the taxpayer's current situation, his or her conduct, and any mitigating circumstances, as well as the taxpayer's projected economic viability. The National Taxpayer Advocate provided training to the employees assigned to the pilot cases. However, even with training, the minimal contact associated with ACS will make it difficult, if not impossible, for ACS employees to make these determinations accurately. It does not appear the ACS manager will have much information about the taxpayer's financial condition or extenuating circumstances before giving rote approval to a levy that could potentially destroy a taxpayer's retirement income security.

Educating taxpayers about tax consequences of contributions to and distributions from a retirement account is necessary for fair and just tax administration given public policy to encourage retirement savings.

Furthermore, the reach of a TSP levy is far more expansive than the levy on a non-TSP retirement account. As discussed above, the levy on a non-TSP retirement account generally only reaches the assets over which the taxpayer has a present withdrawal right. However, recent changes in the law and regulations written by the Federal Retirement Thrift Investment Board that manages TSP accounts, allow a TSP levy to reach up to the vested account balance.[56] Thus, the IRS can levy upon the *entire vested balance* of the TSP account, even if the participant has no current right to access the funds.[57] As a result, a levy on a TSP account could be even more damaging to a taxpayer than a levy on a non-TSP retirement plan (*e.g.*, 401(k) plans). This greater risk of harm should cause the IRS to provide more taxpayer rights protections rather than less. Retirement levy determinations should require assignment to employees with the skills, training, and resources required to ensure appropriate and consistent application of retirement levies.

53 IRM 5.19.6.1, *ACS Support Overview/What Is ACS Support* (June 17, 2014). ACS Support is experiencing a backlog of work and in response the IRS recently announced that ACS Support will, among other things, cease processing paper third-party levy responses in order to address taxpayer correspondence. This deviation will occur until the end of September 2015. Memorandum to Campus Collection Directors from DelRey Jenkins, Director, Campus Collection, *Deviation Authority to Discontinue the Processing of ACS Support (ACSS) Levy Responses* (Mar. 23, 2015).

54 Two or more employees will be designated to work the pilot inventory. The cases will not be assigned to a specific employee. The lead who receives the case will complete the investigation and will make a levy determination if appropriate. If a taxpayer calls in response to the levy, the ACS employee will prepare Form 4442, *Inquiry Referral*, to the levy originator and advise the taxpayer that they will be contacted by the levy originator within 24 hours. IRS, *ACS Thrift Savings Plan Levy Pilot Procedures* (Dec 9, 2015). Any taxpayer correspondence will be routed to the designated leads. IRS response to TAS information request (July 6, 2015).

55 For information on how the lack of an assigned employee can affect taxpayers under correspondence examination, an automated system for examinations, *see* National Taxpayer Advocate 2014 Annual Report to Congress 134-44. This situation is also made worse by the fact that the level of ACS customer service has decreased. Treasury Inspector General for Tax Administration (TIGTA) determined that ACS has answered 25 percent fewer calls even though total calls into the ACS unit have decreased 16 percent since FY 2011. TIGTA, Ref. No. 2015-30-035, *Reduced Budget and Collection Resources Have Resulted in Declines in Taxpayer Service, Case Closures, and Dollars Collected* 10 (May 2015).

56 5 U.S.C. § 8437(e)(3) and 5 CFR § 1653.35.

57 IRM 5.11.6.2.1(1) (July 17, 2015).

CONCLUSION

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 and does not fully recognize the importance of retirement savings. It also disregards the balance between the need for enforcement to be no more intrusive than necessary. Without clear guidance, the IRS employee's determination is subjective and susceptible to personal judgment. This could lead to inconsistent treatment of similarly situated taxpayers, which could erode taxpayers' confidence in a fair tax system and decrease voluntary compliance. Moreover, 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*. Last, without clear guidance, taxpayers do not know what they need to do to comply with tax laws, which diminishes the *right to be informed*.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. In collaboration with TAS, revise the IRM on retirement account levies to define flagrant conduct, which should include elements of willful and voluntary conduct that appears to be a gross violation from a reasonable person standard, include examples of extenuating circumstances that can mitigate flagrant conduct, require a full pre-levy financial analysis, and educate taxpayers about actions available to avoid a levy on a retirement account.
2. The IRS should identify calculators that it can use, such as those provided by the SSA or TSP, to determine the impact of a levy on a retirement account on the taxpayer's future well-being. Alternatively, the IRS could create its own calculator.
3. Create a unique Designated Payment Code for retirement levy proceeds or a unique identifier within the Integrated Collection System to identify, track, and review retirement levy cases.
4. Postpone the ACS retirement levy pilot program until all of the National Taxpayer Advocate's concerns have been addressed; and if they are not able to be addressed, do not implement the pilot.

MSP #11 NOTICES OF FEDERAL TAX LIEN (NFTL): The IRS Files Most NFTLs Based on Arbitrary Dollar Thresholds Rather Than on a Thorough Analysis of a Taxpayer's Financial Circumstances and the Impact on Future Compliance and Overall Revenue Collection

RESPONSIBLE OFFICIALS

Deborah Holland, Commissioner, Wage and Investment Division
Karen Shiller, Commissioner, Small Business/Self-Employed Division
Janice Hedemann, Acting Director, Office of Research, Analysis and Statistics

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

Notices of Federal Tax Lien (NFTLs) establish priority of the government's interest in a tax debtor's property with respect to certain creditors by putting the public, including third-party creditors, on notice of an existing statutory lien.[2] Several TAS studies show that NFTLs can unnecessarily harm taxpayers and reduce their ability to become or remain compliant with their federal tax filing obligations.[3] NFTLs also generate significant downstream costs for the government, often without attaching to any tangible assets.[4] The IRS files most NFTLs based on an arbitrary dollar threshold of the unpaid liability, with over 21 percent of NFTLs filed without human involvement in determining lien filings,[5] rather than a thorough analysis of the taxpayer's individual circumstances and financial situation or consideration of the NFTL's impact on future compliance and collected revenue. Even when the taxpayer attempts to initiate contact with the IRS by calling the number provided on the majority of notices, only about one in three taxpayers can get through to the IRS to make payment arrangements prior to the NFTL filing.[6]

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

2 Internal Revenue Code (IRC) §§ 6321, 6322, and 6323(a).

3 In fiscal years (FYs) 2009-2012, TAS Research & Analysis investigated the IRS's use of NFTLs and their impact on the compliance behavior of delinquent taxpayers. *See* National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 105-30 (TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111 (TAS Research Study: *Estimating the Impact on Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 89-100 (*Estimating the Impact of Liens on Taxpayer Compliance Behavior: An Ongoing Research Initiative*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Study: *The IRS's Use of Notices of Federal Tax Lien*).

4 *See* T. Keith Fogg, *Systemic Problems with Low-Dollar Lien Filing*, 2011 TNT 194-9 (Oct. 6, 2011); National Taxpayer Advocate 2011 Annual Report to Congress 109-28 (Most Serious Problem: *Changes to IRS Lien Filing Practices Are Needed to Improve Future Compliance, Increase Revenue Collection, and Minimize Economic Harm Inflicted on Financially Struggling Taxpayers*).

5 IRS Collection Activity Report (CAR), NO-5000-25, *Lien Report, September, FY 2015*. In FY 2015, there were 515,247 liens filed, including 4,918 refiled liens, with 202,127 arising in the Automated Collection System (ACS). Approximately 47 percent, of ACS NFTLs are filed manually. Small Business/Self-Employed (SB/SE) response to TAS information request (Oct. 19, 2015); IRS CAR, NO-5000-25, *Lien Report, September, FY 2015.*

6 IRS Joint Operations Center (JOC), *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2015) (specifying that 37 percent level of service for the installment agreement line).

The National Taxpayer Advocate has repeatedly expressed concerns regarding the negative impact of the IRS's NFTL filing policies on taxpayers and on future compliance.[7] The IRS can significantly increase the effectiveness of NFTL filings without needlessly harming taxpayers by replacing the current policy with a cost-efficient algorithm for making NFTL filing determinations incorporating:

- meaningful contact with the taxpayer to obtain financial information and establishing a payment plan;
- thorough analysis of the taxpayer's financial situation, including whether the NFTL will attach to tangible property; and
- the impact of the NFTL on future compliance.

ANALYSIS OF PROBLEM

Background

The IRS's ability to file a NFTL, which protects the government's interest in property against subsequent purchasers, secured creditors, and junior lien holders, is a power unlike that of other creditors, since the IRS does not need to obtain a judgment to file a NFTL.[8] The filing of a NFTL can significantly damage the creditworthiness of a taxpayer, which can negatively impact the ability to obtain financing for a home or other major purchases, find or maintain a job, secure affordable rental housing or insurance, and pay the tax debt.[9]

Congress recognized the unique nature of a NFTL and, when enacting the IRS Restructuring and Reform Act of 1998 (RRA 98), it precluded the IRS from "abusively us[ing] its liens and seizure authority."[10] Upon assessment of a tax liability, notice to the taxpayer, demand for payment, and the taxpayer's failure to pay, a lien in favor of the United States attaches to the taxpayer's property.[11] This statutory lien, known as a "secret lien" because the taxpayer does not usually know it has arisen, attaches to all of the taxpayer's property and rights to property, both real and personal, and to any future property acquired by the taxpayer.[12] However, this "secret lien" does not provide the IRS with priority over other creditors that do not have actual knowledge of the secret lien; thus, the IRS must file an NFTL to establish priority of the

7 *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 225-36 (Most Serious Problem: *Managerial Approval for Liens: The IRS's Administrative Approval Process for Notices of Federal Tax Liens Circumvents Key Taxpayer Protections in RRA 98*); National Taxpayer Advocate 2012 Annual Report to Congress 403-25 (Most Serious Problem: *Although the IRS "Fresh Start" Initiative Has Reduced the Number of Lien Notices Filed, the IRS Has Failed to Determine Whether Its Lien Policies Are Clearly Supported by Either Increased Taxpayer Compliance or Revenue*); National Taxpayer Advocate 2011 Annual Report to Congress 109-28 (Most Serious Problem: *Changes to IRS Lien Filing Practices Are Needed to Improve Future Compliance, Increase Revenue Collection, and Minimize Economic Harm Inflicted on Financially Struggling Taxpayers*).

8 IRC §§ 6321, 6322, and 6323(a).

9 *See* National Taxpayer Advocate 2014 Annual Report to Congress 225; *see also* Heather Struck, *A Bad Credit Score Affects a Lot More Than Credit*, Forbes, Jul. 20, 2011, *available at* http://www.forbes.com/sites/heatherstruck/2011/07/20/credit-score-fico-can-hurt-you/; written response from Vantage Score® (Sept. 17, 2009).

10 RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 758 (1998). *See also* S. Rep. No. 105-174, at 78 (1998); Unanimous Consent Request – H.R. 26767, 143 Cong. Rec. S12230-02, at S12231 (statement of Senator Roth).

11 IRC §§ 6321 and 6322. IRC § 6201 authorizes the IRS to assess all taxes owed, and IRC § 6303 provides that within 60 days of the assessment, the IRS must provide notice and demand payment to any taxpayer liable for an unpaid tax.

12 *Id*. Internal Revenue Manual (IRM) 5.12.1.3, *Creation and Duration* (Oct. 14, 2013). The NFTL is effective as of the date of assessment and continues until the liability is either paid in full or is legally unenforceable. The IRS must release the lien within 30 days after the underlying liability is satisfied or becomes legally unenforceable. IRC § 6325(a)(1). Because the NFTL is a statutory lien — or "secret" lien — third parties have no knowledge of the existence of the underlying debt. IRC § 6321.

The filing of a Notice of Federal Tax Lien (NFTL) can significantly damage the creditworthiness of a taxpayer, which can negatively impact the ability to obtain financing for a home or other major purchases, find or maintain a job, secure affordable rental housing or insurance, and pay the tax debt.

government's interest in the property against subsequent purchasers, secured creditors, and junior lien holders.[13]

In 2011, in response in part to the National Taxpayer Advocate's continued concern over NFTL filing and withdrawal policies, the IRS announced a new effort to help financially struggling taxpayers get a "fresh start."[14] The "Fresh Start Initiative" resulted in several positive changes in how the IRS files and withdraws NFTLs, including increasing the Automated Collection System (ACS) NFTL filing threshold from $10,000 to $25,000.[15] However, the IRS continues to file NFTLs automatically based on that threshold, with little management review and without attempting meaningful contact with a taxpayer, doing a financial analysis, or considering the impact on future compliance.[16]

Current NFTL Filing Policy Is Based on an Arbitrary Dollar Threshold of the Unpaid Liability Rather Than Focused on Meaningful Contact with the Taxpayer

As stated above, the IRS generally files NFTLs if the aggregate unpaid balance of assessment is over $10,000, or for accounts in ACS, if the assessment is over $25,000.[17] Contrary to congressional intent, only the decision to *not* file an NFTL requires managerial approval in most circumstances.[18] Prior to the filing of an NFTL, the IRS must make "reasonable efforts" to contact the taxpayer to "advise [the taxpayer] that an NFTL may be filed if full payment is not made when requested."[19] However, the Internal Revenue Manual (IRM) provides that "reasonable effort" includes "issuance of the statutory assessment notices and the balance due notices sent during

13 *See* IRC § 6323(f); Treas. Reg. § 301.6323(f)-1; IRM 5.12.1.4, *Purpose and Effect of Filing a Notice of Federal Tax Lien (NFTL)* (Oct. 14, 2013). The IRS must file the NFTL in the correct county or jurisdiction where the taxpayer's property is located.

14 IRS, Media Relations Office, *IRS Announces New Efforts to Help Struggling Taxpayers Get a Fresh Start; Major Changes to Lien Process*, IR-2011-20 (Feb. 24, 2011).

15 National Taxpayer Advocate 2012 Annual Report to Congress 408. The IRS implemented this change through a policy decision that reprogrammed ACS to file NFTLs only where the unpaid balance of assessment is over $25,000. However, the IRS did not update the IRM or issue interim guidance reflecting this change.

16 National Taxpayer Advocate 2014 Annual Report to Congress 225-36 (Most Serious Problem: *Managerial Approval for Liens: The IRS's Administrative Approval Process for Notices of Federal Tax Liens Circumvents Key Taxpayer Protections in RRA 98*).

17 *See* IRM 5.12.2.6(1) (Oct. 14, 2013); IRM 5.19.4.5.3, *NFTL Filing Decisions* (Aug. 4, 2014); *see also supra* note 15 (noting that the $25,000 threshold is not listed in the IRM nor in interim guidance but is an established policy decision); SB/SE response to TAS information request (June 10, 2015) (stating that on April 15, 2011, the "ACS Systemic Lien threshold was increased to $25,000").

18 National Taxpayer Advocate 2014 Annual Report to Congress 226, 229. As described in the 2014 Annual Report, despite the congressional direction that the IRS adopt procedures in which an employee's determination to file a NFTL would, "where appropriate," be approved by a supervisor in RRA 98 § 3421, the IRS's current policy is to only have those reviews take place when the determination is to *not* file a NFTL or if the Revenue Officer is below a full performance level of GS-9. *See* RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 758 (1998); Memorandum from Assistant Commissioner (Collection) (July 30, 1998) (concluding that RRA 98 § 3421 does not require supervisory review of all collection actions but allows the IRS the discretion to determine where such review would be appropriate); IRM 5.12.2.5.2(1) (Oct. 14, 2013). Furthermore, IRM 5.12.2.5.3(2) (Nov. 9, 2015) provides that managerial approval is required for the *non*-filing or deferral of an NFTL filing when the "known aggregate assessed or to be assessed balance will be greater than $10,000," there are ten or more modules open, or the "NFTL filing is deferred or not filed for more than 120 days from initial or last [taxpayer] contact," including "situations when the Revenue Officer is waiting for either actions by or documentation from a taxpayer." The only exceptions to managerial approval are limited to cases in which the balance is less than $2,500, there has previously been a non-filing or deferral approval in the case and circumstances remain the same, the case meets the Streamline Installment Agreement criteria under IRM 5.14.5.2, or the case meets the criteria for specifically not filing an NFTL under IRM 5.12.2.4.2(2) or 5.12.2.4.2(3). IRM 5.12.2.5.3(1) (Nov. 9, 2015).

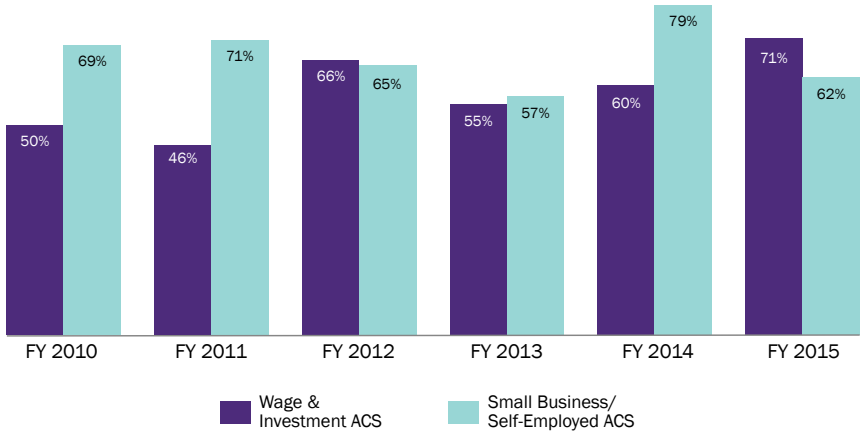
19 IRM 5.12.2.2(1) (Nov. 9, 2015).

the collection process ….”[20] This guidance suggests the IRS is simply “checking the box” on contacting taxpayers without actually attempting meaningful contact to resolve the tax liability.

Under current procedures, the request for an NFTL filing or the appropriate non-filing documentation must be prepared within ten calendar days of the initial attempted contact or the initial actual contact with the taxpayer or his or her representative.[21] A “contact,” as defined in the IRM, is made by either a field contact, the preferred method for Revenue Officers; a telephone call; or mailing a notice or letter to the taxpayer’s last known mailing address.[22] As Figure 1.11.1 below illustrates, a majority of these attempted telephone calls by ACS using predictive dialers do not result in actual contact with the taxpayers.[23]

FIGURE 1.11.1[24]

Percentage of Predictive Dialer Outbound Calls in the Automated Collection System (ACS) That Resulted in “No Contact”



This ten-day timeframe is an incredibly short period to allow any “meaningful contact” to occur, let alone enable the taxpayer to provide the IRS with a clear picture of his or her current financial situation. The IRS does not take into account the amount of time it takes for the taxpayer to contact the IRS and gather and send the necessary financial information or for the IRS to process and deliver that information.[25]

20 IRM 5.12.2.2(1) (Nov. 9, 2015).

21 IRM 5.12.2.3.2(1) (Oct. 14, 2013). The NFTL determination is separate from the NFTL filing consideration. The ten-day pre-filing consideration is a process of deciding whether to file, defer, or not file, an NFTL. IRM 5.12.2.3(1) (Oct. 14, 2013).

22 IRM 5.12.2.2(2) (Nov. 9, 2015). The IRS does not systemically track how often each “contact” method is utilized. *See* SB/SE response to TAS information request (Nov. 6, 2015).

23 SB/SE response to TAS information request (June 10 and Oct. 19, 2015).

24 *Id*. This does not include the limited number of “manual outbound calls” initiated by an ACS employee working an ACS case.

25 Over half of Accounts Management correspondence inventories are in “overage,” meaning they have not been handled in the established timelines. *See* IRS, Customer Account Services Accounts Management Paper Inventory Reports, *Inventory Age Report – All Programs* (week ending Sept. 30, 2015) (noting that 54 percent of Individual Master File Correspondence is in “overage”).

And, all this assumes the taxpayer receives correspondence about the NFTL and it is not returned to the IRS as undeliverable mail.[26]

Additionally, even if the taxpayer receives a notice or a phone message and attempts to call the IRS back at the number provided on the majority of notices, it is unlikely he or she will get through to the IRS to make payment arrangements prior to going into ACS. In fiscal year (FY) 2015, the level of service (LOS) for the Installment Agreement/Balance Due phone number was less than 40 percent.[27] Because of the poor level of service on the payment phone line, the IRS may view taxpayers as being unwilling to pay when they were actually trying to reach the IRS to set up payment plans. Consequently, given the short timeframes for taxpayer response, the IRS files NFTLs against taxpayers who are trying to reach the IRS but cannot. This situation not only harms taxpayers but also erodes trust in the IRS and can undermine future compliance.

The IRS Could Learn From Meaningful Contact Practices in the Financial Industry and Other Tax Administration Agencies

The National Taxpayer Advocate has continuously discussed the importance and usefulness of meaningful contact, specifically personal contact, rather than simply mailing letters and providing taxpayers with information regarding their payment options.[28] In the private sector, creditors routinely use early intervention as a pre-collection mechanism.[29] It has become a standard in the mortgage industry for loan servicers to contact borrowers at least twice within the first 45 days of delinquency to discuss potential loss

26 *See* National Taxpayer Advocate 2013 Annual Report to Congress 157; National Taxpayer Advocate 2010 Annual Report to Congress 221-32 (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*).

27 IRS JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2015). The customer service representative (CSR) level of service for the Installment Agreement/Balance Due phone number in FY 2015 was approximately 37 percent. *Id*. Overall, taxpayers have to wait a significant amount of time on hold to actually speak with an assistor, and almost 18 million callers were disconnected via a "courtesy disconnect" message. *See* IRS, JOC, *Custom Report RRC 2015-1623* (including weekly data on the number of courtesy disconnects from FYs 2011 to 2015) (noting that 4,853,347 courtesy disconnects occurred in the "individual category" alone for FY 2015). The SB/SE ACS number, 800-829-3903, and the W&I ACS number, 800-829-7650, do have a significantly higher level of service, over 70 percent, but the taxpayer is not provided this number until after he or she has entered into ACS and the NFTL may have already been filed by ACS. IRS JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2015). For ACS incoming calls in FY 2015 the average handle time was 16.2 (W&I) to 16.5 (SB/SE) minutes and an average queue time of 12.8 (SB/SE) to 14.5 (W&I) minutes. SB/SE response to TAS information request (Oct. 19, 2015).

28 National Taxpayer Advocate 2011 Annual Report to Congress 336-47 (Most Serious Problem: *The IRS Does Not Emphasize the Importance of Personal Taxpayer Contact as an Effective Tax Collection Tool*); National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 40-70 (TAS Research Study: *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*); National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*); National Taxpayer Advocate 2008 Annual Report to Congress 114-25 (Most Serious Problem: *Navigating the IRS*); National Taxpayer Advocate 2006 Annual Report to Congress 62-82 (Most Serious Problem: *Early Intervention in IRS Collection Cases*), 83-109 (Most Serious Problem: *IRS Collection Payment Alternatives*), 110-29 (Most Serious Problem: *Levies*), 141-56 (Most Serious Problem: *Collection Issues of Low Income Taxpayers*); National Taxpayer Advocate 2004 Annual Report to Congress 226-45 (Most Serious Problem: *IRS Collection Strategy*). The National Taxpayer Advocate has also discussed in detail the impact of future compliance with meaningful contact in her prior reports. *See* National Taxpayer Advocate 2014 Annual Report to Congress 225-35 (Most Serious Problem: *Managerial Approval For Liens: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98*); National Taxpayer Advocate 2012 Annual Report to Congress 403-25 (Most Serious Problem: *Although the IRS "Fresh Start" Initiative Has Reduced the Number of Lien Notices Filed, the IRS Has Failed to Determine Whether Its Lien Policies Are Clearly Supported by Either Increased Taxpayer Compliance or Revenue*).

29 *See, e.g.*, National Service Bureau, *Pre-Collection Services (Early Intervention)*, *available at* http://www.nsbi.net/early-out-pre-collect (last visited Dec. 4, 2015).

Because of the poor level of service on the payment phone line, the IRS may view taxpayers as being unwilling to pay when they were actually trying to reach the IRS to set up payment plans. Consequently, given the short timeframes for taxpayer response, the IRS files Notices of Federal Tax Liens (NFTLs) against taxpayers who are trying to reach the IRS but cannot.

mitigation options available.[30] The Real Estate Settlement Procedures Act requires that the first contact, which must take place by the 36th day of delinquency, is a "live contact," or at least a good faith effort for live contact.[31] Furthermore, tax administration agencies around the world, including Sweden, Australia, Norway, and New Zealand, successfully use reminders, specifically "gentle" reminders, to increase tax payment compliance and prevent enforcement measures.[32] For example, New Zealand saw an increase of on-time payments by 12.6 percent between 2010 and 2013 by simply using short message service (SMS) to provide real-time reminders of key payments to a targeted group of taxpayers.[33]

Meaningful and personal contact, such as a "soft" letter followed by a telephone call, sends a timely message to a taxpayer. Often a reminder is all that is necessary to resolve past-due debts prior to placing them in full collection. It would be beneficial for the IRS, in terms of saving NFTL filing fees and promoting taxpayer rights and future compliance, to make multiple attempts to *contact* taxpayers by phone and through mailing monthly reminder notices (or SMS) instead of filing an NFTL after just one attempt. The IRS could use technology, such as a predictive dialer system, to reach taxpayers proactively and utilize third-party databases, such as *LexisNexis® Accurint*, to find alternative numbers and addresses associated with taxpayers.[34] However, given the current LOS and limited ability for taxpayers to reach the IRS via telephone, the IRS should expand the ten-day time frame to enable it to make meaningful contact with the taxpayer before making lien determinations.[35]

A Thorough Analysis of the Taxpayer's Financial Situation Is Necessary to Make an Accurate NFTL Filing Determination

NFTLs are currently filed pursuant to strict business rules as opposed to a thorough review of the taxpayer's financial situation. It was not until 2013, after consistent criticism from TAS, that the IRS added

30 The Consumer Financial Protection Bureau has incorporated the need for early contact with delinquent debtors in the 2013 updated mortgage servicing rules by requiring loan servicers to contact borrowers at least twice within the first 45 days of delinquency and discuss potential loss mitigation options available, if appropriate. *See* 12 C.F.R. § 1024.39; Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X), 78 Fed. Reg. 10696, 10787-10807 (Feb. 14, 2013).

31 *Id*.

32 *See* OECD, Working Smarter in Tax Debt Management 44 (2014), *available at* http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/working-smarter-in-tax-debt-management_9789264223257-en#page1. The use of reminders, specifically "gentle" reminders, has proven to be successful in increasing tax payment compliance and preventing enforcement measures in both Sweden and Australia. *Id*. Norway has seen a reduction in the need for "attachments" by 30 percent and a decrease in unsatisfied callers simply by sending gentler reminders.

33 *Id*. at Table 3.3 (2014) (stating that New Zealand saw an increase in on-time payments from 72 percent to 84.6 percent between 2010 and 2013 due to the use of SMS reminders to targeted groups of taxpayers).

34 Predictive dialer is a computer-based system that automatically dials groups of telephone numbers and then passes live calls to available CSRs. *See, e.g.*, SpitFire Predictive Dialers, *available at* http://www.tmcnet.com/channels/predictive-dialer/ (last visited Dec. 4, 2015). *See also* National Taxpayer Advocate 2012 Annual Report to Congress 526-36 (Legislative Recommendation: *Amend IRC § 7701 to Provide a Definition of "Last Known Address," and Require the IRS to Mail Duplicate Notices to Credible Alternative Addresses*); LexisNexis® Accurint, *available at* http://accurint.com/ (last visited Dec. 4, 2015). The IRM does instruct employees to "research" within 14 days to determine if there is a more current address available for reissuance of the notice. *See* IRM 5.19.6.17.4(1) (Oct. 15. 2014).

35 *See supra* note 27.

the lien determination pre-filing considerations to the IRM to assist employees in deciding whether to file an NFTL.[36] The pre-filing considerations include:

(1) the taxpayer compliance history;

(2) taxpayer qualification for a determination exception;

(3) protection of the government's interest, including exigent circumstances, where the filing of an NFTL is necessary to protect those interests; and

(4) taxpayer's qualification for a determination that a NFTL filing will hamper collection.[37]

To ensure that the IRS is balancing the need to protect the government's interest with the taxpayer's right that the collection action be no more intrusive than necessary,[38] the IRS should complete a thorough analysis of the taxpayer's financial situation when it makes a lien determination.[39] At minimum, the IRS should complete a limited analysis of the taxpayer's financial situation, using a form similar to the Form 433-F, *Collection Information Statement*, to determine if the taxpayer has assets currently or will have assets in the foreseeable future.[40] The IRS files approximately 21 percent of NFTLs automatically without human involvement in determining lien filing.[41] Even in an automated environment, it should develop an automated basic financial analysis for NFTL filing determinations, through the use of credit scoring and automated asset verification, while elevating close call or complex cases to an employee.

Using Technology and Databases to Improve Financial Analyses

The IRS is "one of the largest financial institutions in the world,"[42] but it is reluctant to implement financial analysis techniques and certain automation techniques used by modern financial institutions, including financial scoring, credit risk analysis, and modeling. Several large credit scoring and credit analysis providers offer solutions to automate collection decisions.[43] For example, *LexisNexis® RiskView™ Solutions* and *Accurint® for Collections: Decision Workflow* enables financial institutions and other creditors to access data from thousands of public sources to find court records, assets, and licenses, which can be factored into the determination of ability to repay, eligibility for a repayment plan, and recommendation of payoff amounts based on a comprehensive analysis of credit risk management data.[44] The IRS can employ new techniques, widely used in the financial industry, to automate analysis and regular monitoring of internal and external sources.

36 IRM 5.12.2.3, *Notice of Federal Tax Lien Filing Determination (Pre-filing Considerations*) (Oct. 14, 2013).

37 IRM 5.12.2.3(3) (Oct. 14, 2013). The IRM does not instruct employees to consider if the taxpayer is attempting to engage with the IRS through correspondence or phone.

38 See Taxpayer Bill of Rights, *The Right to Privacy*, *available at* http://www.taxpayeradvocate.irs.gov/taxpayer-rights/right-7.

39 IRC § 6320; IRM 5.12.2.3(2) (Oct. 14, 2013).

40 Form 433-F, *Collection Information Statement* (Rev. Jan. 2013), Catalog 62053J.

41 *See supra* note 5. The IRS has provided that "lien filing determinations are not tracked," and thus it is not studying the number of lien determinations that are made, and of that number, how many resulted in a lien actually being filed and the length of time between the determination and filing. SB/SE response to TAS information request (June 10, 2015).

42 IRS, *Careers Home*, *available at* http://www.jobs.irs.gov/student/accounting-budget-finance.html (last visited Dec. 4, 2015).

43 *See generally* Experian, *Financial Stability Risk Score*, *available at* http://www.experian.com/business-information/financial-stability-risk-score.html (last visited Dec. 4, 2015); Rosella, *Credit Risk Analysis and Modeling*, *available at* http://www.roselladb.com/credit-risk-analysis.htm (last visited Dec. 4, 2015); Rapid Insight® Analytics, *Predictive Modeling Software*, *available at* http://www.rapidinsightinc.com/products/analytics/ (last visited Dec. 4, 2015).

44 LexisNexis, *RiskView*, *available at* http://www.lexisnexis.com/risk/products/riskview-credit-risk-management.aspx (last visited Dec. 4, 2015); LexisNexis, *Accurint® for Collections: Decisioning Workflow*, *available at* http://www.lexisnexis.com/risk/products/collections/accurint-collections-decisioning.aspx (last visited Dec. 4, 2015).

The IRS should develop a risk-scoring algorithm for meaningful NFTL filing determinations in an automated setting and regularly update these models to reflect actual and up-to-date data. Currently, the IRS does not utilize any risk-scoring system or business rules in determining when to consider the filing of an NFTL.[45] While there would be an initial investment in terms of programming costs, it would likely result in more efficient lien filing and would save the IRS expenses associated with the filing of liens against nonexistent assets.[46]

Any such model, however, must be built based on the fundamental principal that the IRS is not a business. That is, unlike private creditors, the IRS is not able to pick and choose with whom it wants to "do business." And unlike a business, the IRS cannot solely focus on the debtor's current tax debt; it must continue "doing business" with the taxpayer from year to year.[47] Future compliance is a predominant concern for any IRS risk scoring. Finally, it is vital that any IRS risk-scoring models are constantly updated with actual taxpayer behavior data.

At the very least, the IRS could replace the mandatory NFTL filing on currently not collectible (CNC) taxpayers and on taxpayers with no assets with a system of automated subsequent filing determinations. These automated subsequent filing determinations would be based on periodic monitoring of whether the taxpayers have acquired assets or their financial situations have improved by developing software that can incorporate analysis of information from *Accurint*® and IRS internal databases. This type of analysis would enable the IRS to continue to protect the government's interest in any future assets without unnecessarily harming taxpayers. The IRS currently allows employees to refile a NFTL, following extension of the collection statute expiration date, using their judgment rather than an arbitrary threshold amount.[48] It could also apply this approach to the original NFTL filing.

Updating IRS e-Guides to Incorporate Basic Financial Analysis on Taxpayers Prior to NFTL

Another cost-effective way to operationalize the review of the taxpayer's financial condition, outside of the ACS lien filing, would be to update the IRS e-Guides with a series of questions determining if the taxpayer has or is likely to have assets to which a lien can actually attach.[49] The e-Guides would instruct IRS employees not to file a lien if they are unable to locate assets and to refrain from filing an NFTL within the ten-day period if no concerted effort is made to contact and speak directly with taxpayer.

45 SB/SE response to TAS information request (Nov. 6, 2015) (stating that the IRS does not currently use any "risk-scoring system or business rules in determining when to consider filing an NFTL").

46 In FY 2015, TAS had a closure rate with relief of 65 percent (603 cases) for lien release and approximately 68 percent (629 cases) for lien withdrawal. *See* TAS Business Performance Management System Report, *Closures – TAS Relief Rate by PCIC by BOD (FYs 2010-2015)*. The IRS has not done a comprehensive study on the costs associated with filing liens, for either individuals or businesses, since 1998, and that study was limited. *See* North Central DORA, South Texas DORA, *Federal Tax Lien Project, Project 13.14, Profile Report* (Dec. 1998).

47 Unlike a private creditor, the IRS cannot decide to never lend to a debtor again.

48 Upon the collection statute expiration date, the liability secured by lien becomes legally unenforceable. *See generally* IRC §§ 6325(a)(1) and 6502(a). The NFTL contains the self-releasing language that extinguishes the NFTL and underlying statutory lien. *See* Form 668(Y)(c), *Notice of Federal Tax Lien* (Rev. Feb. 2004). If the collection statute is extended or suspended on the underlying assessment, beyond the ten-year period, the NFTL must be refiled in the original jurisdiction to keep its priority back to the original filing date. *See* IRC § 6323(g).

49 E-Guides, or "electronic procedure guides," have been developed and used by the IRS for many years. They are formal guides for IRS employees that organize the different types of important processes and procedures in an easily accessible and usable way. *See* IRM 5.19.1.1(6) (Sept. 29, 2014).

The IRS should redefine the use of a Notice of Federal Tax Lien (NFTL) as a powerful collection tool based on meaningful and early contact with taxpayers, automation of financial analysis and asset verification, and the impact of NFTL filing on the taxpayer's financial viability and future compliance.

Current Data Reveals That Early Interventions Drive the Collection of Revenue

TAS Research & Analysis is currently studying how the aging of a delinquency affects dollars collected on Taxpayer Delinquent Accounts (TDAs).[50] A study, set forth in Volume 2 of this report, examines the Individual Master File (IMF) Accounts Receivable Dollar Inventory (ARDI) to determine how dollars collected fluctuate as time elapses.[51] The study determined that collection decreases as time passes, with dollar collections of over twice as much during the first year as in the second year, and over three times the collections in the third year.[52] Furthermore, the study found that even within the first year, dollars collected decreased by about one-third after every three-month period elapsed. Not only do raw dollars collected decrease, but the percent of the amount collected declines as time progresses with only about seven percent collected in the third year.[53] This study clearly demonstrates the importance of early meaningful contact. The IRS should use the data collected by TAS Research to revise its NFTL filing policies and increase its efforts to make early and frequent taxpayer contacts.

The IRS' Lien Pilot Program May Provide Significant Evidence of What IRS Actions Result in Revenue Collection

In the summer of 2014, the IRS indicated its plan to revert back to the published NFTL filing threshold of $10,000 for ACS NFTL filings.[54] After intervention by the National Taxpayer Advocate, the IRS agreed to conduct a lien filing pilot before it makes any changes in ACS filing threshold, to determine whether lowering the ACS NFTL filing threshold to $10,000 would result in enhanced protection of the government's interest and would facilitate the collection of delinquent tax liabilities. The IRS anticipates starting the Collection Lien Pilot in February 2016. The lien pilot program could become an excellent starting point in the development of a risk-scoring algorithm for meaningful NFTL filing determinations.

The National Taxpayer Advocate has suggested that the lien pilot program focus on the use of "meaningful contact" with taxpayers prior to the filing of the NFTL, rather than just studying the impact of different dollar thresholds, and examine the impact of NFTLs on future compliance. Specifically, the National

50 *IRS Collectibility Curve*, vol. 2, *infra*. In prior Annual Reports, the National Taxpayer Advocate has discussed how many TDAs in the IRS Automated Collection Branch and the Collection Field function are often delinquencies that have existed for many years. The age of IRS TDA inventory is highlighted in the following statistics: (1) 55 percent of the IRS IMF TDA inventory has been in the function assigned the delinquency for at least ten months; however, the delinquency may have been in the TDA status much longer; (2) nearly 70 percent of the IMF TDAs in IRS inventory at the end of FY 2015 are Tax Year 2011 and prior liabilities; and (3) over 22 percent of the TDAs have less than four years remaining on the collection statute, meaning that the delinquency has existed for over six years. IRS CAR, NO-5000-5 (Oct. 3, 2015).

51 *Id.*

52 *Id.* The analysis showed that dollars collected decreased by over 50 percent from the first year to the second year and collection decreased in the third year by over 30 percent from the amount collected in the second year.

53 *Id.* Although the balance of tax due continues to decrease slightly, the amount of assessed and accrued penalties and interest continue to rise.

54 *See* email from John Dalrymple, Deputy Commissioner for Services and Enforcement, to Nina Olson, National Taxpayer Advocate (Aug. 4, 2014). IRM 5.19.4.5.3.2, *Filing Criteria* (Jan. 1, 2015) provides that a NFTL filing threshold is $10,000, not $25,000.

Taxpayer Advocate has recommended, and the IRS has accepted, the following four treatment groups for the lien filing pilots, plus a control group:

- Treatment Group 1 will provide for the IRS to file NFTLs on a group of taxpayers with cases in the queue with unpaid liabilities between $10,000 and $25,000. TAS has requested that Collection ensure these taxpayers have been advised by someone in ACS that the NFTL will be filed and the pre-lien determination considerations in IRM 5.12.2.3 be used prior to the filing of a lien.
- Treatment Group 2 will receive a reminder notice that the taxes are still owed and that the taxpayers need to contact the IRS to resolve the delinquencies.
- Treatment Group 3 will receive a new notice that also provides more information about payment alternatives that may be available to the taxpayers.
- Treatment Group 4 will receive monthly reminder notices throughout the pilot period.
- The control group will follow the current process without any new treatment.

Using the treatment groups suggested by the National Taxpayer Advocate will result in measuring the impact of various types and frequency of contact with taxpayers instead of an automatic lien filing and would provide a basis for future NFTL filing criteria.

CONCLUSION

The IRS's policy of filing NFTLs based on an arbitrary dollar threshold fails to take into account the taxpayers' ability to repay the liability and future compliance. The IRS needs to utilize data analysis and the results of the lien pilot program to drive its decision on whether to continue using monetary thresholds to trigger NFTLs. The IRS should redefine the use of an NFTL as a powerful collection tool based on meaningful and early contact with taxpayers, automation of financial analysis and asset verification, and the impact of NFTL filing on the taxpayer's financial viability and future compliance. By developing modern, comprehensive, and automated financial analysis and using early intervention tools, including personal contact, the IRS will improve revenue collection and future compliance, and promote taxpayer *rights to a fair and just tax system* and *to privacy*.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Revise the IRM to require employees to make multiple attempts to initiate a meaningful personal contact with the taxpayer by phone or through mailing notices, instead of filing a NFTL after just one attempt. The IRS should adopt an early intervention policy similar to the new standard in the mortgage industry that requires two contacts, one of which is a person-to-person attempt, rather than simply mailing a letter.
2. The IRS should increase the ten-day timeframe for filing an NFTL to enable taxpayers to reach out to the IRS and provide financial information.
3. The IRS should continue to mail monthly notices to the taxpayers while the account is in the queue, ACS, or the field.
4. In collaboration with TAS, develop criteria for conducting the lien pilot as agreed upon with the National Taxpayer Advocate and refrain from decreasing the NFTL filing monetary threshold until the results of the lien pilot can be examined and discussed.
5. Amend the IRM and related e-Guides and training materials to incorporate rules for NFTL filing determinations. The rules should specify that the following items are needed prior to filing: "meaningful contact;" analysis of the taxpayer's financial situation, including a hardship determination if needed; consideration of collection alternatives; application of the balancing test, which is to balance the need for efficient collection of the tax with legitimate concerns of the taxpayer that actions be no more intrusive than necessary; and the impact on future compliance.
6. Incorporate credit scoring and automated asset verification into financial analysis for making NFTL filing determinations in ACS, with the provision to elevate close call and complex cases to a manager.
7. For accounts moving from ACS to the queue, revise the IRM to require employees to conduct a limited financial analysis based on a Form 433-F and refrain from filing an NFTL, if the employee has determined there are no assets or reasonable expectation of the taxpayer to acquire assets in the future.
8. Update the e-Guides with a series of questions determining if the taxpayer has or is likely to have assets to which an NFTL can actually attach.

MSP #12 THIRD PARTY CONTACTS: IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers' Businesses and Reputations

RESPONSIBLE OFFICIALS

Karen Schiller, Commissioner, Small Business/Self-Employed Division

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

The IRS is generally required by Internal Revenue Code (IRC) § 7602(c) to give taxpayers reasonable advanced notice before making third party contacts (TPC) and to provide them with post-contact reports both periodically and upon request. Advance notice should allow taxpayers an opportunity to volunteer information that would, in many cases, make TPCs unnecessary, avoiding potential damage to the taxpayer's business and reputation.[2] The IRS often satisfies this requirement by including Publication 1, *Your Rights as a Taxpayer* (Pub 1), or a similarly general notice with its initial contact letter. These notices are ineffective because they do not identify the information the IRS needs, inform the taxpayer the IRS *will* make a TPC in the taxpayer's particular case, or provide the taxpayer with enough advanced notice to deliver the information before the contact.[3] TAS found that in cases where the IRS made TPCs, IRS employees did not first ask taxpayers for the specific information at issue in 22.8 percent of field exam cases and 11.1 percent of field collection cases.[4]

In addition, timely post-contact reports—*i.e.*, reports provided to taxpayers informing them of which TPCs were actually made—could help taxpayers mitigate damage caused by TPCs. However, they are also ineffective because the IRS does not provide them automatically (on a periodic basis), as required by

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

2 *See, e.g.*, S. Rep. No. 105-174 at 77 (1998).

3 The IRS may proceed with a TPC just ten days after sending the TPC notice or immediately after confirming its receipt. IRM 4.11.57.4.1.1.1, *Providing Notification Using Publication 1* (Dec. 20, 2011); IRM 25.27.1.3.1, *TPC Notification Procedures* (Jan. 16, 2014).

4 Unless otherwise indicated, the data in this discussion are drawn from a stratified random sample of 423 field collection and 485 field examination cases closed in fiscal year (FY 2013) that TAS reviewed in 2015 (collectively, the "TPC Sample (2015)"). TAS reviewers could not determine if the IRS employee had first asked the taxpayer for this information in another 22.2 percent of the field exam cases and 14.0 percent of the field collection cases. TPC Sample (2015) (Q6). For a description of the sampling methodology and tables that show the extent to which the results can be projected to the population at a 95 percent level of confidence (*i.e.*, standard errors and confidence intervals), see the appendix. For example, although we estimate that Revenue Agents (RAs) did not ask the taxpayer for specific information before asking a third party 22.8 percent of the time, the size of our sample only allows us to be 95 percent confident that the true figure is between 10.8 and 41.7 percent for the population as a whole, as shown in the appendix.

The IRS is generally required by Internal Revenue Code § 7602(c) to give taxpayers reasonable advanced notice before making third party contacts… Advance notice should allow taxpayers an opportunity to volunteer information that would, in many cases, make third party contacts unnecessary, avoiding potential damage to the taxpayer's business and reputation.

IRC § 7602(c)(3), and taxpayers have no reason to request them unless they know the IRS has made a TPC. Moreover, TPC notices generally do not inform taxpayers of how to request a report.[5] Perhaps for these reasons, taxpayers did not request TPC reports in any of the 908 cases that TAS reviewed.[6] Even if a taxpayer requests one, the IRS does not have sufficient controls in place to ensure exceptions to the TPC reporting requirements are applied correctly or that the reports are complete. TAS found the IRS's TPC database, which it uses to generate these reports, was incomplete in 42.1 percent of field examination cases and in 48.5 percent of field collection cases.[7] Moreover, the IRS's case quality reviews do not effectively detect these discrepancies.

Addressing these problems would help minimize unnecessary damage to the taxpayer's reputation and business and further the taxpayer's *rights to be informed*, *to a fair and just tax system*, *to privacy*, *to confidentiality*, and *to challenge the IRS's position and be heard*.[8] Thus, the IRS's current TPC procedures dilute five of the ten taxpayer rights adopted by the IRS.

ANALYSIS OF PROBLEM

When the IRS Contacts Third Parties, It Discloses Confidential Taxpayer Information Otherwise Protected Under IRC § 6103

In general, IRC § 6103 prevents IRS employees from disclosing confidential taxpayer information. If they unnecessarily disclose taxpayer information, the taxpayer may sue the IRS for damages.[9] However, IRS employees may disclose confidential return information to the extent necessary to conduct their official duties.[10] For example, IRS employees may need to disclose to a taxpayer's customers, employees, or colleagues that he or she is under investigation by the IRS to obtain information in connection with an examination or investigation. Some customers may decide to use other suppliers in light of the implication that the IRS suspects the taxpayer is a tax cheat or has unpaid tax liabilities. TAS's study found the IRS made TPCs in 68.1 percent of its field collection cases and 8.5 percent of its field examination cases.[11] Although in some instances damage to the taxpayer's reputation and business may be unavoidable, IRC § 7602(c) provides some procedural protection.

5 IRS training materials for TPC coordinators indicate that if a taxpayer requests a list from an IRS employee, the employee should forward the request to the TPC coordinator. IRS response to TAS information request (June 29, 2015).

6 TAS Sample (2015) (Q1 and Q11). Specifically, 284 of the 908 cases TAS reviewed had a non-exempt TPC and no one requested a TPC report.

7 TAS Sample (2015) (Q9). Please see the appendix for confidence intervals.

8 IRS Pub 1, *Your Rights as a Taxpayer* (Dec. 2014).

9 IRC § 7431; IRM 11.3.1.6.4, *Civil Liberty Under IRC § 7431* (May 24, 2005).

10 *See, e.g.*, IRC § 6103(k)(6); Treas. Reg. § 301.6103(k)(6)-1; IRM 4.2.5.3, *Investigative Disclosures* (July 29, 2011).

11 TPC Sample (2015) (Q1). Please see the appendix for confidence intervals.

IRC § 7602(c) Requires the IRS to Notify Taxpayers Before Making TPCs and to Provide Them With Reports of TPCs

Enacted as part of the Internal Revenue Restructuring and Reform Act of 1998 (RRA 98), IRC § 7602(c)(1) provides that:

> An officer or employee of the Internal Revenue Service may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of such taxpayer without providing *reasonable notice in advance* to the taxpayer that contacts with persons other than the taxpayer may be made. (Emphasis added).[12]

In addition to the advance TPC notice requirement, IRC § 7602(c)(2) requires the IRS to provide the taxpayer with a record of TPCs both "periodically" and upon request. If taxpayers know which third parties the IRS contacted, they may be able to mitigate the resulting damage.

The Advanced TPC Notice Requirement Is Supposed to Give Taxpayers an Opportunity to Volunteer Information

In describing the reasons for IRC § 7602(c), the Senate Committee on Finance report explains:

> [T]axpayers should be notified before the IRS contacts third parties regarding examination or collection activities with respect to the taxpayer. Such contacts may have a chilling effect on the taxpayer's business and could damage the taxpayer's reputation in the community. Accordingly, the Committee believes that taxpayers should have the *opportunity to resolve issues and volunteer information before the IRS contacts third parties*.[13]

The preamble to the Treasury Regulations reiterates that the TPC procedures:

> *[E]nable a taxpayer to come forward with information required* by the IRS before third parties are contacted. The taxpayer's business and reputational interests therefore can be addressed without impeding the IRS' ability to make those third-party contacts that are necessary…[14]

Similarly, the current Internal Revenue Manual (IRM) acknowledges:

> [T]he intent behind this statute is to prevent the Service from disclosing to third parties that the taxpayer is the subject of a Service action without first providing reasonable notice to the

12 Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3417, 112 Stat. 685, 757 (1998). The language of IRC § 7602(c)(1) differs from the bill that passed in the Senate, which would have required the IRS to identify specific third parties. H.R. 2676, § 3417, 105th Cong. 2d Sess. (May 7, 1998) (requiring the IRS to provide the taxpayer with "reasonable notice" of "such contact"). *See also*, Third Party Contacts, NPRM, 66 Fed. Reg. 77 (Jan 2, 2001) ("As originally drafted by the Senate Finance Committee, the third-party contact rule would have prohibited most IRS contacts with third parties prior to taxpayer notification of the specific contact to be made... The requirement for specific pre-contact notice was modified by the Conference Committee to require only a generalized notice of IRS intent to contact third parties..."). If this change was based on a concern that if the taxpayer knew who the IRS would contact he or she might try to influence a third party's testimony, it would still be reasonable to expect the IRS to give the taxpayer advanced notice of the specific information it would seek from third parties if not provided by the taxpayer.

13 S. Rep. No. 105-174 at 77 (1998) (emphasis added). The Conference Report explains the IRS will provide "reasonable notice in advance to the taxpayer that the IRS may contact persons other than the taxpayer," and contemplates that it will "be provided as part of an existing IRS notice." Conf. Rept. 105-599 at 277 (1998). Thus, the IRS could include a specific TPC notice in an existing notice or letter, such as an information document request (IDR) or in correspondence confirming its receipt or non-receipt of the taxpayer's response to an IDR. The IRS could revert to its practice of using IRS Letter 3164-G (DO), *(Exam-3) Third Party Contact Letter*, for this purpose.

14 T.D. 9028, 67 Fed. Reg. 77,419, 77,420 (Dec. 18, 2002) (emphasis added). *See also* Chief Counsel Advice (CCA) 200109047 (2001) ("[T]he congressional intent behind these requirements is to provide taxpayers with the opportunity to come forward with information before third parties are contacted and the means to address any reputational concerns arising from such contacts...").

taxpayer and allowing the taxpayer an opportunity to provide the information and resolve the matter.[15]

When the TPC is to verify information already provided by the taxpayer, a reasonable notice can be less specific because the taxpayer is unlikely to avoid it by providing the verification.[16] When the TPC is to obtain information, however, reasonable advanced notice may require the IRS to identify the specific information it needs so the taxpayer can avoid the contact by either providing the information or resolving the matter. Indeed, practitioners, including representatives of the State Bar of California Tax Section, have complained that the IRS's current TPC notice process does not give taxpayers a realistic opportunity to provide the information (or to resolve the matter) and avoid TPCs.[17]

TPC Notices Can Be So Vague That the Taxpayer Has No Opportunity to Provide the Information

The IRM explains that "*[G]enerally*, contacts with third parties are made when the examiner is unable to obtain the information from the taxpayer or when it is necessary for the examiner to verify the information provided by the taxpayer."[18] However, it does not actually require the employee to first request the information from the taxpayer or even disclose what information the examiner plans to seek from third parties.

The IRS uses Pub 1 and various other documents to satisfy the TPC notice requirement.[19] They generally include language such as the following:

> Generally, the IRS will deal directly with you or your duly authorized representative. However, we sometimes talk with other persons if we need information that you have been unable to provide, or to verify information we have received. If we do contact other persons, such as a neighbor, bank, employer, or employees, we will generally need to tell them limited information, such as your name. The law prohibits us from disclosing any more information than is necessary to obtain or verify the information we are seeking. Our need to contact other persons may continue as long as there is activity in your case. If we do contact other persons, you have a right to request a list of those contacted.[20]

15 IRM 4.11.57.2(3) (Jan. 17, 2014) (emphasis added). *See also* IRM 4.10.3.2.1.4, *Third Party Interviews* (Mar. 1, 2003).

16 *See, e.g.*, Treas. Reg. § 301.6103(k)(6)-1(d) (Ex. 1) ("In contacting the suppliers, the revenue agent discloses the taxpayer's name, the dates of purchase, and the type of merchandise at issue. These disclosures are permissible under section 6103(k)(6) because, under the facts and circumstances known to the revenue agent at the time of the disclosures, the disclosures were necessary to obtain information (corroboration of invoices) not otherwise reasonably available because suppliers would be the only source available for corroboration of this information."). An IRS CCA has approved the practice of sending general notices to verify wage information—a context in which less specific notice may, in fact, be reasonable. CCA 200814008 (Apr. 4, 2008).

17 *See, e.g.*, Kevan P. McLaughlin, State Bar of California Tax Section, *Balancing Privacy and Efficiency Under Section 7602: What Is "Reasonable Notice" and Changing IRS Procedures Related to Third Party Contacts* (2012); Systemic Advocacy Management System (SAMS), Submission 26446 (Feb. 5, 2013).

18 IRM 4.11.57.4(1) (Dec. 20, 2011) (emphasis added). *See also* IRM 4.32.2.7.3.2(3) (2012) ("Examiners should attempt to obtain the information in writing from the promoter before contacting any third parties."); IRM 25.27.1.3, *Notification Requirements* (Jan. 16, 2014) ("It is the Service's practice to obtain information relating to a liability or collectability determination directly from the taxpayer whenever possible."); IRM 4.10.3.2.1.4(2) (Mar. 1, 2003) ("Information will be collected, to the greatest extent practicable, directly from the taxpayer to whom it relates... Information about taxpayers collected from third parties will be verified to the extent practicable with the taxpayer before action is taken.").

19 *See, e.g.*, IRM 25.27.1.3.1(1) (Jan. 16, 2014). For example, Letters 3164, 3230, 3232, 3234, 3236, 3238, 3345, 3404, 4464, and Notice 1219 all contain TPC language.

20 IRS Pub 1, *Your Rights as a Taxpayer*.

This language is vague. It does not even reveal whether the IRS plans to make a TPC in the taxpayer's particular case. Moreover, the IRS generally delivers the TPC notice with the initial contact letter—potentially before the IRS has requested any information from the taxpayer.[21] Finally, this language fails to disclose that the IRS is required to provide the taxpayer with periodic reports of the TPCs it makes. Instead, the IRS ignores the law and places the burden on the taxpayer to request such reports (as discussed below).

The IRS No Longer Provides a Second, More Specific TPC Notice

The IRS used to provide more specific TPC notices. In testimony before the Senate Finance Committee on February 2, 2000, Commissioner Rossotti explained that:

> When we first implemented this provision [TPC notices], we attempted a "one size fits all" approach by sending a broadly written notice to virtually every taxpayer in our administrative stream… The reaction was immediate, strong, and negative. We were told that the generic nature of the notice did not provide its recipients with any indication of why we would contact third parties to talk about their tax situations or what information we would seek.[22]

Accordingly, under IRS procedures in effect between 2000 and 2005, the IRS issued a general TPC notice followed by a more detailed one.[23] The second notice was more likely to alert the taxpayer that the IRS was actually planning to make TPCs unless it received additional information from the taxpayer. These notices included a specific IRS employee's contact information and sometimes even identified the specific information that the IRS needed or needed to verify and why. For example, Letter 3164-G (DO), *(Exam-3) Third Party Contact Letter*, specifies the information the IRS needs and the date it was requested from the taxpayer. Similarly, Letter 3164-F (DO), *(Exam-2) Third Party Contact Letter*, identifies the specific information the IRS needs to verify.[24]

21 IRM 4.10.2.7.4.2, *Contacting the Taxpayer by Letter* (Apr. 2, 2010) (requiring Pub 1 to be included with the initial contact letter).

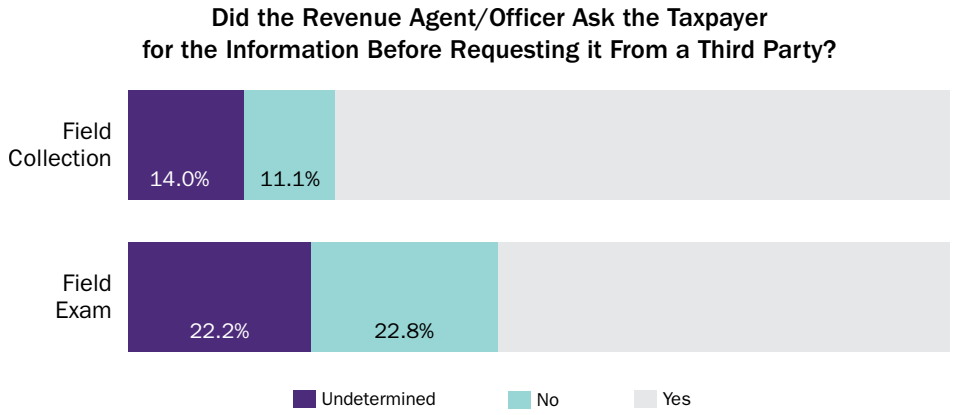
22 *Hearing Before the S. Finance Comm. on Status of IRS Reform*, 106th Cong. 2nd Sess. 46 (2000) (testimony of IRS Commissioner Rossotti).

23 The IRS previously sent Notice 1219, which included language similar to Pub 1, and then followed up with one of the more specific versions of Letter 3164. *See, e.g.*, IRM 4.10.1.6.12.2.1(5), *Notification Procedures* (May 14, 1999) ("CAUTION: Providing the taxpayer with Notice 1219 alone does not constitute adequate notification of third party contacts. It must be attached to another letter that contains the required information found in Letter 3164: date, taxpayer's name, address and TIN, employee's name, telephone number, identification (badge) number and officer hours, tax form, type of tax and tax period(s)."). The 1999 version of IRM 4.10.1.6.12.2.1, which described this two-notice process, remains a part of the current IRM, but it conflicts with more current guidance, which states that a second more-specific TPC notice is not required. *See, e.g.*, IRM 4.11.57.4.1.1, *Procedures for Providing Advance General Notice That Third Parties May Be Contacted* (Dec. 20, 2011); IRM 25.27.1.3.1, *TPC Notification Procedures* (Jan. 1, 2014); IRM 4.8.8.18.1(2) (July 1, 2011). *Accord*, T.D. 9028, 67 Fed. Reg. 77,419, 77,420 (Dec. 18, 2002) (describing "general pre-contact notice followed by post-contact identification…").

24 Letter 3404C, *AUR Third Party Contact*, even identifies the third parties to be contacted. By contrast, Letter 3164-N, *Third Party Contact to Preparers*, and Letter 3164-P, *Third Party Notification for IRC 6700/6701 Investigations*, provide more generic statements such as the one quoted above.

However, the IRS has reverted to its prior practice of providing a single generic notice. According to the current IRM, Letters 3164-G and 3164-F "are no longer applicable because notice is given via Pub 1."[25] This guidance may suggest that those who take the trouble to identify and request the specific information from the taxpayer before making a TPC to obtain it are going beyond what is required. TAS found that in 22.8 percent of field exam cases and 11.1 percent of field collection cases IRS employees did not ask taxpayers for such specific information before making TPCs to obtain it.

FIGURE 1.12.1[26]



The IRS Does Not Provide TPC Notice Far Enough in Advance to Allow the Taxpayer to Provide the Information

Even if the IRS were to give taxpayers meaningful advance TPC notice (*e.g.*, by using Letter 3164-G or something similar), IRS employees can make TPCs just ten business days after sending it or immediately after they deliver it by hand or otherwise confirm its receipt.[27] TAS's review found that IRS employees did not even wait this long in 5.3 percent of the field collection cases and in 2.3 percent of the field exam cases.[28] Similarly, an IRS review of 39 field examination cases closed without agreement in

25 IRM 4.11.57.4.1.1, *Procedures for Providing Advance General Notice That Third Parties May Be Contacted* (Dec. 20, 2011). *See also*, IRM 25.27.1.3.1, *TPC Notification Procedures* (Jan. 1, 2014) ("If the appropriate Letter 3164 **or** Publication 1 (Pub 1), *Your Rights as a Taxpayer*, version dated 09/2012 has been sent and the requisite waiting period has lapsed, the employee may seek additional information." (Emphasis added)); IRM 4.8.8.18.1(2) (July 1, 2011) (explaining, "[P]reviously, the advance general notice of potential third-party contact was usually accomplished by issuance of one of several versions of Letter 3164, *Third Party Notice*. In May 2005, Pub 1, *Your Rights as a Taxpayer*, was revised to include the advance general notice of potential third-party contact that is required by IRC § 7602. This revision is consistent with the amendment of IRC § 7602, as the Conference Committee Report (H.R. Conf. Rep. 105-599) for that section specifies, '[I]t is intended that in general this notice will be provided as part of an existing IRS notice provided to taxpayers.'"). *Accord* IRM 5.1.1.10.1, *TPC Advance Notification Procedures* (May 15, 2014) ("Letter(s) 3164 B or C (DO) are not required prior to making a third party contact as long as the revenue officer can verify through ICS that the taxpayer has received a Pub 1 (Rev. 05/2005) and/or Notice CP-504 or Notice CP-518.").

26 TPC Sample (2015) (Q6). Although we estimate that RAs and ROs did not ask the taxpayer for specific information before asking a third party 22.8 and 11.1 percent of the time (respectively), the size of our sample only allows us to be 95 percent confident that the true figure is within the range of 10.8 to 41.7 percent for RAs and 7.8 to 15.6 percent for ROs, as shown in the appendix.

27 IRM 4.11.57.4.1.1.1, *Providing Notification Using Publication 1* (Dec. 20, 2011); IRM 25.27.1.3.1, *TPC Notification Procedures* (Jan. 16, 2014).

28 TPC Sample (2015) (Q5).

fiscal year (FY) 2014 found that in 13 percent, the examiner did not provide the taxpayer with appropriate advanced notice of the TPC.[29]

In addition, practitioners have complained that a TPC notice delivered immediately before the contact leaves the taxpayer with no opportunity to provide information to the IRS.[30] Even ten days is not likely to give the taxpayer enough time to obtain information (potentially from third parties) and deliver it to the IRS, assuming the notice is specific enough that the taxpayer knows what information the IRS needs.

The IRS Provides a Specific and Timely Notice When It Issues a Third-Party Summons

In contrast to other TPCs, when the IRS issues a third-party summons, it is generally required to give the taxpayer a copy of the summons that identifies a specific third party, the information being summoned, and a discussion of the taxpayer's right to bring an action to quash the summons.[31] Such specific information is necessary to empower the taxpayer to provide the information or initiate proceedings to quash the summons before it is executed.

The IRS generally must provide the taxpayer with a copy of the summons within three days of issuing it and no later than 23 days before the third party is required to respond.[32] A taxpayer would probably need at least as much time to gather information (potentially from a third party) and transmit it to the IRS, as contemplated by the TPC notice requirement. Thus, unlike the TPC notice, the third-party summons notice identifies the information the IRS needs, who the IRS believes may have it, and is delivered to the taxpayer far enough in advance that the taxpayer has an opportunity to obtain and deliver the information to the IRS (making summons enforcement unnecessary) or take action to quash it.

> The IRS could potentially reduce internal paperwork while increasing the transparency of its third party contacts by providing the taxpayer with a copy of any written request for information from (or an interview with) a third party, instead of sending Form 12175 to the third party contact coordinator.

Increased Transparency Could Reduce the Resources Needed to Track and Report TPCs

To comply with the requirement to provide taxpayers with a record of TPCs, IRS employees record them on Form 12175 (in addition to their normal case activity record) and send it to a TPC coordinator, so that the coordinator can track and report TPCs to the taxpayer upon request.[33] This paperwork is not required with respect to TPCs already provided to the taxpayer.[34] For example, if the IRS gives the taxpayer a copy of a third-party summons, the taxpayer already has a record of the TPC. For this reason, IRS employees do not need to track third-party summons, provide them to the TPC coordinator, or include them in TPC reports provided to the taxpayer.[35] Thus, the IRS could potentially reduce internal paper-

29 SB/SE, *Third Party Contact, Program Review Report, Field Exam Special Processes* 4-5 (Oct. 30, 2015). This was a review of cases involving non-filers, return preparers, or information reports that were closed unagreed in FY 2014 with TPCs that were documented by examiners on contact sheets. *Id.* Unlike the cases TAS reviewed, SB/SE's cases were not selected using a random sampling methodology. *Id.* Examiners are not required to ask the taxpayer for the information before asking a third party, and SB/SE's review did not consider whether examiners had done so.

30 *See, e.g.*, Kevan P. McLaughlin, State Bar of California Tax Section, *Balancing Privacy and Efficiency Under Section 7602: What Is "Reasonable Notice" and Changing IRS Procedures Related to Third Party Contacts* (2012).

31 IRC § 7609(a).

32 *Id.*

33 IRM 25.27.1.4, *Recording and Reporting TPCs* (Jan. 16, 2014).

34 Treas. Reg. § 301.7602–2(e)(3).

35 Treas. Reg. § 301.7602-2(e)(4) (Example 4); IRM 4.11.57.5.1, *Documentation of Contact Not Required* (Jan. 17, 2014).

work while increasing the transparency of its TPCs by providing the taxpayer with a copy of any written request for information from (or an interview with) a third party, instead of sending Form 12175 to the TPC coordinator.

The IRS Is Violating the Law by Failing to Provide Taxpayers With Periodic Reports

The IRS only provides post-contact reports to taxpayers upon request. It does not provide them to taxpayers "periodically," as required by IRC § 7602(c)(3).[36] The IRS's failure to provide "periodic" TPC reports violates IRC § 7602(c)(3). Although the IRS proposed regulations that would have implemented periodic reporting, the final regulations omit these provisions, explaining that the IRS and Treasury "determined that the issuance of periodic reports may result in harm to third parties and, accordingly, has determined that periodic reports should not be issued."[37] It does not indicate hat TPC reports are optional under the law

The IRS may take the position it is not violating the law because the regulation implicitly presents a re-interpretation of the statutory requirement, but the language in the preamble seems more properly described as an explanation for why the IRS has decided to violate the law. A regulatory preamble does not carry the same force as a regulation. Moreover, even a regulation that had been subject to notice and comment (and the preamble to the final regulations was not) could not overturn such a clear statutory mandate under *Chevron* step-one.[38]

In addition, the reason given by the preamble (*i.e.*, "harm to third parties") does not make sense. The regulations already protect third parties by providing that the IRS will withhold the identity of those who may be subject to reprisal.[39] It would be illogical to withhold TPC reports from taxpayers to protect third parties whose identities would not be disclosed on those reports.[40] Further, if the government were concerned about harm to the third parties, it is unclear why it would nonetheless provide *ad hoc* reports upon request that would reveal their identities. Although the IRS may now speculate that it was concerned that third parties who do not express any fear of reprisal could, in fact, be harmed if periodic reports were delivered, it did not express this concern in the preamble to the regulations (and there does not appear to be any evidence to support it) or present any other evidence for its disregard of a statutory taxpayer protection.

36 IRM 4.10.1.6.12.3, *Providing Taxpayers With Notice of Third Party Contacts* (May 14, 1999) states that the IRS will provide the taxpayer with a list of TPCs once per year, but it became obsolete once the IRS issued Treasury Regulations in 2002. T.D. 9028, 67 Fed. Reg. 77,419, 77,420 (Dec. 18, 2002). *See also* IRM 4.11.57.4.6, *Provide a List to the Taxpayer* (Dec. 20, 2011). A seemingly obsolete IRS training document directs employees to inform third parties their name will appear on a list of contacts that will be sent to the taxpayer "once a year" unless the third party indicates that including his or her name may result in reprisal. IRS response to TAS information request (June 29, 2015). TAS has also confirmed with TPC coordinators that they do not send periodic reports.

37 *Compare Third Party Contacts*, NPRM, 66 Fed. Reg. 77-84 (Jan 2, 2001) (proposed regulations), *with* T.D. 9028, 67 Fed. Reg. 77,419, 77,420-25 (Dec. 18, 2002) (final regulations). Contemporaneous news reports of an employee in Wakefield, Massachusetts who killed seven co-workers after learning about a pending wage levy could have colored the IRS's thinking about the periodic reporting requirement. See Carey Goldberg, *7 Die in Rampage at Company; Co-Worker of Victims Arrested*, N.Y. Times (Dec. 27, 2000), *available at* http://www.nytimes.com/2000/12/27/us/7-die-in-rampage-at-company-co-worker-of-victims-arrested.html. However, this particular shooting occurred before the IRS issued the proposed regulations that would have provided periodic reports. Moreover, the IRS could not have concealed a wage levy from the shooter in any event.

38 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). A court only gives deference to agency regulations under *Chevron* step-two, if it first determines the statute is ambiguous under *Chevron* step-one. *Id*.

39 Treas. Reg. § 301.7602-2(f)(3).

40 However, SB/SE found that field examiners did not document consideration of reprisal in any of the TPC cases it reviewed. SB/SE, *Third Party Contact, Program Review Report, Field Exam Special Processes* 1 (Oct. 30, 2015). SB/SE suggested this may result, in part, because 70 percent of the TPCs in the cases it reviewed were conducted using Letter 1995, which was last revised in 1985, before IRC § 7602(c) was enacted, and does not include any language concerning reprisal. *Id*. at 6.

Further, there is a difference between requiring the IRS to provide periodic TPC reports and merely making them available upon request. Many taxpayers who would want to know who the IRS contacted will not know that any contacts were made. Providing TPC reports only upon request also burdens taxpayers to take action where otherwise they would be informed of TPCs automatically. Inasmuch as Congress enacted the periodic reporting requirement to empower taxpayers to repair their reputations, and to ensure that taxpayers know what the IRS is doing, the IRS's nullification of the periodic reporting requirement frustrates that purpose.

Finally, to the extent the IRS gives the impression it is ignoring the law, it may encourage taxpayers to ignore tax laws. It will also seem hypocritical when the IRS enforces them.

The IRS Should Do More to Empower Taxpayers to Receive TPC Reports

Because the IRS does not send periodic TPC reports, it is even more important for it to empower taxpayers to request TPC reports so that they can mitigate damage from the TPCs. However, the IRS no longer informs taxpayers when it makes a TPC, nor does it explain how to request a list of TPCs.[41] Perhaps for these reasons, taxpayers did not request TPC reports in any of the 908 cases that TAS reviewed.[42] Thus, the IRS should do more to alert taxpayers when TPCs have been made and explain how they can request TPC reports.

There Are No Effective Remedies for Taxpayers Harmed by the IRS's Violation of the TPC Notice and Reporting Requirements

If IRS employees violate the TPC notice requirements or erroneously omit TPCs from the list provided to the taxpayer, taxpayers have little recourse. In theory, a taxpayer may seek to quash a third-party summons on the basis that the IRS failed to follow IRC § 7602(c), but those who receive Pub 1 before the IRS issues a summons are unlikely to prevail.[43] Moreover, if a third party provides information voluntarily, the IRS would have no reason to issue a summons. In limited circumstances, a taxpayer may also seek to recover actual civil damages resulting from an IRS employee's failure to follow procedures in connection with a third party contact.[44] However, Chief Counsel Advice (CCA) suggests the IRS has never been sued on this basis because it is difficult for taxpayers to show actual damages.[45] Without judicial remedies for the violations of the important taxpayer protections afforded by IRC § 7602(c), taxpayers depend on the IRS's internal controls to ensure employees comply with the law.

41 For example, neither Pub 1 nor Letter 3164-N, *Third Party Contact to Preparers*, explain who a taxpayer should call or write to in making the request and whether any particular form is required.

42 TPC Sample (2015) (Q1 and Q11). Specifically, 284 of the 908 cases TAS reviewed had a non-exempt TPC and no one requested a TPC report.

43 *See, e.g., U.S. v. Jillson*, 84 A.F.T.R.2d 99–7115 (S.D.Fla.,1999) (unreported) (quashing summons issued before TPC notice); *Gangi v. U.S.*, 107 A.F.T.R.2d 2011-1542 (D.N.J. 2011) (unreported), *aff'd* 453 Fed. App'x. 255 (3rd Cir. 2011) (same). *But see, e.g., Thompson v. U.S.*, 102 A.F.T.R.2d 2008-6130 (S.D. Tex. 2008) (unreported) (refusing to quash a summons issued after TPC notice included in Pub 1); *Gangi v. U.S.*, 2 F.Supp.3d 12 (D. Mass. 2014) (same).

44 *See, e.g.*, IRC §§ 7433 (damages for unauthorized collection actions by the IRS); 7433A (damages for unauthorized collection actions by contractors). Taxpayers can also sue for damages if an IRS employee unnecessarily discloses taxpayer information protected by IRC § 6103. IRC § 7431; IRM 11.3.1.6.4, *Civil Liberty Under IRC § 7431* (May 24, 2005).

45 *See, e.g.*, CCA 2013071915074952 (2013) ("There is no independent cause of action for violating third-party contact rules. As far as we are aware, the IRS has never been sued for violating the third-party contact rules, though taxpayers have occasionally attempted to assert these types of violations as a defense to summons enforcement or collection actions. In theory, a violation of section 7602(c) might support a suit by a taxpayer against the IRS under section 7433. However, section 7433 only allows a taxpayer to recover actual, direct economic damages and court costs. It is unclear what actual, direct economic damage a taxpayer would suffer as a result of a violation of section 7602(c).").

Without Sufficient Oversight, Employees Could Fail to Record TPCs on the Database or Apply the "Reprisal" Exception Excessively

Low-Graded IRS Employees Are Authorized to Make Reprisal Determinations Without Oversight

There are several exceptions to the TPC notice and reporting requirements, including situations where an IRS employee has "good cause to believe" that disclosure of the contact "may cause any person to harm any other person in any way" (*i.e.*, a risk of reprisal).[46] The IRS has delegated the authority to make such determinations to low-graded (GS-4 and GS-5) employees.[47] Employees are not required to investigate a third party's reprisal claim, but they should be required to document some valid basis for the determination (*e.g.*, that a third party expressed a fear of reprisal rather than simply a preference not to be named).[48] One commentator argued that because "good cause" is a low standard that is determined solely by the IRS employee making the contact, it would make them a "nullity."[49] The commentator recommended that reprisal determinations be documented and subject to supervisory review, but this comment was rejected without explanation. Nonetheless, it would make sense for a supervisor to ensure the employee considered reprisal and included some valid reason for any reprisal determination in the file.

Post-Examination Quality Reviews May Not Reliably Identify Third Party Contact Problems

After the IRS closes an examination, its technical services function may review whether the examiner documented any applicable exceptions to the reporting requirements.[50] However, the reviewer would not necessarily look for anything more than something like: "No third party reporting is required because there is a risk of reprisal" (or some other conclusory justification).[51] Thus, an employee is not necessarily required to document the "good cause" underlying his or her reprisal determination. Although TAS's sample included only seven reprisal determinations (six in collection and one in exam), employees did not document the reasons for those determinations in any the cases TAS reviewed.[52]

In theory, Field Exam National Quality Review System Attribute 617, which covers whether the taxpayer was "advised of all rights and kept informed throughout the examination process," could cover failures to provide advanced notice of third party contacts.[53] Because the IRS does not associate a "reason code" with third party contact rule violations, however, the only way to determine if a failure for "other" reasons

46 Treas. Reg. § 301.7602-2(f)(3); IRM 4.11.57.4.2.3, *Reprisal* (Jan. 17, 2014); IRM 25.27.1.3, *Notification Requirements* (Jan. 16, 2014).

47 Authority to make the reprisal determination is delegated to Revenue Agents, Examination Aides, Tax Auditors, Revenue Officers, Tax Compliance Officers, Bankruptcy Specialists, GS-4 Tax Examiners, GS-5 Revenue Officer Aides, GS-5 Correspondence Examination Technicians, and GS-5 ACS Collection Representatives, among others. *See* IRM 1.2.52.13, *Delegation Order 25-12 (Rev. 1)* (May 22, 2009).

48 Treas. Reg. § 301.7602-2(f)(3)(i) ("A statement by the person contacted that harm may occur against any person is sufficient to constitute good cause for the IRS employee to believe that reprisal may occur. The IRS employee is not required to further question the contacted person about reprisal or otherwise make further inquiries regarding the statement"); Treas. Reg. § 301.7602-2(f)(3)(ii) (Ex. 1) (explaining a "contact is not excepted from the statute merely because the... [third party] asks that his name be left off the list of contacts.").

49 T.D. 9028, 67 Fed. Reg. 77,419, 77,420 (Dec. 18, 2002).

50 IRM 4.8.8.18.3(3) (Dec. 6, 2013) ("The reviewer will review Form 9984 to ensure that the examiner documented whether the exceptions to the notice requirements of IRC 7602(c) applied...").

51 Although not required by the current IRM, seemingly-obsolete training for TPC coordinators states that "[E]mployees *should* document the case file with the facts surrounding the decision and complete a Form 12175 as outlined above to document the reprisal determination." IRS response to TAS information request (June 29, 2015) (emphasis added).

52 TPC Sample (2015) (Q8).

53 SB/SE, *Field Compliance Embedded Quality, Field Examination Attribute Job Aid*, Doc. 13128 (Dec. 2014); IRM Exhibit 4.8.3-1, *Quality Attributes* (Mar. 21, 2013).

is due to third party contact problems is to review the narrative provided by the reviewer.[54] When the IRS searched the narratives for FYs 2012-2014 cases closed by Small Business/Self-Employed (SB/SE) Division Revenue Agents (RAs) and Tax Compliance Officers (TCOs) that failed Attribute 617 for "other" reasons, it found no mention of third party contact violations. This may suggest that reviewers were not looking for such violations, perhaps because there was no reason code for them or because they were difficult to detect.[55]

One reason TPC reporting violations are difficult to detect is because employees are not always required to include the TPC's identity on Form 12175 or the TPC database. For example, the contact's name is omitted from the form when there is a risk of reprisal. To identify an incorrectly excluded contact, a reviewer would have to compare the TPCs in the paper case file (if any) with the number and date of those reflected in the TPC database. TAS's review found that in 42.1 percent of the field exam cases non-exempt TPCs were missing from the TPC database.[56] Similarly, in a limited one-time review of certain field exam cases with TPCs, SB/SE found that in 36 percent, examiners did not properly document TPCs reflected in case histories on Form 12175.[57] Even where Form 12175 was used, only about 71 percent of the case histories included information about the contact.[58] Thus, it appears that the IRS's regular field exam quality reviews do not effectively capture such omissions.

Post-Collection Quality Reviews May Not Reliably Identify Third Party Contact Problems

The IRS also reviews closed collection cases to identify errors on specific quality attributes. Field collection quality Attribute 607 addresses whether "the Third Party Contact Database was [not] updated when identifiable third party contact was made."[59] The IRS's Integrated Collection System (ICS) functions as a Revenue Officer's (RO) case activity record. It automatically updates the TPC database whenever a RO records an activity that involves a TPC (*e.g.*, a levy). The RO records such activities by selecting them from a "pick list." Except for cases involving Trust Fund Recovery Penalties or manual levies where the RO might instead use Form 12175, it is difficult for an RO to avoid updating the TPC database if he or she selects the appropriate pick list item.[60] Nonetheless, in nearly half (48.5 percent) of field collection cases TAS found non-exempt TPCs that were omitted from the TPC database.[61]

54 SB/SE RAs scored between 82.4 and 90.9 percent on attribute 617 over the last three years (FY 2012-2014) and SB/SE TCOs scored between 94.0 and 95.3 over the same period. IRS response to TAS information request (May 18, 2015).

55 IRS response to TAS information request (May 18, 2015). When it conducted the same review for RAs in Specialty Excise or Employment Tax, SB/SE found a few references to noncompliance with the third party contact rules. *Id*. These comments were associated with attribute 409 (appropriate procedural actions) or 609 (confidentiality), however. *Id*.

56 TPC Sample (2015) (Q9). As noted below, TAS's review also identified nonexempt TPCs that were omitted from the TPC database in 48.5 percent of the field collection cases. *Id*. These omissions often (94.5 percent in exam cases and 34.5 percent in collection cases) occurred because the RA or RO did not send Form 12175 to the TPC coordinator, or in 57.2 percent of the collection cases, because the RO did not use the proper pick list item, as discussed below. *Id*. (Q10).

57 SB/SE, *Third Party Contact, Program Review Report, Field Exam Special Processes* 5-6 (Oct. 30, 2015).

58 *Id.*

59 SB/SE, *Field Compliance Embedded Quality Field Collection (FC) Job Aid*, Doc. 12359, 27-28 (Dec. 2014) (Reason Code 5).

60 IRM 5.1.1.10.2, *TPC Reporting and Recording Procedures* (May 15, 2015) ("ICS systemically generates TPC data and updates the TPC Command Code database... Usually, the Form 12175 will not need to be completed by Collection personnel. Exceptions, however, are manually prepared levies, Trust Fund Recovery Penalty Investigations, Jeopardy and Other Investigations, templates or documents created in Word."); ICS Users Guide at 10-31 and 29-11 to 29-15 (Jan. 2015).

61 TAS Sample (2015) (Q9). TAS reviewers concluded that 34.5 percent of these omissions resulted because the RO did not send Form 12175 to the TPC coordinator and 57.2 percent occurred because the RO did not select the proper entry from the ICS pick list. *Id*. (Q10).

Further, ROs failed to document a reason for their reprisal determinations in each of the six cases in TAS's sample where ROs made them.[62] Thus, Attribute 607 may not reliably identify all violations of the third party contact rules.

The IRS Could Do More to Ensure Post-Contact Reports Are Accurate

To improve the accuracy of post-contact reports, the IRS could review the work completed by TPC coordinators.[63] Employees who send Form 12175 to the TPC coordinator could confirm its receipt, as they do when they transmit returns.[64] The IRS could also reconcile TPCs reflected in case histories with those found in the TPC database to ensure employees record TPCs on Form 12175 (when necessary) and the TPC coordinator enters them into the database.[65] As noted above, such controls will be less burdensome if the IRS increases the transparency of TPCs, for example, by sending the taxpayer a copy of any written request for information from a third party within three days of the contact, as it does in connection with third-party summonses.[66]

CONCLUSION

Improving the TPC notice and reporting procedures would be consistent with the recently-adopted Taxpayer Bill of Rights. The taxpayer's *right to be informed*, as described in Pub 1, includes the right to "be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes." Under current procedures, however, the IRS issues vague or non-specific TPC notices and potentially incomplete TPC reports that do not allow taxpayers to be informed about what information the IRS has decided it needs from third parties, whether it has actually contacted third parties, and how to obtain a list of the TPCs.

Pub 1 also explains that the taxpayer's *right to privacy* includes the right to "expect that any IRS inquiry… will comply with the law and be no more intrusive than necessary." With the possible exception of certain

62 TAS Sample (2015) (Q7 and Q8).

63 Except for personal performance appraisals, the IRS does not regularly evaluate the quality of the work completed by TPC coordinators, nor does it regularly reconcile TPCs reflected in case histories with those found in the TPC database to ensure employees record TPCs on Form 12175 (when necessary) and the TPC coordinator enters them into the database. IRS response to TAS fact check (Nov. 10, 2015).

64 According to a limited review of certain field exam cases by SB/SE, in 36 percent the examiner did not properly record the contact on Forms 12175. SB/SE, *Third Party Contact, Program Review Report, Field Exam Special Processes* 5 (Oct. 30, 2015). Even when examiners filled out Form 12175 it only reached the TPC 92 percent of the time. *Id*. at 6. When an IRS employee ships one or more returns, he or she must include Form 3210, *Document Transmittal*, to provide a method for tracking their receipt. Form 3210 can be manually prepared or computer generated by ERCS. It must identify the taxpayer's name, tax period(s), to whom it is being sent, the originator, and the date sent. The sender must sign and date the form and keep a portion. Upon receipt of the return(s), the recipient must verify the contents, sign Form 3210, and return the acknowledgment portion to the sender. *See, e.g.*, IRM 1.4.40.4.2.6, *Shipment of Returns* (May 19, 2010).

65 IRS field exam embedded quality Attribute 617 addresses third party contacts. *See* IRM 4.11.57.1, *References – Third Party Contacts* (Jan. 17, 2014). However, it only seems to address whether the IRS informed the taxpayer that a TPC could occur (*e.g.*, by sending Pub 1). *See* IRM Exhibit 4.8.3-1, *Quality Attributes* (Mar. 21, 2013) ("This Attribute [617] measures if the taxpayer/representative was advised of all rights and kept informed throughout the examination process."). By contrast, SB/SE's Field Collection quality measures are more specific, addressing whether "[T]he Third Party Contact Database was not updated when an identifiable third party contact was made." SB/SE, *Field Compliance Embedded Quality Field Collection (FC) Job Aid*, Doc. 12359, 27-28 (Dec. 2014) (Reason Code 5). As noted above, however, automated systems often update the TPC database for collection employees. *See, e.g.*, IRM 5.1.1.10, *Third Party Contacts* (May 15, 2014); ICS Users Guide at 10-31 and 29-11 (Jan. 2015). The IRS does not measure whether employees ask taxpayers for specific information before making TPCs to obtain it.

66 Under IRC § 7609(a), the IRS must provide the taxpayer a copy of a third-party summons within three days of serving it on the third party and no later than the 23rd day before the third party has to produce the records or testimony. The IRS could use the three day period to determine if the TPC is exempt from the TPC notice and reporting requirements (*e.g.*, because of the potential for reprisal).

cases where the IRS needs to verify information already provided by the taxpayer, TPCs will be more intrusive than necessary unless the IRS gives the taxpayer a reasonable opportunity to provide information needed to avoid the TPC. No such reasonable opportunity exists if the taxpayer does not know the specific information the IRS needs or is not given enough time to respond.

The IRS's current third party contact procedures dilute five of the ten taxpayer rights adopted by the IRS.

Moreover, Pub 1 states that taxpayers have the *right to challenge the IRS's position and be heard*, which includes the "… right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions, to expect that the IRS will consider their timely objections and documentation promptly and fairly, and to receive a response if the IRS does not agree with their position." If the IRS does not inform the taxpayer about what specific information it plans to seek from third parties (or does not provide the taxpayer enough time to respond), then the taxpayer does not have a realistic opportunity to raise objections or provide additional documentation for the IRS to consider.

In furtherance of the *rights to be informed*, *to privacy*, and *to challenge the IRS's position and be heard*, the IRS should include with the TPC notice a request for information, which would make the TPC unnecessary, except where the IRS employee documents why a TPC notice exception applies. Before making a TPC, the IRS should send the taxpayer a TPC notice that asks for the specific information it is planning to request from a third party (except in cases where such a request would be unproductive, such as where it needs to verify information already provided). It should not make the TPC if the taxpayer responds by providing (or agreeing to provide) the information within a reasonable period. It should also send taxpayers periodic reports of TPCs, as required by IRC § 7602(c)(3).

These recommendations are also consistent with the taxpayer's *right to a fair and just tax system*. Empowering only some taxpayers but not others to exercise their rights to avoid TPCs (*e.g.*, by letting them know what information they could provide to avoid it) or learn about TPCs (*e.g.*, by describing how to request TPC reports) is inconsistent with the *right to a fair and just tax system*.

In addition, Pub 1 states that the taxpayer's *right to confidentiality* includes the right to "expect that any information they provide to the IRS will not be disclosed unless authorized... [and] to expect that appropriate action will be taken against employees... who wrongfully use or disclose return information." IRS employees are only "authorized" to make TPCs, which necessarily disclose confidential taxpayer information, if they comply with the TPC notice requirements. Yet, the IRS's internal controls do not ensure it knows when employees wrongfully disclose confidential information by making TPCs that do not comply with IRC § 7602(c). Thus, the IRS's current TPC procedures dilute five of the ten taxpayer rights adopted by the IRS.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Include with a TPC notice a specific request for information that would make the TPC unnecessary, except where the IRS employee documents that a TPC notice exception applies or that requesting the information from the taxpayer would be pointless (*e.g.*, because the IRS needs to verify information already provided).[67]
2. Allow the taxpayer at least ten days to provide the information being requested before making the third party contact to obtain it.[68]
3. Send the taxpayer a copy of any written request for information from a third party within three days of any non-exempt contact (except in collection cases), as the IRS does in connection with third-party summonses.[69]
4. Provide taxpayers with periodic TPC reports of TPCs not already provided (if any), as required by IRC § 7602(c)(3).[70]
5. Modify TPC notices to inform taxpayers of their right to receive post-TPC reports periodically and to explain how to request these reports.
6. Require employees to document the basis (*i.e.*, "good cause") for the reprisal and other exceptions to TPC reporting, require supervisory review of such documentation, and train employees on how to apply them.[71]
7. Improve measures to ensure management knows when and how employees are not following TPC procedures.[72] For example, the IRS's reviews should regularly compare TPCs reflected in the administrative file to those reported to TPC coordinators (*e.g.*, through supervisory, quality, or operational reviews) and require TPC coordinators to acknowledge receipt of these forms. To facilitate these reviews, the IRS may need to require employees to include information on the Form 12175 that it can tie back to the TPCs referenced in the administrative file in cases where a reporting exception applies (*e.g.*, reprisal).

67 The IRS could return to its prior practice of using Letter 3164-G (DO), (Exam-3) Third Party Contact Letter, and Letter 3164-F (DO), *(Exam-2) Third Party Contact Letter*, for this purpose.

68 In the context of an examination, a taxpayer is notified when the Service issues a third-party summons, and the Service is required to wait 23 days before taking the summoned records. IRC § 7609(a). A collection summons is excepted from those procedures by IRC § 7609(c) to prevent the taxpayer from relocating and hiding assets. H.R. REP. 94-658, 94th Cong., 2nd Sess. at 3206 (1976). In collection cases, however, the IRS still allows at least ten days for the production of summoned records. *See* IRM 25.5.3.4, *Time and Place of Examination Set by Summons* (July 11, 2013).

69 In collection cases, the taxpayer could still mitigate the damage resulting from the contacts by requesting a TPC list.

70 Such periodic TPC reports would be unnecessary if the IRS had already reported all TPCs to the taxpayer, as recommended.

71 The supervisory review and training would ensure employees are familiar with the TPC rules, including IRM 25.27.1.3.3(4), which requires them to describe good cause in the case history by documenting "the facts surrounding the reason for the reprisal determination" and that they do not apply the exception based solely on an unexplained request by a third party for his or her name to be left off of the list of contacts provided to the taxpayer. *See, e.g.*, Treas. Reg. § 301.7602-2(f)(3)(ii) (Ex. 1) (explaining a "contact is not excepted from the statute merely because the… [third party] asks that his name be left off the list of contacts."). An SB/SE review supports the need for training. It found that a focus group of field examiners had not received any refresher TPC training and could answer polling questions about what is or is not a TPC only 84 percent of the time; and SB/SE's case reviews found that examiners did not document consideration of the potential for reprisal in any cases SB/SE reviewed. SB/SE, *Third Party Contact, Program Review Report, Field Exam Special Processes* 5-6 (Oct. 30, 2015).

72 Similarly, an SB/SE review recommended the addition of a new reason code to the Exam Quality Measurement System (EQMS) to track adherence to TPC procedures. SB/SE, *Third Party Contact, Program Review Report, Field Exam Special Processes* 8 (Oct. 30, 2015).

Appendix: Third Party Contact Sampling Methodology and Data Collection Instrument

Methodology

TAS identified a stratified random sample of 1,200 taxpayers whose cases were closed in field exam (600 cases) or field collection (600 cases) in FY 2013. The sample was larger than necessary to project the results to IRS cases nationwide because TAS expected that some case files would not be retrieved in time to complete the study. In addition, TAS oversampled the types of cases (identified by activity code and project code) deemed most likely to involve TPCs so that the sample would yield more precise estimates about how the IRS handles the relatively small percentage of cases that require TPCs.[73] Five TAS Revenue Agent Technical Advisors (RATAs) and four TAS Revenue Officer Technical Advisors (ROTAs) ordered the administrative files and a copy of the IRS's TPC database (*i.e.*, data available on IDRS) for these randomly selected cases. After TAS identified the subset of cases where taxpayers requested TPC lists, it planned to request information about the IRS's responses (*e.g.*, Letter 3173) in these cases from the IRS. However, TAS did not identify any cases where the taxpayer requested a TPC list. The ROTAs and RATAs recorded their findings on an electronic data collection instrument (DCI). TAS research tabulated the data. These results are analyzed in the body of the Most Serious Problem (MSP) above.

Data Collection Instrument

The DCI used by TAS reviewers included the following questions:

1. Did the RA/RO make any third party contacts (TPC)?
2. Were all of the TPCs exempt from the notice and reporting requirements (*e.g.*, authorized on Form 12180, criminal investigation, risk of reprisal, collection in jeopardy, matter in litigation, and certain contacts with contractors, informants, or government officials)?
3. On what date was the first non-exempt TPC?
4. Did the IRS send the taxpayer a TPC notice (*e.g.*, Pub 1, Letters 3164, 3230, 3232, 3234, 3236, 3238, 3345, 3404, 4464, or Notice 1219)?
5. If the RA/RO sent a TPC notice, did the RO/RA wait until the (a) confirming receipt of the TPC notice or (b) at least ten calendar days after sending the TPC notice before making the first non-exempt TPC (as required by IRM 4.11.57.4.1.1.1 and IRM 25.27.1.3.1)?
6. Did the RA/RO ask the taxpayer for the information before requesting it from a third party? (For example, a formal request for specific information through personal contact or letter.)
7. Did the RA/RO determine a "reprisal" TPC reporting exception applied (as provided by IRC § 7602(c)(3), IRM 25.27.1.3.3, or IRM 4.11.57.4.2.3)?
8. If the RO/RA determined the reprisal exception applied, did the RA/RO document the reason(s) why?

73 Field exam cases consisted of two strata: one with certain activity codes and project codes, and the other with the remaining field exam cases. Field collection cases were divided into six strata: (1) individual closed as full paid or with an installment agreement, (2) individual closed as currently not collectible, (3) individual trust fund recovery penalty, (4) individual referred to exam and closed as full paid or with an installment agreement, (5) small business closed as full paid or with an installment agreement, and (6) small business closed as currently not collectible. Each strata was weighted to reflect the proportion of that strata in the population.

9. Does the admin file (case activity record (CAR), Forms 12175, Integrated Collection System (ICS), or memo of interview (MOI)) show one or more non-exempt TPCs that are not reflected on the TPC Coordinator database?
10. Why were one or more TPCs omitted from the TPC database? [Choices included "Form 12175 not completed" or "other" with an explanation.]
11. Did the taxpayer request a TPC list? [yes/no and date recorded]
12. If the taxpayer requested one or more TPC list(s), did the IRS always mail/fax the list (*e.g.*, Letter 3173) within 10 working days (per IRMs 4.11.57.4.6 and 25.27.1.5)?
13. If the IRS sent a TPC list, were there non-exempt TPCs in the admin file that were omitted from the list and not previously disclosed to the taxpayer (*e.g.*, in response to a prior request or on a third-party summons or CDP notice)?

Sample Results

The tables below summarize the results of TAS's sample, which are discussed in the MSP (above). The "counts" reflect the number of times a result was observed in the sample. Because TAS did not review all of the IRS's cases, the "estimate" column reflects how many times we would expect a particular result to occur in the overall population of IRS cases. The results from the sample were weighted so that the extent to which TAS over or under-sampled a particular project code did not bias the results. The upper and lower bounds of the "95% Confidence Interval" shows how close the estimate is likely to be to the true value for the entire population of IRS exam or collection cases at 95 percent level of confidence.[74] This range is generally wider for questions that were not answered very often (*i.e.*, for which the sample has relatively few data points) because the estimates become more precise when you have more data points.

1. Did the RA/RO make any third party contacts (TPC)?

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	No	31.9%	2.5%	27.2%	37.0%	151
	Yes	68.1%	2.5%	63.0%	72.8%	272
	Total					**423**
Field Exam	No	91.5%	1.5%	88.1%	94.1%	435
	Yes	8.5%	1.5%	5.9%	11.9%	50
	Total					**485**

74 Unless otherwise indicated, TAS assumed reviewers only left questions blank if they could not determine how to answer them based on the information in the case file.

2. Were all of the TPCs exempt from the notice and reporting requirements (*e.g.*, authorized on Form 12180, criminal investigation, risk of reprisal, collection in jeopardy, matter in litigation, and certain contacts with contractors, informants, or government officials)?

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Missing	0.3%	0.3%	0.1%	1.9%	2
	No	96.3%	1.2%	93.1%	98.1%	261
	Yes	3.4%	1.2%	1.7%	6.6%	9
	Total					**272**
Field Exam	Missing	4.0%	3.9%	0.6%	23.7%	1
	No	47.2%	9.3%	30.0%	65.1%	23
	Yes	48.8%	9.3%	31.4%	66.5%	26
	Total					**50**

4. Did the IRS send the taxpayer a TPC notice (*e.g.*, Pub 1, Letters 3164, 3230, 3232, 3234, 3236, 3238, 3345, 3404, 4464, or Notice 1219)?

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Missing	3.6%	1.3%	1.8%	7.2%	8
	No	0.8%	0.6%	0.2%	3.2%	3
	Yes	95.5%	1.4%	91.8%	97.6%	250
	Total					**261**
Field Exam	Missing	1.1%	1.2%	0.2%	8.2%	1
	Yes	98.9%	1.2%	91.8%	99.8%	22
	Total					**23**

5. If the RA/RO sent a TPC notice, did the RO/RA wait until the (a) confirming receipt of the TPC notice or (b) at least ten calendar days after sending the TPC notice before making the first non-exempt TPC (as required by IRM 4.11.57.4.1.1.1 and IRM 25.27.1.3.1)?[75]

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Missing	72.1%	3.0%	65.8%	77.7%	180
	No	5.3%	1.5%	3.0%	9.2%	14
	Yes	22.5%	2.8%	17.5%	28.6%	56
	Total					**250**
Field Exam	No	2.3%	1.7%	0.5%	9.7%	2
	Yes	97.7%	1.7%	90.3%	99.5%	20
	Total					**22**

6. Did the RA/RO ask the taxpayer for the information before requesting it from a third party? (For example, a formal request for specific information through personal contact or letter)[76]

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Missing	14.0%	2.3%	10.1%	19.1%	39
	No	11.1%	2.0%	7.8%	15.6%	34
	Yes	75.0%	2.8%	69.1%	80.1%	199
	Total					**272**
Field Exam	Missing	22.2%	7.9%	10.4%	41.3%	9
	No	22.8%	7.9%	10.8%	41.7%	10
	Yes	55.0%	9.3%	36.8%	71.9%	31
	Total					**50**

75 TAS reviewers left this question (Q5) blank if the RO/RA did not send the taxpayer a TPC letter, even if some other part of the IRS had done so.

76 A very broad request for information from the taxpayer that might technically have covered the information later included in the specific request to the third party was scored as "NO" (for Q6) if it would not have occurred to the taxpayer to provide such information because the IRS did not identify what it wanted with enough specificity.

7. Did the RA/RO determine a "reprisal" TPC reporting exception applied (as provided by IRC § 7602(c)(3), IRM 25.27.1.3.3, or IRM 4.11.57.4.2.3)?

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Missing	25.1%	2.8%	20.0%	31.0%	71
	No	72.9%	2.9%	66.9%	78.1%	195
	Yes	2.0%	0.8%	0.9%	4.5%	6
	Total					**272**
Field Exam	Missing	8.6%	5.4%	2.3%	26.9%	3
	No	87.4%	6.5%	68.6%	95.7%	46
	Yes	4.0%	3.9%	0.6%	23.7%	1
	Total					**50**

8. If the RO/RA determined the reprisal exception applied, did the RA/RO document the reason(s) why?[77]

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	No	100.0%	0.0%	100.0%	100.0%	6
	Total					**6**
Field Exam	No	100.0%	0.0%	100.0%	100.0%	1
	Total					**1**

9. Does the admin file (case activity record (CAR), Forms 12175, Integrated Collection System (ICS), or memo of interview (MOI)) show one or more non-exempt TPCs that are not reflected on the TPC Coordinator database?

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	No	51.5%	3.3%	44.9%	58.0%	137
	Yes	48.5%	3.3%	42.0%	55.1%	124
	Total					**261**
Field Exam	No	57.9%	13.4%	31.8%	80.2%	12
	Yes	42.1%	13.4%	19.8%	68.2%	11
	Total					**23**

77 To improve consistency, TAS had a single reviewer examine each of the seven field collection cases. In the absence of any indication the third party actually feared reprisal, documentation that a third party "did not want to be named" was not treated as a documented reason for a reprisal determination. Similar verbiage was present in three of the collection cases TAS reviewed, but there was no express indication this was the basis for the determination. Thus, TAS avoided inferring that the RO applied the reprisal rules incorrectly. *See, e.g.*, Treas. Reg. § 301.7602-2(f)(3)(ii) (Ex.1) (explaining a "contact is not excepted from the statute merely because the… [third party] asks that his name be left off the list of contacts."). Rather, TAS assumed the RO had other undocumented reasons for making the reprisal determination.

10. Why were one or more TPCs omitted from the TPC database?[78]

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Form 12175 Not Used	34.5%	4.6%	26.1%	44.0%	43
	Pick List Not Used	57.2%	4.7%	47.7%	66.2%	70
	Other	8.3%	2.5%	4.4%	14.9%	11
	Total					**126**
Field Exam	Form 12175 Not Used	94.5%	4.3%	76.9%	98.9%	9
	Other	5.5%	4.3%	1.1%	23.1%	2
	Total					**11**

11. Did the taxpayer request a TPC list?

		Estimate	Standard Error	95% Confidence Interval		Unweighted Count
				Lower	Upper	
Field Collection	Missing	0.8%	0.6%	0.2%	3.2%	3
	No	99.2%	0.6%	96.8%	99.8%	258
	Total					**261**
Field Exam	No	100.0%	0.0%	0.0%	100.0%	23
	Total					**23**

78 Because TAS reviewers frequently indicated that the "other" reason was that ROs did not select the correct pick list item, TAS compiled and reported these results separately.

MSP #13 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

RESPONSIBLE OFFICIALS

Jeff Wallbaum, Chief Financial Officer
John M. Dalrymple, Deputy Commissioner for Services and Enforcement
Edward Killen, Director, Privacy, Governmental Liaison and Disclosure
Douglas W. O'Donnell, Commissioner, Large Business and International
Sunita Lough, Commissioner, Tax Exempt and Government Entities Division
Karen Schiller, Commissioner, Small Business/Self-Employed Division
Richard Weber, Chief, Criminal Investigation
Kirsten B. Wielobob, Chief, Appeals
Lee D. Martin, Director, Whistleblower Office
William J. Wilkins, Chief Counsel

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to Confidentiality*

DEFINITION OF PROBLEM

In 2006, in the light of empirical evidence that audits initiated on the basis of whistleblower information resulted in the recovery of hundreds of millions of dollars of unpaid tax and cost less than half, per dollar of taxes collected, of other Internal Revenue Service (IRS) enforcement programs, Congress concluded that "rewarding whistleblowers is one of the best ways to fight tax cheats."[2] The legitimate use of whistleblowers, however, creates risks for the subject of the whistleblower claim, especially when the claim is unsupported or not pursued. As Congress is aware, voluntary compliance may be undermined if taxpayers perceive the IRS is not adequately guarding their tax information.[3] It is possible to balance these two

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

2 See Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2006-30-092, *The Informants' Rewards Program Needs More Centralized Management Oversight* 3-4 (June 6, 2006) (describing the contents of IRS, *The Informants' Project: A Study of the Present Law Reward Program* (Sept. 1999)); *Grassley Says IRS, Treasury Need to Put Out "Welcome Mat" for Whistleblowers*, 2006 TNT 112-96 (June 12, 2006).

3 See Dept. of Treas., *Report to The Congress on Scope and Use of Taxpayer Confidentiality and Disclosure Provisions*, Vol. I, Study of General Provisions 34 (Oct. 2000) (stating that "[t]axpayers who view the IRS as a resource for a variety of other interests will be less inclined to voluntarily turn over sensitive financial information out of fear of where it might ultimately land").

concerns; however, the whistleblower program as currently administered by the IRS and the Internal Revenue Code (IRC) do not adequately strike that balance.

The legitimate use of whistleblowers, however, creates risks for the subject of the whistleblower claim, especially when the claim is unsupported or not pursued. As Congress is aware, voluntary compliance may be undermined if taxpayers perceive the IRS is not adequately guarding their tax information.

The IRS has long had the authority, at its own discretion, to compensate informants who report violations of the internal revenue laws.[4] Using this discretion, now codified as subsection (a) of IRC § 7623, the IRS adopted a policy of paying informants up to 15 percent of the amount recovered, subject to a $10 million cap.[5] In 2006, Congress added subsection (b) to IRC § 7623, significantly expanding the scope of the statute by *requiring* the IRS to award certain whistleblowers an amount between 15 and 30 percent of the collected proceeds, with no maximum dollar limit.[6]

Whistleblowers took an immediate interest in IRC § 7623(b), making 50 submissions in fiscal year (FY) 2007 that appeared to meet the threshold requirements, including that the amount in dispute exceed $2 million.[7] The number of submissions under IRC § 7623(b) increased dramatically thereafter; there were 352 in FY 2014 alone.[8] The IRS paid the first IRC § 7623(b) award in 2011 and paid 11 such awards from FYs 2011 to 2014.[9] The total amount of awards under IRC § 7623 was $13.6 million in FY 2007 (when the IRS paid claims only at its discretion, under IRC § 7623(a)) and fluctuated over the years, reaching a high of $125 million in FY 2012 (when the IRS paid claims under both subsections).[10]

Despite the increased willingness of whistleblowers to come forward, the effectiveness of the whistleblower program has been undermined by conditions such as:

- The length of time it takes to resolve whistleblower cases, which averaged almost six years for awards paid in FY 2014;[11]
- Statutory provisions that impede the IRS from communicating effectively and regularly with whistleblowers; and

4 *See* Act of Mar. 2, 1867, ch. 169, §7, 14 Stat. 471, 473 (codified by ch.11, § 3463, 35 Rev. Stat. 686 (1893-74)).

5 IRC § 7623(a); Internal Revenue Manual (IRM) 1.2.13.1.12, *Policy Statement 4-27* (Aug. 13, 2004).

6 Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 406(a)(1)(D), 120 Stat. 2921, 2958 (adding subsection (b) to IRC § 7623); IRC § 7623(b)(1). The IRS does not take into account penalties collected for failing to file Form TD F 90-22.1 (now FinCEN Form 114), *Report of Foreign Bank and Financial Accounts (FBAR)*, as required by 31 U.S.C. § 5314 in making awards under IRC § 7623. *See* Legislative Recommendation: *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*, *infra*.

7 IRS Whistleblower Office (WO), *Fiscal Year 2011 Report to the Congress on the Use of Section 7623*, Table 1; IRC § 7623(b)(5)(B). As the WO annual reports note, the number of submissions reported was subject to change. For this reason, we cite to the most recent report for which the cited data is available.

8 IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623*, Appx. Table 2.

9 *Id*. at 4.

10 IRS WO, *Fiscal Year 2011 Report to the Congress on the Use of Section 7623*, Table 4; IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623*, Appx. Table 6.

11 IRS WO response to TAS information request (Aug. 27, 2015) (noting that 101 awards were paid in FY 2014, with an average elapsed time from Form 211 receipt to award payment date of 5.8 years). The timeframes ranged from 2.4 years to 14.8 years, with a median of 5.3 years. For the 11 awards paid under IRC § 7623(b) from FYs 2011-2014, the average elapsed time from Form 211 receipt to award payment date was 4.9 years. The timeframes ranged from 3.9 years to 6.1 years, with a median of 4.9 years.

- The lack of statutory protection of whistleblowers from retaliation.[12]

Moreover, the whistleblower program does not adequately protect taxpayers from disclosure of their confidential information by whistleblowers. The causes of some of these difficulties are beyond the IRS's control, and the IRS shares some of the National Taxpayer Advocate's concerns.[13] However, the IRS has moved slowly to address issues within its purview, and has occasionally exacerbated the difficulties.[14] The whistleblower program enjoys the support of the IRS Commissioner but has yet to realize its full potential.[15]

ANALYSIS OF PROBLEM

Accepting Assistance From Whistleblowers Is an Efficient Enforcement Mechanism But Carries Heightened Risk for the Subject of the Claim

The IRS selects returns for audit in a variety of ways, most often using Discriminant Index Function (DIF) formulas.[16] In 1999, the IRS reported that audits of 1996-1998 returns initiated on the basis of information from an informant (now referred to as a whistleblower) "had a higher dollar yield per hour[17] and a lower no-change[18] rate" than returns selected on the basis of DIF scores.[19] Moreover, the cost/benefit ratio of whistleblower audits compared favorably with other IRS enforcement programs: "[t]he report estimated the IRS incurred slightly over four cents in cost (including personnel and administrative costs) for each dollar collected from the Informants' Rewards Program (including interest), compared to a cost of over ten cents per dollar collected for all enforcement programs."[20] From FYs 2001-2005, audits based on whistleblower information resulted in a total recovery of tax, fines, interest and penalties of more than $340 million.[21]

When the IRS accepts assistance from a whistleblower, the risk arises that the audited taxpayer's confidential information will be inappropriately disclosed to the whistleblower, a risk for which Congress and the IRS have little tolerance. IRC § 6103 generally prohibits IRS employees from disclosing a taxpayer's

12 The Government Accountability Office (GAO) has voiced similar concerns. See GAO, GAO-16-20, *IRS Whistleblower Program Billions Collected, but Timeliness and Communication Concerns May Discourage Whistleblowers* (Oct. 2015).

13 See IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623* 6-7.

14 See the discussion below pertaining to the IRS's refusal to enter into tax administration contracts with whistleblowers, its determination that an "administrative proceeding" begins when the IRS proposes an award, and the inadequacy of confidentiality agreements executed by whistleblowers to deter re-disclosure of taxpayer information.

15 See, *e.g.*, William Hoffman, *Tax Analysts Interview with John Koskinen* (Oct. 17, 2014) (reiterating his support for the whistleblower program generally, expressing his willingness to explore ways to improve communication with whistleblowers, and noting the need for anti-retaliation legislation).

16 See IRM 4.22.1.5, *Benefits of NRP* (Oct. 1, 2008); IRM 4.19.11.1.5.1, *How DIF Works* (Nov. 9, 2007) (explaining, among other things, that "DIF is a mathematical technique used to score income tax returns as to examination potential").

17 Dollar yield per hour refers to the total recommended adjustments to tax liability divided by the number of examiner hours charged to examinations. (fn. in original.)

18 For the purpose of this analysis, an examination of a return results in a "no-change" when the examination is closed in the Audit Information Management System (AIMS) using Disposal Code 02 (no adjustments or changes to tax liability). (fn. in original.)

19 TIGTA, Ref. No. 2006-30-092, *The Informants' Rewards Program Needs More Centralized Management Oversight* 4 (June 6, 2006) (describing the contents of IRS, *The Informants' Project: A Study of the Present Law Reward Program* (Sept. 1999)).

20 *Id.*

21 *Id.* at 3

"return" or "return information" and civil and criminal penalties are imposed for violating the bar.[22] The broad definitions of "return" and "return information" forbid the IRS from telling a whistleblower, for example:

- Whether the claim led to an audit;
- Why a claim did not lead to an audit;
- Whether an audit resulted in assessment of additional tax; or
- The extent to which any additional tax was collected.[23]

The following statutory provisions allow taxpayers to recover damages for unauthorized disclosures and permit imposition of fines and prison terms, in addition to requiring termination of employment if the violator was a federal employee:

- IRC § 7431 generally allows a taxpayer whose return or return information was knowingly or negligently disclosed to bring a civil action for statutory damages of $1,000 or actual damages;[24]
- IRC § 7213 imposes a fine of up to $5,000 and imprisonment of up to five years for willful disclosure of return or return information;[25] and
- IRC § 7213A imposes a fine of up to $1,000 and imprisonment for up to one year for willful unauthorized inspection of a taxpayer's return or return information.[26]

Additionally, IRC § 6103(p) imposes requirements that pertain generally to appropriate storage and secure access of return information and requires the specified possessor to "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."[27]

22 IRC § 6103(a) prohibits the IRS from disclosing taxpayers' returns or return information absent an exception. There are 13 exceptions found in IRC § 6103(c)-(o), none of which expressly allows disclosures to whistleblowers. 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."

23 As the IRS advises, "[o]nce a claim is submitted, the informant may be told only the status and disposition of the claim — not the action taken in the taxpayer case. We can say whether the claim is still open or has been closed. If closed we can say that a claim is payable (and the amount) or that the claim is denied." *Confidentiality and Disclosure for Whistleblowers*, *available at* www.irs.gov/uac/Confidentiality-and-Disclosure-for-Whistleblowers.

24 IRC § 7431(a)(2), (c) (imposing the same penalties for unauthorized inspection and for disclosure). In addition, the *Taxpayer Bill of Rights Enhancement Act of 2015*, § 202, S. 1578, introduced on June 16, 2015, would increase the statutory damage amount to $5,000 for each instance of unauthorized inspection and $10,000 for each instance of unauthorized disclosure, among other things.

25 IRC § 7213(a)(1) (also providing that a federal employee who violates IRC § 7213 "shall, in addition to any other punishment, be dismissed from office or discharged from employment upon conviction for such offense"). In addition, the *Taxpayer Bill of Rights Enhancement Act of 2015*, § 201, S. 1578, introduced on June 16, 2015, would increase the maximum fine for unauthorized disclosure to $20,000.

26 IRC § 7213A(a)(1)(B), (b)(1). A federal employee "who is convicted of any violation of subsection (a) shall, in addition to any other punishment, be dismissed from office or discharged from employment." IRC § 7213A(b)(2). In addition, the *Taxpayer Bill of Rights Enhancement Act of 2015*, § 201, S. 1578, introduced on June 16, 2015, would increase the maximum fine for unauthorized inspection to $5,000.

27 IRC § 6103(p)(4)(D).

The National Taxpayer Advocate has long been a proponent of enforcing and extending (where appropriate) these statutory sanctions and safeguarding provisions.[28]

Although Similar to Whistleblower Provisions of the False Claims Act, the Tax Whistleblower Statute Differs in Important Respects

In 1863, Congress enacted the False Claims Act (FCA) to address the rampant fraud on the government perpetrated during the Civil War.[29] Under the FCA, the United States Attorney General and the Department of Justice (DOJ) are delegated the discretion to bring a civil suit for statutory penalties and damages on the basis of an informant's information, but if the government declines to proceed with the action, the informant may continue alone as a *qui tam* plaintiff in the name of the government.[30] Prior to 1987, courts had discretion to award the informant up to ten percent of the proceeds collected if the government brought suit, and up to 25 percent of the proceeds collected, as well as the reasonable expenses for the costs of litigation, if the government declined to proceed and an individual brought the action.[31] In 1987, amendments to the FCA strengthened the *qui tam* provisions by *requiring* payments to the informant of between 15 and 25 percent of the proceeds if the government brought suit, or 25 to 30 percent if the informant proceeded alone, and adding protections from retaliation for employee whistleblowers.[32] The amendments also included a "tax bar," which codified prior court holdings that tax fraud is excluded from the purview of the FCA.[33]

28 *See* National Taxpayer Advocate 2003 Annual Report to Congress 232-54 (recommending that "[d]uring pilots and in statutory disclosures, agencies and their contractors must be subject to the safeguard provisions of IRC § 6103(p)(4), and agencies and their contractors or agents must be subject to the civil and criminal sanctions of IRC §§ 7213, 7213A, and 7341"); National Taxpayer Advocate 2010 Annual Report to Congress 396 (recommending that taxpayers be allowed to recover damages for unauthorized disclosure by whistleblowers). The President's Budget submissions for FYs 2014-2016 included legislative proposals to amend IRC § 6103 "to provide that the section 6103(p) safeguarding requirements apply to whistleblowers and their legal representatives who receive returns and return information in whistleblower administrative proceedings. In addition, the proposal extends the penalties for unauthorized inspections and disclosures of returns and return information to whistleblowers and their legal representatives." *See General Explanations of the Administration's Fiscal Year Revenue Proposals* (Treasury Greenbook) FYs 2014-2016 at 205, 236, and 250-51, respectively, *available at* www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx. As discussed below, the National Taxpayer Advocate this year recommends that Congress make the safeguarding provisions and statutory sanctions applicable to whistleblowers. *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 Requirement of IRC § 6103(p)*, *infra*.

29 H.R. Rep. No. 99-660, at 17 (1986).

30 31 U.S.C. § 3730(a), (b); 31 U.S.C. § 3729. *Qui tam* is "[a]n action brought under a statute that allows a private person to sue for a penalty, part of which the government or some specified public institution will receive." Black's Law Dictionary (9th ed. 2009). The private person who brings a *qui tam* action is the "relator." According to one 2011 DOJ memo, "[t]here are no statistics reported on the length of time the average *qui tam* case remains under seal [the preliminary period during which DOJ investigates a FCA complaint and decides whether it will intervene]… In this District, most intervened or settled cases are under seal for at least two years (with, of course, periodic reports to the supervising judge concerning the progress of the case, and the justification of the need for additional time)." See *False Claims Act Cases: Government Intervention in Qui Tam (Whistleblower) Suits* 2, *available at* http://www.justice.gov/sites/default/files/usao-edpa/legacy/2011/04/18/fcaprocess2_0.pdf. The length of time the suit will take appears to vary widely. *See, e.g.*, Ben Hallman, *Whistleblowers, Beware: Most Claims End in Disappointment, Despair, available at* http://www.huffingtonpost.com/2012/06/04/whistleblower-law-false-claims-act-awards-james-holzrichter_n_1563783.html, reporting on FCA suits that took as long as 17 years to resolve, as well as one that took less than a year to resolve.

31 *See* Pub. L. 97-258, § 3730(c)(1) and (2), 96 Stat. 877, 978.

32 *See* False Claims Amendment Act of 1986, Pub. L. 99-562, Sec. 3, § 3730(d)(2), 100 Stat. 3153, 3154-3157.

33 31 U.S.C. § 3729(d). As one commenter observed, "[s]ince the [False Claims Act] deals only with misrepresentations made in connection with the presentation of claims, misrepresentations for the purpose of defrauding the Government are in many situations not proscribed. The Supreme Court [in *United States v. Cohn*, 270 U.S. 339 at 345] has defined a 'claim' as a demand upon the Government for the payment of money or delivery of property… However, where the citizen uses false statements to reduce his own liability to the Government, the statute is inapplicable" (fn. refs. omitted). Note, *The False Claims Act*, 69 Harv. L. Rev. 1106 (1956).

Although there is room for improvement in the cycle time of whistleblower cases, these cases are often complex and involve built-in time constraints and waiting periods.

The "tax informant statute," now codified as IRC § 7623, was enacted in 1867.[34] Prior to 2006, payments to tax whistleblowers were not mandatory (like payments under the FCA prior to 1986); whether to pay an award and the amount of any award were within the IRS's discretion.[35] In 2006, following a Treasury Inspector General for Tax Administration (TIGTA) report identifying weaknesses in the whistleblower program, Congress added subsection (b) to IRC § 7623.[36] The 2006 amendments made whistleblower awards mandatory in certain cases, specified an award amount from 15 to 30 percent of the collected proceeds (with no cap on the amount of the award), created the IRS Whistleblower Office (WO), and provided for United States Tax Court review of whistleblower award determinations.[37] The IRS and Treasury drafted proposed regulations implementing IRC § 7623(b) in 2012, and after notice, public comment, and a public hearing, issued final regulations in August 2014.[38]

Under IRC § 7623, a tax whistleblower's statutory role has always been limited to reporting information to the IRS, which, like the Attorney General for purposes of the FCA, has the discretion to pursue the claim or not.[39] Unlike the FCA, there is no *qui tam* provision in the IRC allowing a tax whistleblower to proceed on behalf of the government, and tax whistleblowers do not have the benefit of statutory protections from retaliation.[40] Tax whistleblowers are protected by statute from having their identities disclosed in certain situations, however, and the IRS provides heightened security for whistleblower information

34 *See* Act of Mar. 2, 1867, ch. 169, § 7, 14 Stat. 471, 473 (codified by ch.11, § 3463, 35 Rev. Stat. 686 (1893-74)).

35 As noted above, the IRS adopted a policy of paying informants up to 15 percent of the amount recovered, subject to a $10 million cap. IRM 1.2.13.1.12, *Policy Statement 4-27* (Aug. 13, 2004).

36 Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 406(a)(1)(D), 120 Stat. 2922, 2958. *See* Joint Committee on Taxation, Technical Explanation of H.R. 6408, the "Tax Relief and Health Care Act of 2006," JCX-50-06, No. 2 (Dec. 7, 2006) (referencing TIGTA, Ref. No. 2006-30-092, *The Informants' Rewards Program Needs More Centralized Management Oversight* (June 6, 2006)).

37 Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432 § 406(b), 120 Stat. 2922, 2959 (an "off-Code" provision creating the WO); IRC § 7623(b)(4) (providing for Tax Court review of the IRS's award determination). For administrative ease, the IRS subsequently changed its policy of awarding only up to 15 percent of the amount recovered for subsection (a) claims, and now applies the same criteria and percentages to subsection (a) claims submitted after July 1, 2010, as for subsection (b) claims. IRM 25.2.2.7.4, *Award Computation - IRC 7623(a) claims filed on or after July 1, 2010 and IRC 7623(b) claims* (Aug. 7, 2015); WO response to TAS information request (Oct. 20, 2015).

38 Notice of Proposed Rulemaking, 77 Fed. Reg. 74798, 2013-3 I.R.B. 289 (Dec. 18, 2012); *Preamble*, T.D. 9687, 79 Fed. Reg. 47246 (Aug. 12, 2014) (noting that the IRS and Treasury held a public hearing on April 10, 2013, at which eight commenters testified).

39 The House proposed including in the 1867 statute a provision allowing *qui tam* actions by informers, but the proposal was rejected, without explanation, by the Senate. *See* Cong. Globe, 39th Cong. 2d Sess. (1867) 1545, 1919. Moreover, a rule similar to the one found in what is now IRC § 7401 (that "[n]o civil action for the collection or recovery of taxes, or of any fine, penalty, or forfeiture, shall be commenced unless the Secretary authorizes or sanctions the proceedings and the Attorney General or his delegate directs that the action be commenced") was in place prior to enactment of the 1867 tax informant statute (Act of July 13, 1866, ch. 184, § 9, 13 Stat. 111), and was left intact. *See also Cohen v. Comm'r*, 139 T.C. 299, 302 (2012) (holding that "section 7623 [does not] confer authority [on the Tax Court] to direct the Commissioner to commence an administrative or judicial action").

40 The President's Budget submissions for FYs 2014, 2015, and 2016 included legislative proposals to provide whistleblowers with protection from retaliation. *See* Treasury Greenbook FYs 2014-2016 at 204, 235, and 250-51, respectively, *available at* www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx. The GAO has also recommended that Congress consider such legislation. *See* GAO, GAO-16-20, *IRS Whistleblower Program Billions Collected, but Timeliness and Communication Concerns May Discourage Whistleblowers* 45 (Oct. 2015).

contained in administrative files.[41] Perhaps the biggest difference between the two whistleblower regimes is due to the protection of taxpayers' confidential information afforded by IRC § 6103, discussed above.

It Takes the IRS Almost Five Years on Average to Make Payouts of IRC § 7623(b) Claims

The IRS paid its first whistleblower award pursuant to IRC § 7623(b) in 2011.[42] Although there is room for improvement in the cycle time of whistleblower cases, these cases are often complex and involve built-in time constraints and waiting periods. The process that culminates in an award under IRC § 7623(b) takes close to five years and generally begins with review of Form 211, *Application for Award for Original Information*, by the WO's Initial Claim Evaluation (ICE) Team.[43] The claim is perfected if necessary (*e.g.*, the submitter may be asked to complete an incomplete Form 211 or provide an original signature) and then considered by a classifier in one of the IRS operating divisions.[44] If the classifier, after reviewing Form 211 and completing a classification check sheet, advises the WO that the claim has merit, the WO refers the claim to the appropriate operating division subject matter expert, who reviews the file and advises whether the IRS should open an audit.[45] If an audit ensues, the general progress of the claim includes: the audit itself; collection of any additional tax resulting from the audit; expiration of any period of limitations within which the audited taxpayer could request a refund; determining the amount of the award; and processing payment.[46]

41 *See* IRC § 6103(h)(4) (allowing disclosure of return or return information in judicial and administrative tax proceedings, except where "the Secretary determines that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation"); Treas. Reg. § 301.7623-1(e) (providing that "[u]nder the informant's privilege, the IRS will use its best efforts to protect the identity of whistleblowers"); IRM 25.2.2.5, *Examining a Whistleblower Claim* (Aug. 7, 2015) (instructing that there be "no mention or discussion of the whistleblower in the regular examination activity log, work papers, or case file" (which the IRS interprets to mean that the existence of a whistleblower, as well as his or her identity, is not to be mentioned). WO response to TAS information request (Oct. 20, 2015)); IRS Notice 2008-4, § 3.06, 2008-2 I.R.B. 253 (providing that the IRS maintains the confidentiality of the whistleblower's identity "to the fullest extent permitted by law").

42 IRS WO, *FY 2011 Report to the Congress on the Use of Section 7623* at 3. The WO's annual reports do not identify, for awards paid, the year in which the claim was submitted.

43 WO response to TAS information request (Aug. 27, 2015) (noting that for the 11 awards paid under IRC § 7623(b) from FYs 2011-2014, the average elapsed time from Form 211 receipt to award payment date was 4.9 years). Timeframes ranged from 3.9 years to 6.1 years, with a median of 4.9 years.

44 IRM 25.2.2.4, *Initial Form 211 Processing* (Aug. 7, 2015). We note that the perception of the independence of the WO's determinations would be enhanced if the classifiers reported to the WO Director, similar to the structure of TAS, where revenue agents and revenue officers bring their skills and experience to TAS, and as TAS employees follow TAS's mission, with their head of office the National Taxpayer Advocate.

45 IRM 25.2.2.4.2, *Selecting a Claim* (Aug. 7, 2015). Alternatively, the classifier may recommend that the WO reject the claim, deny the claim, refer the claim to another group for consideration, or, where the claim requires special handling or coordination among operating divisions, refer the claim(s) to the WO's Case Development and Oversight group, which analyzes and decides whether to send the claim to the field for possible audit. A classifier who recommends not proceeding with the claim must provide documentation showing he or she considered the issue(s) reflected on the Form 211 and provide the reason he or she did not select the claim. WO Procedural Guide, *ICE Process: Classification* 18 (rev. Mar. 27, 2015). A subject matter expert who ultimately determines not to proceed with the case must complete Form 11369, *Confidential Evaluation Report on Claim for Award*, which his or her manager approves, and submit it to the WO Analyst, who forwards it for approval by a WO manager or senior manager. IRM 25.2.2.4.4(8), *Operating Division SME Responsibilities* (Aug. 7, 2015).

46 *See* IRM 25.2.2, *Whistleblower Awards* (Aug. 7, 2015). A claim may be transferred to Criminal Investigation (CI), accompanied by Form 11369 explaining the reason for the transfer, and CI may recommend the claim for prosecution, assist the Tax Division of the DOJ in prosecuting the claim, and at its conclusion, return it to the WO for consideration of an award. IRM 9.4.1.5.1.1(7), *Information Items and Whistleblowers* (Mar. 30, 2012). If CI determines that the referral lacks prosecution potential, it returns the case to WO, which may refer the claim to an operating division for audit consideration. IRM 9.4.1.5.1.1(4), *Information Items and Whistleblowers* (Mar. 30, 2012). A decision by CI to initially not take action does not prevent a criminal referral by an operating division after further development.

Even if performance goals (which do not include the time it takes to conduct the audit) are met or exceeded, and even assuming the claim is never suspended pending the outcome of an appeal, collection action, or similar case developments, it will take more than three and a half years on average for a claim to culminate in an award to the whistleblower.

Performance goals established by the IRS Deputy Commissioner of Services and Enforcement apply to some (but not all) phases of the process.[47] For example, there are no target timeframes for completing whistleblower field audits, which take about a year and a half on average and account for the claims of more than a third of all whistleblowers.[48] Even if performance goals (which do not include the time it takes to conduct the audit) are met or exceeded, and even assuming the claim is never suspended pending the outcome of an appeal, collection action, or similar case developments, it will take more than three and a half years on average for a claim to culminate in an award to the whistleblower.[49] A substantial number of whistleblowers (221 out of 1,489, or about 15 percent) were awaiting the WO's review of audit results to determine whether there is sufficient information to make an award decision, which takes almost a year.[50] The number of days this phase consumes presents an opportunity for the IRS to truncate the cycle time for whistleblower cases and reduce the time whistleblowers must wait to learn whether they will receive an award.[51] Figure 1.13.1 shows the principal phases required in most successful IRC § 7623(b) claims.

47 Memo from John M. Dalrymple, Deputy Commissioner for Services and Enforcement, to Commissioners of the Large Business & International (LB&I), Small Business/Self-Employed (SB/SE), Tax Exempt and Government Entities (TE/GE) divisions, Chief of CI, and Director of the WO (Aug. 20, 2014).

48 CI response to TAS information request (Sept. 3, 2015); TE/GE response to TAS information request (Aug. 5, 2015); SB/SE response to TAS information request (July 30, 2015); LB&I response to TAS information request (July 29, 2015). IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623*, 20,18 Appx. Tables 5, 4 (showing field audits in WB cases take on average 544 days, with 2,344 days (more than six years) the longest audit and that as of May 14, 2015, out of 1,489 whistleblowers with open claims, the claims of 500 whistleblowers (34 percent) were in field audit). Criminal investigations of whistleblower claims take on average close to two years. CI response to TAS information request (Sept. 3, 2015) (noting that the average number of days from the start of an investigation to its completion for investigations closed in FYs 2012, 2013, and 2014 was 572, 656, and 762, respectively).

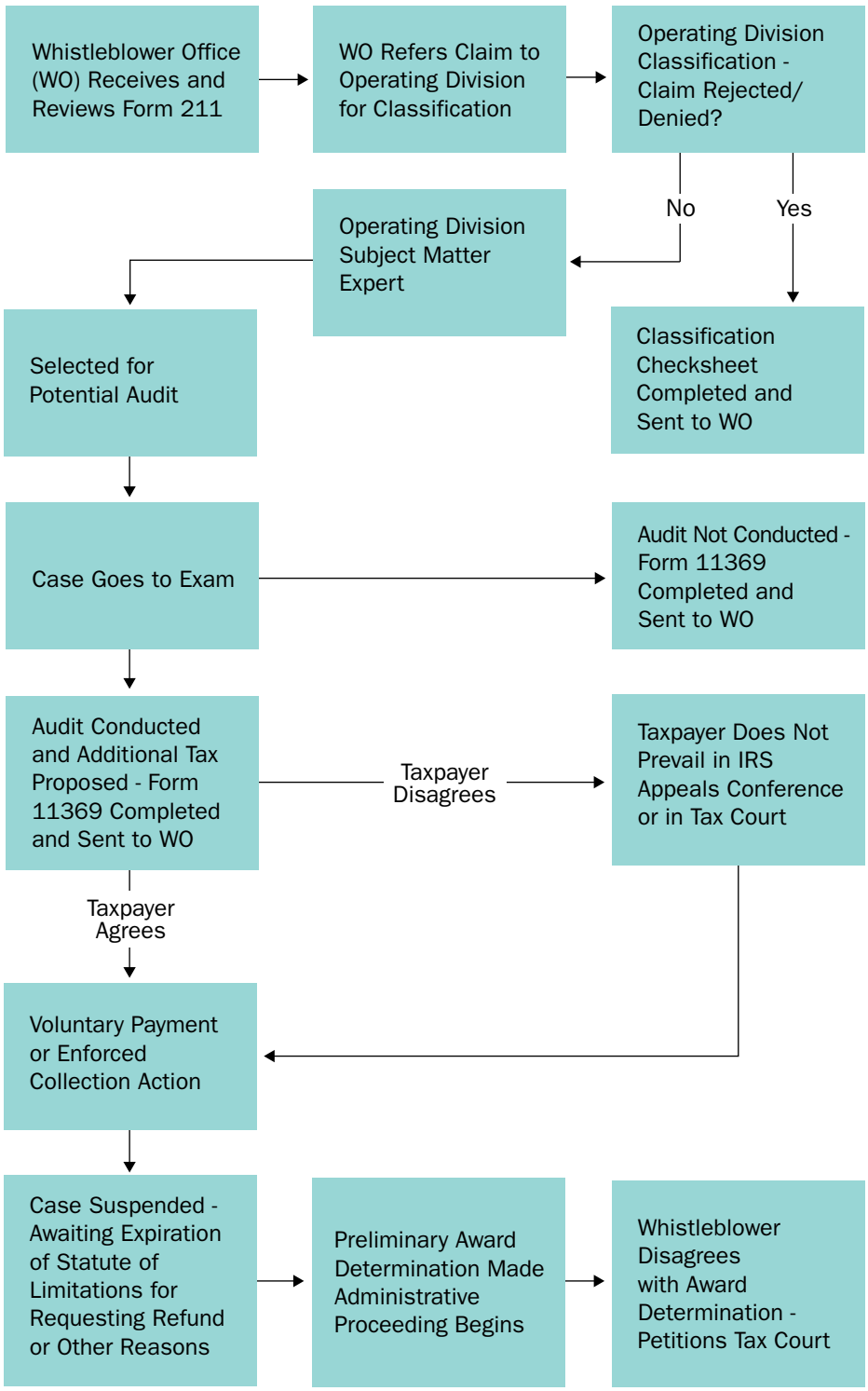
49 The WO is in the process of updating its records to reflect new status categories and expects its future reports to more accurately capture the status of subsection (b) claims. Current data shows that it takes 85 days on average for the WO to complete its initial review of the claim (which is faster than the 90-day target); 80 days on average for operating division subject matter expert review to determine whether to audit (which is also faster than the 90-day target); 544 days on average for operating division OD field examination; 362 days on average for the WO review of the results of field action to determine whether there is sufficient information to make an award decision; 45 days on average for the whistleblower to be notified of award decision after collected proceeds are finally determined (which is faster than the 90-day target); and 218 days for final award processing. The sum of these periods is 1,334 days, more than 3.5 years. IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623* 20 Appx. Table 5.

50 *Id.* at 18, 20 Appx. Tables 4 and 5 (noting that this step takes 362 days on average). As noted, the WO is in the process of updating its records. It is possible that some claims included in this step will be re-classified as in another status, which could affect the average number of days claims await the WO's review of audit results. WO response to TAS information request (Oct. 20, 2015).

51 A 90-day time period for this phase would be an appropriate performance goal.

FIGURE 1.13.1

Principal Phases of Most Successful IRC § 7623(b) Claims



If the claim is suspended, which could occur for a variety of reasons, the average timeframe is extended, potentially for several additional years.[52] One important reason for suspending a claim, at least in cases where the taxpayer has not waived the right to request a refund, is to allow the statutory period of limitations for requesting a refund to expire.[53] Suspending the claim obviates the risk that the IRS would pay an award to a whistleblower out of collected proceeds it is later required to refund to the taxpayer. Treasury regulations permit, but do not require the IRS to separate the components of a claim so that a payout on one issue can go forward while other issues are litigated.[54]

Because processing times may be lengthy, whistleblowers seek information about the status of their claims. They approach the WO with requests for information, they submit requests to the IRS under the Freedom of Information Act (FOIA), and they inform TAS of systemic delays.[55]

The IRS Has Never Availed Itself of IRC § 6103(n), an Exception to the Statutory Prohibition on Disclosing Confidential Taxpayer Information, That Would Allow the IRS to Update Whistleblowers on the Status of Their Claims and Protect Taxpayer Confidential Information From Re-Disclosure by the Whistleblower

There are exceptions to the nondisclosure rules of IRC § 6103, some of which may apply in the context of whistleblower claims, although none specifically addresses disclosures to whistleblowers. For example, 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.[56] In that event, the IRS "may inform the whistleblower and, if applicable, the legal representative of the whistleblower, of the status of the whistleblower's claim for award under IRC § 7623, including whether the claim is being evaluated for potential investigative action, or is pending due to an ongoing examination, appeal, collection action, or litigation."[57] If a tax administration contract is in effect, the regulations under IRC § 6103 provide that the sanctions imposed by IRC §§ 7431, 7213, and 7213A, discussed above, apply to the whistleblower.[58] Moreover, a whistleblower who executes a contract under IRC § 6103(n) must "permit an inspection of the whistleblower's

52 The shortest average suspension period, arising while the claim is awaiting collection action, affected 76 whistleblowers in FY 2014 and adds about nine months on average to the timeframe. The longest average suspension period, arising while the IRS evaluates a bulk claim involving a large number of taxpayers, affected ten whistleblowers in FY 2014 and adds almost three years to the timeframe. IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623* at 17 Appx. Table 4.

53 Generally, taxpayers must request a refund within three years from the date their return was filed, or two years from the time the tax was paid, whichever occurs later, or, if no return was filed, within two years from the time the tax was paid. IRC § 6511(a). If taxpayers meet the three-year requirement, they can recover payments made during the three-year period that precedes the date of the refund request, plus the period of any extension of time for filing the return. Taxpayers who do not meet the three-year requirement can recover only payments made during the two-year period preceding the date of the refund request. IRC § 6511(b)(2).

54 *See* Treas. Reg. § 301.7623-4(d)(2), T.D. 9687, 79 Fed. Reg. 47246, 47275 (Aug. 12, 2014). In any event, Form 870, *Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment*, provides that the consenting taxpayer cannot petition Tax Court, but "[y]our consent will not prevent you from filing a claim for refund (after you have paid the tax) if you later believe you are so entitled."

55 From FYs 2012-2015 (as of June 22), the IRS received 38 FOIA requests seeking access to whistleblower records, 11 of which were from whistleblowers seeking access to records about their claim. In those cases, the whistleblower can obtain the claim and any attachments he or she provided to the IRS, and the IRS can confirm that the claim exists and is still open or closed, but cannot provide any other information about actions the IRS will take on the claim. Privacy, Governmental Liaison and Disclosure response to TAS information request (June 29, 2015); SAMS 31265, submitted Aug. 18, 2014.

56 *See* IRC § 6103(n); Treas. Reg. § 301-6103(n)-2.

57 Treas. Reg. § 301.6103(n)-2(b)(3).

58 Treas. Reg. § 301.6103(n)-2(c) (providing "[a]ny whistleblower, or legal representative of a whistleblower, who receives return information under this section, is subject to the civil and criminal penalty provisions of sections 7431, 7213, and 7213A for the unauthorized inspection or disclosure of the return information").

or the legal representative's premises by the IRS" to ensure that return information is adequately protected from unauthorized disclosure.[59]

The IRS advises its officials they may use an IRC § 6103(n) contract when disclosure to a whistleblower is "necessary to obtain a whistleblower's insights and expertise into complex technical or factual issues,"[60] and as discussed below, the regulations under IRC § 7623 contemplate the use of such contracts.[61] At the same time, the IRS views these contracts as "not intended to be used to disseminate information to whistleblowers."[62] On the contrary, "[a] whistleblower who thinks the IRS will grant a section 6103 contract 'without a compelling need on the part of the IRS to get information from the whistleblower has just misunderstood what (n) contracts were intended to do.'"[63] In any event, the IRS has never entered into an IRC § 6103(n) contract with a whistleblower.[64]

The IRS Does Provide Confidential Taxpayer Information to Whistleblowers Under Provisions That Do Not Adequately Protect Taxpayers from Re-Disclosure of Their Confidential Information by Whistleblowers

The IRS does disclose return information to whistleblowers pursuant to another exception to IRC § 6103 for what are sometimes referred to as "investigative disclosures."[65] Under IRC § 6103(k)(6), to the extent necessary to obtain information related to the IRS's official duties or to accomplish properly any activity connected with such official duties, the IRS may disclose return information to third parties (persons other than the taxpayer). Whether or not this exception would allow the IRS to provide status updates to a whistleblower, a whistleblower to whom a disclosure is made under IRC § 6103(k)(6), unlike a whistleblower to whom a disclosure was made pursuant to an IRC § 6103(n) contract, is not subject to statutory requirements for safeguarding the information or the statutory sanctions for re-disclosing it.[66]

The IRS discloses taxpayer information to a successful whistleblower pursuant to another exception to IRC § 6103 after it concludes an audit, collects proceeds from the taxpayer, determines that a

59 Treas. Reg. § 301.6103(n)-2(d)(3). *See also* Treas. Reg. § 301.6103(n)-1 (providing analogous provisions that apply to tax administration contracts generally (not only those entered into by whistleblowers)).

60 Memorandum from John M. Dalrymple, IRS Deputy Commissioner for Services and Enforcement to Commissioners of the LB&I, SB/SE, TE/GE divisions, Chief of Criminal Investigation, and Director of the Whistleblower Office (Aug. 20, 2014); Memorandum from Steven Miller, IRS Deputy Commissioner for Services and Enforcement to Commissioners of the LB&I, SB/SE, TE/GE and W&I divisions, Chief of Criminal Investigation, and Director of the Whistleblower Office (June 20, 2012), 2012 TNT 121-15.

61 *Preamble*, T.D. 9687, 79 Fed. Reg. 47246, 47256 (Aug. 12, 2014).

62 Andrew Velarde, *Whistleblower Status Letters Seen as a Good Start but Not Enough* 2015 TNT 53-5 (Mar. 19, 2015) (describing the WO Director's view of IRS § 6103(n) contracts).

63 *Id*. (quoting the WO Director).

64 SB/SE response to TAS information request (July 31, 2015); LB&I response to TAS information request (July 29, 2015); TE/GE response to TAS information request (Aug. 5, 2015). The GAO has recommended that the IRS "[d]evelop guidance for examiners in operating divisions to use in determining whether an Internal Revenue Code section 6103(n) contract with a whistleblower would be beneficial and outline the steps for requesting such a contract." *See* GAO, GAO-16-20, *IRS Whistleblower Program Billions Collected, but Timeliness and Communication Concerns May Discourage Whistleblowers* 46 (Oct. 2015).

65 Andrew Velarde, *Whistleblower Status Letters Seen as a Good Start but Not Enough* 2015 TNT 53-5 (Mar. 19, 2015) (reporting that according to the WO Director, "as a practical matter, investigative disclosures under section 6103(k)(6) can be and have been used to interact with whistleblowers, and auditors are confident in using that authority, which 'works a little easier' and serves as a fair substitute" for IRC § 6103(n) contracts). For a detailed discussion of disclosures under IRC § 6103(k)(6) to third parties other than whistleblowers, where it is *presumed* that the contact with the third party will be disclosed to the taxpayer, see Most Serious Problem: *Third Party Contacts: IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers' Businesses and Reputations*, *supra*. In contrast, as discussed above, IRS procedures require that it not disclose a whistleblower's identity to the affected taxpayer.

66 Treas. Reg. § 301.6103(k)(6)-1(c)(1) provides that these disclosures "may not be made indiscriminately or solely for the benefit of the recipient or as part of a negotiated *quid pro quo* arrangement." The National Taxpayer Advocate does not view providing status updates pursuant to a confidentiality agreement as contravening this requirement.

whistleblower award could be paid, and notifies the whistleblower of a preliminary, or proposed, award.[67] 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."[68]

Although the Internal Revenue Manual (IRM) initially treated the administrative process as beginning on the date the WO received the claim for award, Treasury regulations now provide that sending the preliminary award marks the beginning of an "administrative proceeding."[69] Pursuant to IRC § 6103(h)(4), the IRS may disclose returns and return information during a whistleblower administrative proceeding.[70] The regulations under IRC § 7623 require the whistleblower to execute a confidentiality agreement before the IRS will share any information beyond that already provided in the preliminary award.[71] Violating the confidentiality agreement, including by re-disclosing return information, is a negative factor the IRS takes into account in calculating the amount of the award.[72] Noting that "[a]s a practical matter, this factor would be ineffective after payment," the National Taxpayer Advocate recommended that taxpayers be allowed to recover damages for subsequent unauthorized disclosure by whistleblowers.[73] The WO has raised the same concern, noting "current law does not provide an effective sanction if the whistleblower discloses taxpayer information in violation of the confidentiality agreement and section 6103(h)."[74]

More Robust Sanctions for Re-Disclosure of Taxpayer Information by Whistleblowers and Less Restrictive Interpretations of IRC §§ 7623 and 6103 Would Better Protect Taxpayers While Allowing Status Updates to Whistleblowers

The regulatory provision that a whistleblower "administrative proceeding" (which triggers an exception to the disclosure rules) begins only when the IRS proposes an award is an obvious impediment to effective communication with whistleblowers while the case is unfolding and wending its way through various phases that lead to an award. In response to a request for comment on proposed regulations under IRC § 7623, "[s]everal commenters suggested that whistleblower administrative proceedings should begin earlier. The commenters offered different suggestions for how this could be accomplished, including

67 IRC § 6103(h)(4), discussed below.

68 Treas. Reg. § 301.7623–3(c)(2)(ii) (for preliminary awards under IRC § 7623(b)). *See* Treas. Reg. § 301.7623-3(b)(1) (for a similar provision for preliminary awards under IRC § 7623(a)).

69 *Compare* IRM 25.2.2.8, *Whistleblower Award Determination Administrative Proceeding - 7623(a) Claims* (June 18, 2010), *with* Treas. Reg. § 301.7623–3(b) and (c). In practice, the IRS has never treated the administrative proceeding as beginning with receipt of the claim for award from the whistleblower. WO response to TAS information request (Oct. 20, 2015). 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 WO does not conduct whistleblower administrative proceedings for claims rejected or denied under IRC § 7623(a). *See* Treas. Reg. § 301.7623-3(b)(3).)

70 Treas. Reg. § 301.7623–3(a); Treas. Reg. § 301.6103(h)(4)-1.

71 Treas. Reg. § 301.7623-3(c)(3)(iii),(c)(4). Requiring a whistleblower to execute a confidentiality agreement before disclosing taxpayer information pursuant to IRC § 6103(h)(4) is intended to "balance whistleblowers' desire for increased communication with protections and safeguards for taxpayers' confidential information," in view of the lack of any prohibition on re-disclosure of taxpayer information in IRC § 6103(h)(4). *Preamble*, T.D. 9687, 79 Fed. Reg. 47246, 47258 (Aug. 12, 2014).

72 Treas. Reg. § 301.7623-4(b)(2)(vi).

73 National Taxpayer Advocate 2010 Annual Report to Congress 396-97 Legislative Recommendation: *Protect Taxpayer Privacy in Whistleblower Cases*, discussed below.

74 IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623* at 6.

beginning whistleblower administrative proceedings at the time that a claim is submitted on the Form 211."[75] However,

> [a]fter considering the comments received, Treasury and the IRS determined that beginning the administrative proceeding before the preliminary award determination letter would not meaningfully increase a whistleblower's ability to participate in and provide comments relating to the award determination. As discussed earlier in this preamble, the IRS will use several tools, including debriefings, section 6103(n) contracts, and section 6103(k)(6) disclosures to communicate with whistleblowers following the submission of a claim.[76]

Implicit in the response is the IRS's position that once a whistleblower submits a claim, further communication with the whistleblower is appropriate only after the IRS determines to make an award (unless the IRS needs information from the whistleblower in the meantime). In view of the lengthy timeframes involved, this approach seems inconsistent with the IRS's announced support for the whistleblower program and its commitment to finding ways of improving communication with whistleblowers.[77]

Neither IRC § 6103 nor any other statute impedes the IRS and Treasury from defining a whistleblower "administrative proceeding" as beginning with the filing of Form 211, and the IRS and Treasury could revise the regulations under IRC § 7623 to allow annual or bi-annual notifications to whistleblowers with basic information, such as whether the claim resulted in an audit, whether an audit has been concluded, whether proceeds from the audit have been collected, and an estimated time within which the WO expects to send a preliminary award. This would allow the WO to retain significant discretion about what it will disclose and how early. As the WO develops procedures for making periodic updates, the IRS and Treasury could update the applicable regulations to define what and when the WO will disclose. However, these changes should not be adopted unless the appropriate regulations (whether under IRC § 6103 or IRC § 7623) are also revised to require whistleblowers who wish to receive status updates to execute confidentiality agreements that carry the statutory penalties imposed by IRC §§ 7431, 7213, and 7213A, and subject them to the safeguarding requirements of IRC § 6103(p).[78]

75 *Preamble*, T.D. 9687, 79 Fed. Reg. 47246, 47256 (Aug. 12, 2014).

76 *Id*. The IRS may meet with a whistleblower as part of a "debriefing," but the purpose of these meetings "is to help us understand what you know," rather than to disclose information to the whistleblower. IRM 25.2.2-1, *Debriefing Checksheet* (Aug. 7, 2015).

77 *See, e.g.*, William Hoffman, *Tax Analysts Interview with John Koskinen* (Oct. 17, 2014) (reiterating his support for the whistleblower program generally, expressing his willingness to explore ways to improve communication with whistleblowers, and noting the need for anti-retaliation legislation).

78 Because IRC § 7623(b)(6)(A) provides that "[n]o contract with the Internal Revenue Service is necessary for any individual to receive an award under this subsection," the requirement that a whistleblower execute a confidentiality agreement would arise if the whistleblower requests status updates, not necessarily in every case. The National Taxpayer Advocate recommends legislative adjustments that would provide an independent statutory basis for imposing the same liability on whistleblowers whether or not a confidentiality agreement is in place. *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 Requirement of IRC § 6103(p)*, *infra*.

Tax Court Rules Protect Taxpayer Information and Whistleblower Identity in Court Filings, But Legislation Is Needed to Protect Taxpayers From Re-Disclosure of Their Confidential Information by Whistleblowers and to Protect Whistleblowers From Retaliation in the Event Their Identity Becomes Known

If a challenge to the proposed award under IRC § 7623(b) is not resolved administratively, the whistleblower may petition the Tax Court for review of the award.[79] Disclosure of relevant return information in a judicial tax proceeding is allowed pursuant to IRC § 6103(h)(4) (the same exception that allows disclosure in "administrative proceedings") and disclosures made in open court are generally in the public domain.[80] Unlike whistleblower cases brought pursuant to other statutes, such as the FCA, in which the alleged wrongdoer is a party to the case, in a tax whistleblower case the alleged wrongdoer (the taxpayer) is not a party and may be unaware the case even exists. As the National Taxpayer Advocate has noted:

> A taxpayer's privacy interest generally should not be compromised without consent, which is implicit in civil litigation initiated to contest a tax deficiency or obtain a refund, but not in whistleblower litigation. In the criminal context, considerable procedural protections leading up to a criminal charge and trial that discloses return information, coupled with the significant public interest in obedience to criminal laws, take the place of taxpayer consent.[81]

In 2010, the National Taxpayer Advocate recommended that Congress:

- Require the redaction of third-party return information in administrative and judicial proceedings relating to whistleblower claims;
- Notify a taxpayer of the intent to disclose confidential information and allow the taxpayer to request further redactions before disclosure; and
- Allow taxpayers to recover damages for subsequent unauthorized disclosure by whistleblowers.[82]

In 2012, the Tax Court adopted Rule 345, *Privacy Protections for Filings in Whistleblower Actions*, which:

- Allows a petitioner in a whistleblower case to proceed anonymously; and
- Requires a party or nonparty making the filing to refrain from including, or to redact, the name, address, and other identifying information of the taxpayer to whom the claim relates.[83]

The Tax Court, in its explanation for the proposed change relating to whistleblower cases, noted and discussed the National Taxpayer Advocate's concerns in detail.[84]

These changes in Tax Court rules, while they offer protection to both taxpayers and whistleblowers with respect to documents filed with the court, do not impede a whistleblower from re-disclosing taxpayer

79 IRC § 7623(b)(4), providing Tax Court jurisdiction to review any determination regarding an award under IRC § 7623(b). The Tax Court's review is limited to the WO's determination; "section 7623 [does not] confer authority to direct the Commissioner to commence an administrative or judicial action." *Cohen v. Comm'r*, 139 T.C. 299, 302 (2012).

80 *See Lampert v. U.S.*, 854 F.2d 335, 337 (9th Cir. 1988) (stating "once return information is disclosed in court, such information is no longer confidential, the taxpayer loses any privacy interests in that information") *cert. den'd* 490 U.S. 1034 (1989).

81 Even in a criminal trial, a taxpayer as a party could make a motion to protect private information. *See* Fed. R. Crim. Proc. 49.1. In a whistleblower case, unlike in a criminal or civil tax case, the taxpayer whose return information is disclosed is a third party. National Taxpayer Advocate 2010 Annual Report to Congress 396, 398 (Legislative Recommendation: *Protect Taxpayer Privacy in Whistleblower Cases*).

82 National Taxpayer Advocate 2010 Annual Report to Congress 396 (Legislative Recommendation: *Protect Taxpayer Privacy in Whistleblower Cases*).

83 *See* Tax Ct. R. 345 (effective July 6, 2012). The rule also cross references Rules 27 and 103(a), pertaining to privacy protections and protective orders.

84 *See* United States Tax Court, Press Release (Dec. 28, 2011), *available at* www.ustaxcourt.gov/press/122811.pdf.

information acquired during the whistleblower administrative proceeding or through discovery in the Tax Court proceeding, in a different venue or medium.[85] However, the Tax Court has been proactive in responding to this risk. In *Whistleblower One 10683-13W v. Comm'r*, the Tax Court granted whistleblowers' motions to compel discovery of information in the IRS's hands that should be included in an administrative record, and also ordered:[86]

- The IRS to mark it as "CONFIDENTIAL—Section 6103 Information Subject to Protective Order" any confidential taxpayer information it provides to the whistleblowers;
- "Any person receiving confidential information" to use it "solely for the *bona fide* purpose of conducting this litigation and not for any other purpose whatsoever," on pain of exposure to "sanctions and punishment in the nature of contempt;"
- Whistleblowers and their counsel to not disclose any confidential information directly or indirectly to any person "except for the sole purpose of trial preparation and in accordance with the provisions of the protective order;"
- Whistleblowers and their counsel, when providing confidential information to other persons for trial preparation, "to provide a copy of this order to the person receiving confidential information and inform the person that he or she must comply with the terms of the order. Before providing confidential information, petitioners and their counsel shall obtain the person's signature on a copy of the order, followed by a business or home address of that person at which service of process can generally be made during business hours. Petitioners and their counsel shall retain the signed copy of the order until one year after the decision in this case becomes final;" and
- Whistleblowers, their counsel, "and any other persons who receive confidential information" to "return all copies of any confidential information to respondent or certify in writing to respondent the destruction of all confidential information" upon final resolution of the case.[87]

Imposing meaningful statutory penalties on whistleblowers who engage in such unauthorized re-disclosure would also help protect taxpayers' *right to confidentiality*.[88] In the meantime, the WO could mitigate this risk by requiring whistleblowers who seek status updates to execute confidentiality agreements that would impose safekeeping requirements on whistleblowers and grant affected taxpayers a remedy for unauthorized re-disclosure of their confidential information.[89]

As for whistleblowers, even proceeding in court anonymously does not guarantee that their identity will not come to light or be inferred, at least by some interested members of the public, including their

85 The WO has also voiced concern about this potential for disclosure of taxpayer information. *See* IRS WO, *Fiscal Year 2014 Report to the Congress on the Use of Section 7623* 6-7. At least two whistleblowers shared with the media confidential taxpayer information they acquired pursuant to informal discovery during Tax Court litigation. *See* Jesse Drucker and Peter S. Green, *IRS Resists Whistle-Blowers Despite Wide U.S. Tax Gap* Bloomberg Business (June 19, 2012). Chief Counsel response to TAS information request (Aug. 6, 2015).

86 *Whistleblower One 10683-13W v. Comm'r*, 145 T.C. No. 8 and Order in docket no. 10683-13W (Sept. 16, 2015).

87 *Id*.

88 *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 Requirement of IRC § 6103(p)*, *infra*.

89 For litigated claims, IRS Chief Counsel attorneys could also seek to protect taxpayer information a whistleblower acquires during discovery or any other phase of the litigation. Tax Court Rule 103, *Protective Orders*, provides in paragraph (a): "Upon motion by a party or any other affected person, and for good cause shown, the Court may make any order which justice requires to protect a party or other person from annoyance, embarrassment, oppression, or undue burden or expense, including but not limited to one or more of the following:… (7) That a trade secret or other information not be disclosed or be disclosed only in a designated way."

employers. As noted above, unlike whistleblowers who proceed under the False Claims Act, tax whistleblowers do not enjoy statutory protection from retaliation. The National Taxpayer Advocate believes IRC provisions are needed to protect tax whistleblowers from retaliation.[90]

CONCLUSION

With its 2006 amendments to the IRC, Congress intended to encourage tax whistleblowing as an efficient means of enforcing the tax laws. The IRS paid only 11 awards under IRC § 7623(b) in the nine years since those amendments and has interpreted statutory provisions protecting taxpayer privacy in ways that prevent it from communicating effectively with whistleblowers who offer to assist the government in recovering unpaid taxes. The IRS relies on exceptions to the same nondisclosure rules in ways that do not adequately protect taxpayers' confidential information from re-disclosure by whistleblowers. Regulatory provisions crafted by the IRS and Treasury reflect these interpretations and should be adjusted to better protect taxpayers and meet the needs of whistleblowers.[91]

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Revise 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.
2. Revise the regulations under IRC § 6103 or IRC § 7623 to provide that the IRC §§ 7431, 7213 and 7213A penalties apply to re-disclosures of returns or return information by a whistleblower who has executed a confidentiality agreement as part of an IRC § 6103(h)(4) administrative proceeding, and that the IRC § 6103(p) safeguarding requirements also apply to such a whistleblower.
3. Revise the regulations under IRC § 7623 to require the IRS, upon the whistleblower's execution of a confidentiality agreement as part of an administrative proceeding under IRC § 6103(h)(4), to provide bi-annual status updates sufficient to allow a whistleblower to monitor the progress of the claim (*e.g.*, whether the claim resulted in an audit, whether the audit has concluded, the existence of any collected proceeds, and whether the case has been suspended) according to procedures developed by the WO.

90 See Legislative Recommendation: *Whistleblower Program: Enact Anti-Retaliation Legislation to Protect Tax Whistleblowers*, *infra*.

91 Legislative action is also necessary. 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 Requirement of IRC § 6103(p)*; Legislative Recommendation: *Whistleblower Program: Enact Anti-Retaliation Legislation to Protect Tax Whistleblowers*, *infra*.

MSP #14 AFFORDABLE CARE ACT (ACA) – BUSINESS: The IRS Faces Challenges in Implementing the Employer Provisions of the ACA While Protecting Taxpayer Rights and Minimizing Burden

RESPONSIBLE OFFICIALS

Carolyn A. Tavenner, Director, Affordable Care Act Office
Karen Schiller, Commissioner, Small Business/Self-Employed Division

TAXPAYER RIGHTS IMPACTED[1]

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

PROBLEM STATEMENT

The IRS is charged with implementing complex Affordable Care Act (ACA) provisions that require updating information technology systems, issuing guidance, and collaborating with other federal agencies.[2] For tax years 2015 and beyond, certain provisions of the ACA impacting employers become effective.[3] For example, applicable large employers (ALEs) must offer minimum essential coverage (MEC) to their full-time employees.[4] Employers not in compliance with this provision may be subject to an assessable payment, referred to as the "employer shared responsibility payment" (ESRP). The IRS expects to receive 77 million new information returns once the business portions of the ACA become effective in 2015.[5]

The ACA also provides for a temporary small business health care tax credit (SBHCTC) designed to defray the costs of employers with 25 or fewer employees whose average annual wage is less than $50,000.[6] Although many businesses will not meet the strict (and complex) criteria for claiming the SBHCTC, the IRS could do more to actively promote this credit to ensure that all eligible employers can take advantage of this subsidy.

The National Taxpayer Advocate is concerned that the IRS's implementation of the ACA provisions for the 2016 filing season may burden both employers and employees if certain conditions and issues are not addressed. Through representation on the IRS ACA Executive Steering Committee and several joint

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

2 See Patient Protection and Affordable Care Act of 2009, Pub. L. 111-148, 124 Stat. 119 (Mar. 2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

3 For a discussion of concerns expressed by the National Taxpayer Advocate regarding the IRS's implementation of the components of the ACA that impact individual taxpayers, see Most Serious Problem: *Affordable Care Act (ACA) - Individuals: The IRS Is Compromising Taxpayer Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions, infra*. *See also* National Taxpayer Advocate FY 2016 Objectives Report to Congress 38 (Area of Focus: *The IRS's Administration of the Affordable Care Act Has Gone Well Overall, But Some Glitches Have Arisen*); National Taxpayer Advocate 2014 Annual Report to Congress 67 (Most Serious Problem: *Implementation of the Affordable Care Act May Unnecessarily Burden Taxpayers*).

4 See Internal Revenue Code (IRC) § 4980H.

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

6 See IRC § 45R(d); Treas. Reg. § 1.45R-2; IRS Notice 2010-44, *available at* www.irs.gov/pub/irs-drop/n-10-44.pdf.

implementation teams, the National Taxpayer Advocate and TAS have identified the following concerns with the implementation of ACA provisions that impact employers:

- Employees in the newly-established ACA Business Exam unit need to receive specialized training on the parts of ACA implementation that impact businesses, including training on concepts such as ALE, MEC, and ESRP;
- The IRS should provide additional guidance to employers on how to calculate the number of full-time equivalents (FTEs) for purposes of meeting MEC requirements;
- The IRS lacks adequate testing of the accuracy of information-reporting data that would verify employer information before the filing season. This could lead to significant taxpayer burden that would subject employers to an unwarranted ESRP or require them to respond to unnecessary notices; and
- The IRS needs to increase active promotion of the availability of the SBHCTC to eligible employers.

Notwithstanding these concerns, we acknowledge the tremendous efforts made by the IRS to implement the health care provisions given their interdependency on decisions made by other federal agencies. Nonetheless, the IRS will be heavily scrutinized by individuals and employers for any ACA-related problems that arise in the context of return filing.

ANALYSIS OF THE PROBLEM

Background

Applicable Large Employers

Internal Revenue Code (IRC) § 4980H(a)(1) provides that an ALE must offer MEC to its full-time employees. In general, an employer is considered an ALE if it employs 50 or more full-time workers (or FTEs), or a combination of full-time and part-time employees that equals at least 50 FTEs.[7]

An employer calculates its FTEs based on each employee's hours of service. For purposes of the ESRP, an employee is considered full-time for a calendar month if he or she averages at least 30 hours of service per week. Under the final regulations, for purposes of determining full-time employee status, 130 hours of service in a calendar month is treated as the monthly equivalent of at least 30 hours of service per week.[8]

IRC § 4980H includes a provision stating that companies with a common owner (or that are otherwise related) generally are combined and treated as a single employer and therefore would be combined for purposes of determining whether or not they collectively employ at least 50 FTEs. If the combined total meets the threshold, then each separate company is subject to the ESRP, including those companies that individually do not employ enough employees to meet the 50 FTEs threshold.

Employer Shared Responsibility Payment

IRC § 4980H provides that ALEs 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 Premium Tax

7 IRC § 4980H(c)(2).

8 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), *available at* www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage.

The National Taxpayer Advocate is concerned that the IRS has not yet firmed up its approach to selecting and working cases involving Affordable Care Act (ACA) business issues, even as the 2016 filing season is rapidly approaching.

Credit 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).[9]

IRC § 4980H(b) requires ALEs to offer affordable MEC that provides minimum value. If an ALE offers MEC but it is not considered affordable, it will be assessed an ESRP of $3,000 for each employee (determined on a monthly basis) that purchases health insurance from the exchange and is granted a tax credit and/or subsidy for health insurance.[10] 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).[11]

The ESRP provisions generally are not effective until January 1, 2015, meaning that the ESRP will be first assessed during the 2016 filing season.[12] However, employers must take action during 2015 to avoid liability for ESRP assessed in 2016.

Minimum Essential Coverage, Minimum Value, and Affordability

MEC, minimum value, and affordability are defined under IRC provisions other than IRC § 4980H but all relate to the determination of ESRP. MEC is defined in IRC § 5000A(f) and the regulations under that section and includes employer-provided health care coverage but not coverage providing only limited benefits, such as coverage only for vision or dental care. IRC § 36B(c)(2)(C)(ii) provides the definition of minimum value. An employer-sponsored health plan meets this standard if it is designed to pay at least 60 percent of the total cost of medical services for a standard population.

If an employee's share of the premium for employer-provided coverage would cost the employee more than 9.5 percent of that employee's annual household income (HHI), the coverage is not considered "affordable" for that employee.[13] Because employers generally will not know their employees' HHI, employers can take advantage of several affordability safe harbors set forth in the final regulations that are based on information the employer will have available.[14] If an employer meets the requirements of any of these safe harbors, the offer of coverage will be deemed affordable for purposes of the ESRP provisions regardless of whether it was actually affordable to the employee.

IRC § 4980D Excise Tax

IRC § 4980D imposes an excise tax on employers who maintain a group health plan that fails to meet certain requirements. There is concern that certain flexible spending accounts, health reimbursement arrangements, and other arrangements that reimburse employee premiums for medical insurance purchased on the individual market are considered group health plans subject to the excise tax imposed by IRC § 4980D. By their nature, these arrangements fail to comply with the ACA market reforms that prohibit annual and lifetime dollar limits (Public Health Service Act § 2711) and require plans to provide cost-free

9 IRC § 4980H(c)(1). The ESRP provisions provide an inflation adjustment mechanism beginning in years after 2014. IRC § 4980H(c)(5).

10 IRS § 4980H(b)(1).

11 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), *available at* www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage.

12 IRS Notice 2013-45, *available at* www.irs.gov/irb/2013-31_IRB/ar08.html.

13 IRC § 36B(c)(2)(B) and (C).

14 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), *available at* www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage.

preventive services (Public Health Service Act § 2713). As a result, it appears that such programs are subject to an excise tax of $100 per affected individual, per day, under IRC § 4980D as plans that fail to satisfy ACA market reforms.[15]

On February 18, 2015, the IRS issued Notice 2015-17[16] providing temporary relief from the IRC § 4980D excise tax for employer programs that reimburse employees for the cost of health insurance coverage purchased individually (including coverage obtained through an Exchange). This excise tax will not be asserted for employers that are not ALEs for 2014 and for January through June 2015. After June 30, 2015, such employers may be liable for the IRC § 4980D excise tax. Understandably, this temporary relief is not all that comforting to small businesses that must decide whether to keep providing such a benefit to their employees at the risk of being assessed an excise tax of $100 per day per employee.

Small Business Health Care Tax Credit

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 equal to at least 50 percent of the premium cost of employee-only insurance coverage.

For 2010 through 2013, the maximum credit was 35 percent of premiums paid by eligible small businesses and 25 percent of premiums paid by eligible tax-exempt organizations. For 2014 and 2015, the maximum credit rate rises to 50 percent for small businesses and 35 percent for tax-exempt organizations.[17] Businesses that have already filed and later find that they qualified in 2013 or an earlier year can still claim the credit by filing an amended return for the affected years.

IRS Employees Need to Receive Training on the Parts of ACA Implementation That Impact Businesses, Including Training on Concepts Such as ALE, MEC, and ESRP

The IRS must ensure that employees who work ACA-related issues, especially those in taxpayer-facing roles, are properly trained on the aspects of the ACA that impact business taxpayers. The IRS has designated that ESRP cases will be worked by a specialized unit out of the Ogden Service Center but does not yet know the grade or series of the examination employees selected to work these ESRP cases.[18] The IRS expects to develop procedures and roll out training for these employees before the ESRP cases are assigned but has not committed to a certain date. The National Taxpayer Advocate is concerned that the IRS has not yet firmed up its approach to selecting and working cases involving ACA business issues, even as the 2016 filing season is rapidly approaching.

Although the IRS developed and delivered a substantial amount of training in advance of the 2015 filing season, much of that training was focused on the components of the ACA that impacted individual taxpayers.[19] In 2015, the IRS expanded training to revenue agents, tax compliance officers, and technical advisors on IRC §§ 4980H, 6055, and 6056. Once the IRS has determined which group of employees

15 *See* IRS Notice 2013-54, *available at* www.irs.gov/pub/irs-drop/n-13-54.pdf.

16 *Available at* www.irs.gov/pub/irs-drop/n-15-17.pdf.

17 *See* Treas. Reg. § 1.45R, 79 FR 36640 (June 30, 2014), *available at* www.federalregister.gov/articles/2014/06/30/2014-15262/tax-credit-for-employee-health-insurance-expenses-of-small-employers.

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

19 *See* National Taxpayer Advocate 2014 Annual Report to Congress 71.

will focus on examining employers' compliance with the business aspects of the ACA, this new group of employees will require comprehensive and specialized training.[20]

The IRS Should Provide Formal Guidance to Employers on the Calculation of FTEs for Purposes of Meeting MEC Requirements

IRS outreach and education should continue to focus on increasing awareness to employers of the ACA requirements that are effective beginning in tax year (TY) 2015. For example, the IRS Information Reporting Advisory Committee (IRPAC) reported that the ACA Information Center for Tax Professionals web page on the IRS website should be improved to provide clearer guidance for TY 2014 about what constitutes MEC.[21]

Employers not in compliance with the provisions under IRC § 4980H may be subject to an assessable payment, referred to as the ESRP. On February 12, 2014, the IRS and Treasury issued final regulations on the ESRP provisions.[22] The guidance acknowledges that there are certain categories of employees whose hours of service will be particularly challenging to identify and track and advises their employers to use "a reasonable method of crediting hours of service that is consistent with section 4980H." The preamble provides some examples of what may be considered a reasonable method in certain industries but is far from comprehensive.

In addition to the final regulations, the IRS provides clarification of the guidance in the form of an ESRP Q&A page and an ALE Information Center on irs.gov.[23] While they contain helpful information, the limited Q&A page and ALE Information Center do not adequately address many questions about the calculation of FTEs for purposes of meeting the MEC requirements. Q&As are helpful, but they do not have the impact of formal guidance, which undergoes a notice and comment period. Furthermore, although informal guidance is better than no guidance, taxpayers may not rely on Q&As found on the IRS website for penalty defense purposes.

The Inability of the IRS to Adequately Test the Accuracy of Information-Reporting Data Before the Filing Season Can Inhibit IRS Verification Efforts and May Cause Significant Taxpayer Burden

The IRS relies on information reports to verify data relevant to the ESRP liability and SBHCTC eligibility. Beginning in the 2016 filing season, the IRS will receive and process an estimated 77 million new information returns from employers.[24]

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

20 The IRS did not provide specific course modules or training schedules for business-related ACA issues. *See* IRS response to TAS information request (Oct. 27, 2015).

21 *See* IRS, *2014 IRPAC Public Report: Employee Benefits and Payroll Subgroup*, *available at* www.irs.gov/Tax-Professionals/IRPAC-Public-Report-Employee-Benefits-and-Payroll-Subgroup-2014.

22 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), *available at* www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage.

23 *See* IRS, *Questions and Answers on Employer Shared Responsibility Provisions Under the Affordable Care Act*, *available at* www.irs.gov/Affordable-Care-Act/Employers/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act (last visited Dec. 1, 2015); IRS, *ACA Information Center for Applicable Large Employers (ALEs)*, *available at* www.irs.gov/Affordable-Care-Act/Employers/ACA-Information-Center-for-Applicable-Large-Employers-ALEs (last visited Dec. 1, 2015).

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

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 and therefore aren't liable for the individual shared responsibility payment; due by February 28 (or March 31 if filing electronically));[25]
- 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* (furnished by ALEs to any full-time employee for one or more months of the year; due by February 28 (or March 31 if filing electronically));[26] and
- Form 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns* (used by ALEs to submit Form 1095-C).

FIGURE 1.14.1, Projected Volume of Information Returns for ACA Exchange Provisions, Tax Years 2015–2017[27]

	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. If this information is not furnished to the IRS timely, the IRS has little opportunity to identify problems and even less opportunity to fix them early in the filing season to prevent potential rejected returns and delays for taxpayers. As of the time of publication, the IRS has not been able to fully test the ability of its information technology systems to handle the expected volume of ACA information returns. Furthermore, the IRS has not expanded the taxpayer identification number (TIN) matching program to health insurers and self-insured employers that are required to file Form 1095-B, which may lead to mismatches and unnecessary notices.[28]

If the IRS receives incomplete or inaccurate data, taxpayers will be harmed.[29] For example, if the IRS cannot accurately verify coverage information, it will inhibit the IRS's ability to verify eligibility for the SBHCTC. Furthermore, ALEs may unnecessarily be required to substantiate coverage to employees if the data is unreliable and contains false positives. If the IRS receives inaccurate data regarding coverage, it may erroneously assess ESRPs on ALEs, which can be costly and time-consuming for both employers and the IRS to rectify.

25 IRS, *Instructions for Forms 1094-B and 1095-B* (2015), *available at* www.irs.gov/pub/irs-pdf/i109495b.pdf.

26 IRS, *Instructions for Forms 1094-C and* 1095-C (2015), *available at* www.irs.gov/pub/irs-pdf/i109495c.pdf.

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

28 *See* Most Serious Problem: Affordable Care Act (ACA) - Individuals: *The IRS Is Compromising Taxpayers Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions*, *infra*.

29 *See* National Taxpayer Advocate 2014 Annual Report to Congress 75-6 (discussing TIN matching for Form 1095-B; the IRS will use Form 1095-B to verify compliance with IRC § 5000A); Legislative Recommendation: *Math Error Authority: Authorize the IRS to Summarily Assess Math and "Correctable" Errors Only in Appropriate Circumstances*, *infra*.

The IRS Should More Actively Promote the Availability of the SBHCTC to Eligible Employers

To educate and assist small business taxpayers, TAS developed an online estimator for the SBHCTC.[30] This tool allows small businesses to estimate their credits (if any) and find out how any changes in circumstances will impact their eligibility. Since November 2012, the SBHCTC estimator has been available on the TAS Tax Toolkit,[31] where small businesses and tax professionals can access it easily, and TAS has continually promoted it through social media, including Twitter and Facebook.

Notwithstanding the efforts of TAS, the IRS should do more to promote the availability of the SBHCTC to eligible employers. Yet it is difficult for the IRS to actively promote this credit to small businesses when it has decimated its public outreach staff, such that as of the end of October 2015, 14 states (plus the District of Columbia) did not have a single outreach and education employee dedicated to small businesses located within their borders.[32]

The IRS expects to receive over 120 million information returns from health insurance providers and Applicable Large Employers (ALEs) during the 2016 filing season. If this information is not furnished to the IRS timely, the IRS has little opportunity to identify problems and even less opportunity to fix them early in the filing season to prevent potential rejected returns and delays for taxpayers.

CONCLUSION

The 2016 filing season will be challenging as the IRS implements several ACA provisions that impact employers against the backdrop of historically low levels of taxpayer service. Although the IRS developed systems and procedures to administer components of the ACA impacting individual taxpayers in the 2015 filing season, the IRS will face new challenges in the 2016 filing season when business taxpayers file their TY 2015 returns and report ESRP liabilities. The IRS will receive and process a significant amount of new information returns from insurers and exchanges to identify errors and noncompliance. While the IRS has little control over some of the anticipated risks, such as delayed or inaccurate data reporting from the exchanges, it will be held publicly responsible when the associated problems surface during the tax return filing process.

Because of the increased risk of taxpayer harm this filing season, TAS will continue to address issues as they arise and identify systemic problems. TAS will continue to assign ACA Rapid Response team members to immediately address any potential ACA systemic issues that arise during the 2016 filing season. In addition, we encourage both internal and external stakeholders to report any suspected ACA systemic issues on TAS's Systemic Advocacy Management System.[33]

30 To educate and assist small business taxpayers, TAS developed an online estimator for the SBHCTC, *available at* www.taxpayeradvocate.irs.gov/estimator/smallbusiness2014/.

31 The TAS Tax Toolkit is a website that contains useful tax information for individuals, businesses, tax professionals and media, including news and updates, ways TAS helps taxpayers, and important information about tax topics and rights and is available at http://www.TaxpayerAdvocate.irs.gov.

32 IRS Human Resources Reporting Center, *Report of SB/SE Job Series, Stakeholder Liaison Field Employees as of October 31, 2015* (Nov. 10, 2015). The 14 states are Alaska, Delaware, Hawaii, Iowa, Kentucky, Mississippi, Montana, Nebraska, New Hampshire, North Dakota, South Dakota, Vermont, West Virginia, and Wyoming. *See also* National Taxpayer Advocate 2014 Annual Report to Congress 31 (Most Serious Problem: *The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*).

33 Stakeholders can report suspected systemic issues at www.irs.gov/sams.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Provide additional guidance to employers and tax practitioners on how to calculate the number of FTEs for purposes of meeting the MEC requirements.
2. Publish regulations explaining how the IRC § 4980D excise tax may apply to certain flexible spending accounts and health reimbursement arrangements.
3. Establish a Rapid Response team to assist front-line IRS employees with issues, problems, or questions from employers or tax practitioners.
4. Provide employees in its newly-established ACA Business Exam unit with comprehensive and specialized training on the parts of ACA implementation that impact businesses, including training on concepts such as ALE, MEC, and ESRP.

MSP #15 AFFORDABLE CARE ACT (ACA) – INDIVIDUALS: The IRS Is Compromising Taxpayer Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions

RESPONSIBLE OFFICIALS

Carolyn A. Tavenner, Director, Affordable Care Act Office
Karen Schiller, Commissioner, Small Business/Self-Employed Division
Sunita B. Lough, Commissioner, Tax Exempt and Government Entities Division
Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*

DEFINITION OF PROBLEM

Overall, the IRS has done a commendable job of implementing the first stages of the Patient Protection and Affordable Care Act of 2010 (ACA), including developing or updating information technology systems, issuing guidance, and collaborating with other federal agencies.[2] The 2015 filing season (FS) presented difficult challenges with the introduction of the Individual Shared Responsibility Payment (ISRP)[3] and the Premium Tax Credit (PTC)[4] on tax year (TY) 2014 federal income tax returns. At the

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

2 ACA, Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act of 2010 (HCERA), Pub. L. No. 111-152, 124 Stat. 1029 (2010).

3 Internal Revenue Code (IRC) § 5000A. Taxpayers filing tax year (TY) 2014 federal income tax returns were required to report they have "minimum essential coverage" (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 a shared responsibility payment (SRP) when filing a return.

4 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 for which a taxpayer is actually eligible 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. IRC § 36B(f).

same time, the IRS received and processed new information returns from insurers and exchanges.[5] While the IRS performed well overall, several developments will likely result in significant burden imposed on both taxpayers and the IRS in future years:

- Taxpayers who received the advanced premium tax credit (APTC) in 2014 and did not file TY 2014 returns (and the Form 8962, *Premium Tax Credit (PTC)*) by Fall 2015 will face difficulties receiving APTC payments in 2016;
- The pre-refund Automated Questionable Credit (AQC) procedures for PTC mismatches impose the same burden as a post-refund PTC examination without the same due process protections, thereby subverting the statutory protections against multiple audits of the same return;[6]
- Taxpayers who receive certain large lump sum payments after receiving APTC may be caught off guard by having to repay APTC amounts, as well as penalties and interest;
- The absence of the Second Lowest Cost Silver Plan (SLCSP) amounts on some Forms 1095-A, *Health Insurance Marketplace Statement*, are delaying the processing of PTC returns and imposing unnecessary burden on taxpayers; and
- The inability of health insurers and self-insured employers to match taxpayer identification numbers (TINs) before filing leads to unnecessary mismatches and notices, increasing issuer burden and wasting IRS resources.

ANALYSIS OF PROBLEM

Background

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 for small businesses, while imposing a personal responsibility on individuals to have health coverage.[7]

Filing Season 2015 Overall Results

Since enactment, the IRS has been implementing complicated ACA provisions that require developing or updating information technology systems, issuing guidance, and collaborating with other federal agencies. The IRS implementation efforts were tested during FS 2015. The IRS achieved a relatively high level of service (LOS) on the ACA telephone hotline (800-919-0452) at about 61 percent for fiscal year (FY) 2015, which far exceeded the 38 percent overall LOS on the Accounts Management (AM) toll-free

5 The Health Insurance Marketplace, also called the "exchange," is a state- or federally-operated program where individuals can buy health care coverage. Coverage is available to people who are uninsured or who buy insurance on their own. See http://www.irs.gov/uac/Newsroom/The-Health-Insurance-Marketplace. IRC § 6055 and the regulations thereunder require every person (*i.e.*, health insurance issuers, self-insuring employers, government agencies, and other providers of health coverage) that provides MEC (as defined in IRC § 5000A(f)) to an individual to report to the IRS information about the coverage of each individual covered under the policy. IRC § 6056 requires annual information reporting by applicable large employers (ALEs) relating to the health insurance that the employer offers (or does not offer) to its full-time employees. Notice 2013-45, 2013–31 I.R.B. 116 (July 29, 2013) and T.D. 9660, 2014-13 I.R.B. 842 provide transition relief by delaying the information reporting required under IRC §§ 6055 and 6056 until 2016 for coverage in 2015, but the IRS has encouraged entities to voluntarily provide information returns for coverage provided in 2014, which was due to be filed and furnished in early 2015.

6 The IRS is prohibited from conducting unnecessary examinations or investigations pursuant to IRC § 7605(b).

7 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 (2010), as amended by HCERA, Pub. L. No. 111-152, 124 Stat. 1029 (2010); Senate Finance Committee, *Description of Policy Options: Expanding Health Care Coverage: Proposals to Provide Affordable Coverage to All Americans* (May 14, 2009).

lines.[8] The IRS received and processed new information returns from employers, insurers, and exchanges. Taxpayers filing TY 2014 federal income tax returns were required to report that they had "minimum essential coverage" (MEC) or were exempt from the responsibility to have the required coverage in 2014. If the taxpayer did not have coverage and was not exempt, he or she was required to make an ISRP when filing the 2014 return.[9] The following figure provides data on the reporting of ISRPs on TY 2014 returns:

FIGURE 1.15.1, Reporting of Individual Shared Responsibility Payments on TY 2014 Returns Through August 27, 2015[10]

Returns claiming coverage	106 million
Returns with ISRP	7.6 million
Average ISRP	$204
Prepared returns reporting ISRP	5.0 million
Forms 8965	12.1 million
Forms 8965 Claiming Household Coverage Exemption	3.65 million
Forms 8965 Claiming Coverage Exemption	8.4 million
Forms 8965 Submitted with Prepared Return	6.5 million

Additionally, eligible individual taxpayers claimed the PTC for the first time on TY 2014 returns filed during FS 2015 filing. If the taxpayers received the credit in advance, they had to reconcile the APTC amount with the amount of the credit to which they were entitled.[11] The following figure provides information regarding the extent to which individual taxpayers claimed the PTC on their TY 2014 returns.

FIGURE 1.15.2, Reporting of the Premium Tax Credit on Forms 8962 for TY 2014 Returns Through August 27, 2015[12]

Forms 8962	3.3 million
Total PTC Claimed	$9.9 billion
Average PTC	$3,011
Returns reporting APTC	3.1 million (93% of total PTC returns)
Total APTC Reported	$11.3 billion
Forms 8962 Submitted with Prepared Returns	2.0 million (61% of total PTC returns)

8 The AM LOS of approximately 38 percent is a combined figure reflecting 30 customer service lines. The higher LOS on the ACA line may be due, at least in part, to the fact that the number of calls to the ACA line was significantly lower than the IRS anticipated. IRS, *FY 2015 President's Budget* 4-5, 19-23. The ACA line received about one million net attempted calls, as compared with over 101 million on the AM lines overall during the period. IRS, Joint Operations Center (JOC), *Product Line Detail (Enterprise Performance)* (week ending Sept. 30, 2015); IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2015).

9 IRC § 5000A.

10 Wage & Investment Research and Analysis (WIRA), *ACA Fact Sheet* (Oct. 8, 2015) (returns processed through August 27, 2015, Cycle 34). This data is based on amounts claimed on returns that had posted as of August 27, 2015, and is preliminary and subject to change as the IRS reviews the data, processes additional TY 2014 returns and conducts compliance activities. IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File for TY 2014 (through cycle 201534).

11 IRC § 36B(f). The amount of the credit paid in advance is based on projected income while the amount for which a taxpayer is actually eligible is based on actual income.

12 WIRA, *ACA Fact Sheet* (Oct. 8, 2015) (returns processed approximately Aug. 27, 2015). This data is based on amounts claimed on returns that had posted as of August 27, 2015, and is preliminary and subject to change as the IRS reviews the data, processes additional TY 2014 returns, and conducts compliance activities.

Significant Issues That Arose During Filing Season 2015

As FS 2015 progressed, the IRS ran into the following three significant issues.[13]

A Significant Number of Taxpayers Overstated the ISRP on TY 2014 Returns

Approximately 412,000 taxpayers overstated their ISRP, totaling about $50.6 million through August 27, 2015 (cycle 34).[14] The *average* ISRP overstatement amount was almost $123 per return.[15] These taxpayers did not owe an ISRP for reasons that include:[16]

- The taxpayer was eligible for an ISRP exemption because the reported income is below the income tax filing threshold;[17]
- The taxpayer indicated that he or she could be claimed on another return;[18] and
- Transposition, calculation, or input error.

The IRS decided to issue soft notices to impacted taxpayers. On November 27, 2015, the IRS began issuing approximately 319,000 Letters 5600-C informing taxpayers of the potential overpayment and instructing them to file an amended return and attach Form 8965, *Health Coverage Exemptions*, if applicable. The IRS is exploring the feasibility of systemically adjusting ISRP amounts through programming. If feasible, the IRS would be able to take this action in late Spring 2016.[19] We believe that the IRS should take preventative measures to avoid ISRP overpayments in the future, such as distributing educational notices to preparers associated with overpayments and conducting a comprehensive review and testing of private-sector tax filing software to ensure that problems arising in FS 2015 do not recur.[20]

13 For a detailed discussion of these issues, see National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 38-47 *(The IRS's Administration of the Affordable Care Act Has Gone Well Overall, But Some Glitches Have Arisen).*

14 WIRA analysis on ISRP overstatements, through cycle 34 (August 27, 2015), on file with TAS Research. The IRS cannot calculate the exact amount of ISRP overpayments until all dependents have filed their TY 2014 tax returns (The amount of the ISRP depends on HHI pursuant to IRC § 5000A(c)).

15 This average only includes returns with an ISRP overstatement.

16 More than 268,000 taxpayers were eligible for an ISRP exemption. These taxpayers paid in over $33 million in ISRP. In addition, more than 50,000 taxpayers paid a total of nearly $12.7 million because the ISRP amount was miscalculated. The remaining nearly 93,000 taxpayers had multiple adjustments to an ISRP, overstatements of $50 or less, or returns under IRS Examination (totaling almost $4.7 million). These amounts include returns processed by the IRS through the end of August 2015. WIRA estimates from the Individual Returns Transaction File on the IRS CDW. This data is preliminary and is subject to change as the IRS reviews the data, processes additional TY 2014 returns, and conducts compliance activities.

17 IRC § 5000A(e)(2).

18 IRC § 5000A(a).

19 W&I response to TAS information request (Oct. 29, 2015); W&I response to TAS fact check (Dec. 14, 2015) (the IRS expected to mail all letters by December 31, 2015).

20 To determine the experience of taxpayers and find out if the Free File programs accurately calculate the ISRP and determine exemption eligibility, TAS created three scenarios and tested them on each of the 14 Free File sites during FS 2015. We found that four programs correctly calculated no ISRP due to an applicable exemption, but never informed the taxpayer whether he or she qualified for the exemption of income amounts that were below the filing threshold. One program did not seem to support IRS Form 8965, *Health Coverage Exemptions*. The program did not provide the appropriate prompts to take the hardship exemption and incorrectly calculated ISRP. Three programs assumed the user already knew about the available exemptions and did not provide sufficient guidance. We reported our findings to the IRS and the IRS coordinated with the Free File Alliance and all software providers associated with any of the above-mentioned problems adjusted their programs to avoid similar errors in the future. For a more detailed discussion of the FS 2015 Free File software issues, see National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 38-47 (*The IRS's Administration of the Affordable Care Act Has Gone Well Overall, But Some Glitches Have Arisen*).

Exchanges Made Errors on Forms 1095-A, Leading to an IRS Resolution to Reduce Taxpayer Burden

The Centers for Medicare and Medicaid Services (CMS) announced in February 2015 that about 20 percent (or 800,000) of the tax return filers who purchased health insurance from the federal exchange received Forms 1095-A, *Health Insurance Marketplace Statement*, with errors in the SLCSP information.[21] The exchange issued corrected Forms 1095-A. The Department of Treasury publicly stated that the IRS would not pursue collection of any additional taxes or require the taxpayer to file an amended return based on the updated information in the corrected forms if the taxpayer filed a 2014 tax return with the incorrect Form 1095-A amounts.[22] On April 10, 2015, the IRS issued Notice 2015-30, providing penalty relief for incorrect or delayed Forms 1095-A for taxpayers who timely filed their 2014 return.[23]

The IRS identified returns with errors in the SLCSP, but did not issue guidance to all employees on how to distinguish taxpayers impacted by the CMS announcement.[24] We believe the IRS may adjust the PTC on returns filed with an incorrect Form 1095-A and pursue collection since there is no guidance to prevent this from occurring. TAS will be monitoring its own case receipts to see if such collection activity, including refund offsets, is taking place, and will work with the IRS to issue interim guidance.

Approximately 412,000 taxpayers overstated their Individual Shared Responsibility Payment (ISRP) totaling about $50.6 million through August 27, 2015 (cycle 34). The average ISRP overstatement amount was almost $123 per return.

Taxpayers Who Received APTC in 2014 and Did Not File TY 2014 Returns (and Form 8962) by Fall 2015 Will Face Difficulties Receiving APTC in 2016

The Department of Health and Human Services (HHS) regulations that implement the ACA include a process for re-enrolling taxpayers in health insurance and determining their eligibility for the APTC. To determine eligibility, the regulations require the exchange to verify income and family size with the IRS.[25] The IRS has begun to provide a response code during the verification process that signifies that a taxpayer has not filed a tax return reconciling the amount of APTC received.[26] The response code indicates to the Marketplace that a taxpayer may not be eligible to receive the APTC for the new coverage year. It is our understanding that the IRS began to provide such response codes during Marketplace open enrollment for coverage year 2016, which began on

21 The amount of the SLCSP is a factor used to determine the amount of PTC a taxpayer is allowed. The SLCSP is based on such factors as an individual's age and the area in which he lives. IRC § 36B(b)(3)(B).

22 U.S. Department of Treasury, Press Center, *Statement from a Treasury Spokesperson on CMS Announcement Last Week About 1095-A* (Feb. 24, 2015) and *Statement from a Treasury Spokesperson on Forms 1095-A* (Mar. 20, 2015), *available at* http://www.treasury.gov/press-center/press-releases/Pages/jl9981.aspx and http://www.treasury.gov/press-center/press-releases/Pages/jl10005.aspx, respectively. *See also* Treasury Inspector General for Tax Administration, Ref. No. 2015-43-043, *Affordable Care Act: Assessment of Internal Revenue Service Preparation for Processing Premium Tax Credit Claims* 12 (May 11, 2015) (urging the IRS to develop a tool to enable taxpayers to determine the correct SLCSP premium); SERP Alert 15A0147, *Responding to Taxpayer Inquiries about Corrected Forms 1095-A, Health Insurance Marketplace Statements* (Feb. 26, 2015, rev. Apr. 6, 2015).

23 Notice 2015-30, 2015-17 I.R.B. 928 (Apr. 27, 2015). For more information regarding the impact of the incorrect Forms 1095-A as well as the National Taxpayer Advocate's concerns, see National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 38-47 (*The IRS's Administration of the Affordable Care Act Has Gone Well Overall, But Some Glitches Have Arisen*).

24 IRM 3.12.3.75.9, *Error Code 198, Form 8962, Annual/Monthly SLCSP Amount(s), Column B (ACA)* (Jan. 1, 2015).

25 45 CFR § 155.335, Annual eligibility redetermination; HHS, *Guidance on Annual Eligibility Redeterminations and Re-enrollments for Marketplace Coverage for 2016* (Apr. 22, 2015), *available at* https://www.cms.gov/CCIIO/Resources/Regulations-and-Guidance/Downloads/annual-redeterminations-for-coverage-42215.pdf.

26 In some cases the taxpayer may have filed a tax return but did not attach the Form 8962 which is necessary to reconcile the APTC. IRS ACA Office response to TAS information request (Nov. 5, 2015).

November 1, 2015.[27] For all taxpayers who previously received the APTC and filed their tax returns and Form 8962 by the date of the verification, the exchanges automatically re-enrolled the taxpayers and recalculated their 2016 APTC amount during the fall of 2015. Taxpayers who failed to file a tax return (or who filed and failed to attach Form 8962) by the date of the verification, regardless of whether they had a valid extension of time to file, will be re-enrolled in their insurance for 2016; however, they will not automatically receive the APTC.[28] To receive the APTC, these taxpayers will have to file their 2014 tax return, including a reconciliation on Form 8962, and then go back to the Marketplace for a redetermination of their eligibility for the APTC. This creates extra burden for taxpayers to reestablish their eligibility for the advanced credit. Some taxpayers may erroneously believe their automatic re-enrollment in their insurance plan also includes APTC re-enrollment and not take the steps necessary to receive the APTC in 2016.

The National Taxpayer Advocate is concerned about the burden imposed on taxpayers due to the timing of the verification process between the IRS and the exchanges. Approximately 360,000 taxpayers with APTC filed for an extension for TY 2014 returns, which allows them to file on or before October 15, 2015.[29] It is our understanding that balance due returns take longer to process and a significant portion of these returns may have been impacted by such response codes in the verification process.[30]

Commendably, the IRS sent Letters 5591 or 5591A to APTC recipients who had not filed tax returns but received APTC. The IRS also sent Letter 5596 to APTC recipients who had yet to file a 2014 return but had filed for an extension. The letters urged the recipient to file as soon as possible to avoid a gap in receiving APTC in 2016.[31] The following figure sets forth how many of each type of letter the IRS sent, as well as the dates mailed:

FIGURE 1.15.3, Letters Sent to APTC Recipients Who Had Not Yet Filed Returns[32]

Type of IRS Letter	Count	Dates Mailed
Ltr 5591	567,976	July 10, 2015 to July 30, 2015
Ltr 5591A	149,688	July 31, 2015 to Aug. 21, 2015
Ltr 5596	337,065	Aug. 6, 2015 to Aug. 21, 2015

TAS did not have the opportunity to provide meaningful review of some of the letters prior to final approval by the IRS. We believe that the letters did not adequately warn taxpayers of the need to file returns by a particular date to avoid a cumbersome process to continue receiving APTC in 2016. We advise the IRS to work with the National Taxpayer Advocate on revisions to Letters 5591, 5591A, and 5596

27 IRS ACA Office response to TAS information request (Nov. 5, 2015).

28 HHS *Guidance on Annual Eligibility Redeterminations and Re-enrollments for Marketplace Coverage for 2016* (Apr. 22, 2015), *available at* https://www.cms.gov/CCIIO/Resources/Regulations-and-Guidance/Downloads/annual-redeterminations-for-coverage-42215.pdf. IRS ACA Office response to TAS information request (Nov. 5, 2015).

29 IRS Commissioner John Koskinen Letter to Members of Congress 3 (July 17, 2015), *available at* http://www.irs.gov/pub/irs-utl/CommissionerLetterIwithcharts.pdf.

30 IRM 21.3.12.2, *Balance Due Research* (Oct. 1, 2015). TAS encounters this issue when the taxpayer needs the return posted for purposes of getting tax transcripts for financial aid, loan applications, and proof of income. The payments for some balance due returns are visible on the account, but no associated return has posted. IRM 1.2.3.5.7, *Transcript Restrictions and Special Handling* (Aug. 19, 2015).

31 IRS Letters 5591, 5591A, 5596.

32 W&I response to TAS information request (Oct. 29, 2015).

Despite the fact that the Letter 4800C begins with the language, "This is not an audit. Your return may be examined in the future," we are concerned that the Automated Questionable Credit (AQC) process and the documentation requirements imposed on the taxpayers under AQC are substantially similar to those in an examination.

for FS 2016. The IRS should provide outreach and education early in the filing season to inform taxpayers about the consequences of filing for an extension if they received the APTC, or at least, the risk of waiting until fall to file even with a valid extension.

The Pre-Refund Automated Questionable Credit (AQC) Procedures for PTC Mismatches Impose the Same Burden As a Post-Refund PTC Exam Without the Same Due Process Protections, Thereby Subverting the Statutory Protections Against Multiple Audits of the Same Return

The IRS is generally prohibited by Internal Revenue Code (IRC) § 7605(b) from auditing a return twice.[33] IRC § 7605(b) first appeared as § 1309 of the Revenue Act of 1921.[34] At that time, Congress designed the section in response to taxpayer complaints that revenue agents were subjecting them to onerous and unnecessarily frequent examinations and investigations. The purpose of the section was to relieve taxpayers from unnecessary annoyance.[35] Accordingly, the manner in which the IRS is conducting pre-refund "reviews" of taxpayers' PTC returns raises serious concerns about the IRS subjecting taxpayers to multiple audits and undermining this important protection.

During submission processing, the IRS ACA Verification Service (AVS) matches data reported on PTC returns with data reported from the Marketplace. AVS checks all returns to verify if the taxpayer received APTC and reconciled the advance payment on Form 8962, *Premium Tax Credit (PTC)*. If the data does not match or the APTC was not reconciled on Form 8962, the IRS will delay processing the return and send the taxpayer Letter 12C, requesting a corrected Form 8962, or Form 1095-A, *Health Insurance Marketplace Statement,* to support the credit and reconcile the APTC.[36]

The IRS cannot use math error authority to adjust return discrepancies attributable to third-party data mismatch. In those cases, the IRS places a freeze on the refund, or a portion thereof, and refers the return to Compliance for further treatment.[37]

33 *See* IRC § 7605(b); Rev. Proc. 2005-32, § 4.03, 2005-1 C.B. 1206 (discussing procedures the IRS does not consider examinations). IRC § 7605(b) provides "No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary, after investigation, notifies the taxpayer in writing that an additional inspection is necessary."

34 Revenue Act of 1921, ch. 136, § 1309, 42 Stat. 310 (1921) (now codified at IRC § 7605(b)).

35 Harold Dubroff and Brant J. Hellwig, United States Tax Court: A Historical Analysis: A Historical Analysis, Government Printing Office fn. 100 (2d. Ed. 2015); *United States. v. Powell*, 379 U.S. 48, 54-55 (1964) (quoting the statement of Senator Penrose, the manager of the bill: "I know that, from many of the cities of the country, very bitter complaints have reached me and have reached the department of unnecessary visits and inquisitions after a thorough examination is supposed to have been had. This section is purely in the interest of quieting all this trouble, and in the interest of the peace of mind of the honest taxpayer.").

36 For FY 2015 the IRS issued 684,332 total ACA-related correspondences. From March 2, 2015, to November 28, 2015, 124,639 returns were suspended for research prior to correspondence for PTC matching issues. Of the suspended returns, 69,019 were resolved via research and 55,620 required correspondence. W&I response to TAS information request (Oct. 29, 2015); W&I response to TAS fact check (Dec. 14, 2015).

37 IRM 21.6.3.4.2.16.3, *At-Filing Overview* (Oct. 1, 2015); IRC § 6213(b). Examples of third-party data mismatch include the following: (1) The taxpayer claims PTC but the taxpayer's household income (HHI) is less than 100 percent of the Federal Poverty Line (FPL) and all tax family members are U.S. citizens; (2) The taxpayer claims PTC but there is no record that anyone claimed on the return was enrolled in a Qualified Health Plan through the Marketplace; (3) Marketplace data is available for all months and the taxpayer's annual premium amount does not equal the annual premium reported by the Marketplace; (4) Marketplace data is available for all months and the taxpayer's annual premium of SLCSP does not equal the annual SLCSP reported by the Marketplace; and (5) Marketplace data is available for all months and the annual APTC reported by the taxpayer does not equal the annual APTC reported by the Marketplace. IRM 25.25.7.8.1, *Premium Tax Credit (PTC) Error Codes (ERC) (associated with AQC)* (Jan. 9, 2015).

Depending on the type of PTC discrepancy, the IRS refers the return either to Examination to work as a traditional audit or to the AQC program for a similar "audit" process.[38] If referred to AQC, the IRS sends a Letter 4800C, *Questionable Credit 30 Day Contact Letter*, which proposes an adjustment and requests Form 1095-A.[39]

Despite the fact that the Letter 4800C begins with the language, "This is not an audit. Your return may be examined in the future," we are concerned that the AQC process and the documentation requirements imposed on the taxpayers under AQC are substantially similar to those in an examination. In AQC, if a Form 1095-A is not verified, the IRS will ask for "documentation proving premium payments, copies of insurance enrollment forms, invoices, or statements from the insurance providers that include the names of those covered by the benefits."[40] An examination of the same issue requires the same documentation on Form 14950, *Premium Tax Credit Verification,* which requests "copies of insurance enrollment forms, invoices, or statements from your insurance providers."[41]

The National Taxpayer Advocate believes that if a taxpayer submits the same information when the return is in AQC as he would in an exam, the AQC constitutes an actual examination of the taxpayer's books and records. When the IRS doesn't classify these tax AQC adjustments as an examination, the IRS does not trigger the taxpayer's right to avoid unnecessary examinations.[42] This position enables the IRS to later conduct an examination of a taxpayer who already has been subjected to an examination of the same return, thereby undercutting an important taxpayer protection enacted by Congress to avoid that very result.

TAS requested an opinion from the Office of Chief Counsel on whether an AQC inquiry into a PTC matching issue constitutes an audit for purposes of IRC § 7605. We received advice in the form of an email which concluded that such AQC inquiries do not constitute an exam for purposes of IRC § 7605(b). The Office of Chief Counsel, Procedure and Administration provided the following advice:[43]

> Revenue Procedure 2005-32 defines a number of taxpayer contacts that are not examinations for purpose of section 7605(b). Among those contacts that do not constitute an examination are matching information on a return with information already in the Service's possession and

38 The AQC program is a type of work stream IRS uses to resolve refundable credit discrepancies that generally do not meet the traditional Examination or AM work stream type. IRM 25.25.7.1, *Automated Questionable Credit (AQC) Overview* (Jan. 9, 2015).

39 If the taxpayer provides an incomplete response to the 4800C, the AQC tax examiner attempts to reach the taxpayer by phone to request additional information. If the examiner is unable to reach the taxpayer by phone, AQC sends Letter 131C, *Information Insufficient or Incomplete for Processing Inquiry*, to request additional documentation in writing. If the taxpayer provides information in response to the Letter 4800C indicating disagreement with the proposed adjustment, but the taxpayer provides documents deemed insufficient or if AQC does not receive a response from the taxpayer, the AQC tax examiner issues a Statutory Notice of Deficiency (SNOD) or Claim Disallowance letter. If there is no response within the notice period, IRS defaults the SNOD and removes the credit from the taxpayer's account. IRM 25.25.7.2, *AQC Inventory Types* (June 1, 2015); IRM 25.25.7.4(8) & (9) (June 8, 2015).

40 IRM 25.25.7.2, *AQC Inventory Types* (June 1, 2015).

41 In FY 2015, the IRS routed 20,147 accounts to AQC for PTC mismatch issues. Of the 20,147 referred to AQC, 8,034 cases were referred to Exam (ERC 197, 198 and 199 determined to need recalculations and Exam treatment) and 6,312 were resolved. The additional 5,801 cases remained open in AQC suspense at the end of FY 2015. The IRS selected 18,810 TY 2014 PTC returns for examination during 2015 (through Sept. 25, 2015). Of the selected cases, Exam closed 2,322 returns, of which 885 were no change; 1,356 were agreed, and 81 were unagreed/default. The 885 no change cases include 462 cases selected incorrectly due to a programming error (figures reflect W&I). W&I response to TAS information request (Oct. 29, 2015); W&I response to TAS fact check (Dec. 14, 2015).

42 IRC § 7605(b).

43 Email from the Office of Chief Counsel (Nov. 13, 2015), on file with TAS.

considering any records the taxpayer provides voluntarily to explain a discrepancy between a filed return and information from third parties that is used as part of a matching program. Rev. Proc. 2005-32 § 4.03(1)(b) & (c). An example of this kind of contact is "a contact with a taxpayer to… verify a discrepancy between the taxpayer's tax return and an information return, or between a tax return and information otherwise in the Service's possession." *Id.* at 4.03(1)(d)(ii)(C). Here, the Service is contacting a taxpayer to resolve a discrepancy between a taxpayer's Form 1095-A or Forms 1040 and 8962 and the 1095-A, already in the Service's possession, provided by the Health Insurance Marketplace. Such a contact falls squarely within the revenue procedure's definition of a contact that does not constitute an examination.

Even if the Service requests that the taxpayer provide additional documentation, such as proof of premium payments or copies of insurance enrollment forms, this contact should not constitute an examination. Requesting this information is a contact designed to verify a discrepancy between the taxpayer's return and information obtained as part of a matching program. It appears to fall within the example the Revenue Procedure provides of the type of contact that does not constitute an examination. Id. This interpretation of the revenue procedure is amplified by Policy Statement 4-3. That policy statement states, "contact[s] to verify a discrepancy disclosed by an information return matching program may include inspection of the taxpayer's books of account, to the extent necessary to resolve the discrepancy, without being considered an inspection within the meaning of section 7605(b) of the Code." IRM 1.2.13.1.1(5). In this case, the documents the Service is likely to request are only those necessary to resolve the discrepancy. See IRM 25.25.7.2 (listing the documents the Service will request).

We strongly disagree with the Office of Chief Counsel on its conclusion. Their response relies on its own administrative guidance and does not squarely address the point that the IRS is asking for the *exact same* information from a taxpayer in a post-refund audit as it asks from a taxpayer in a pre-refund "non-audit." The Office of Chief Counsel advice is calling a wolf a lamb because it is wearing a sheepskin on its back. Because in our view the AQC review is an examination, the IRS must follow formal audit reopening procedures if it tried to conduct a subsequent examination on the tax return in question.[44]

The IRS may compromise the taxpayer's right to an appeal and impose unnecessary delays on the taxpayer while the IRS holds the PTC portion of the taxpayer's refund.[45] If the taxpayer replies to Letter 4800C and makes changes that do not match AQC's proposed changes, AQC sends Letter 89C, *Amended Return Required to Correct Account,* to require the taxpayer to file an amended return. If this procedure were properly characterized as an examination, and the IRS proposed an adjustment, the IRS would offer the taxpayer administrative appeal rights, and the taxpayer would eventually have the right to appeal in the U.S. Tax Court upon receiving the statutory notice of deficiency.[46]

44 The audit reopening procedures can be found in Rev. Proc. 2005-32, 2005-23 I.R.B. 1206 (June 6, 2005); IRM, 1.2.13.1.1, *Policy Statement 4-3* (Dec. 21, 1984).

45 IRM 25.25.7.3, *AQC Initial Case Processing* (Jan. 9, 2015).

46 In the AQC process, the taxpayer may also face additional delays. If the taxpayer submits an amended return to AQC and the amended return changes the amount of the PTC other than the amount proposed by AQC, the taxpayer's return must then go through the IRS AM function to process the amended return. IRM 25.25.7.4, *Taxpayer Responses* (Aug. 25, 2015). AM reviews the claim for examination criteria and refers it to Examination if the criteria are met. IRM Exhibit 21.5.3-1, *Claim Processing with Examination Involvement* (Oct. 1, 2014). If these returns were sent to Examination from the onset, there would be no need for AQC and AM involvement, which created taxpayer burden and caused unnecessary delays. IRM 25.25.7.4, *Taxpayer Responses* (Aug. 25, 2015).

We understand that the IRS has a responsibility to protect revenue and avoid issuing improper refunds. However, we believe the IRS can achieve this goal without violating the statutory restrictions on multiple audits. It needs to coordinate the detection of PTC discrepancies with the detection of other questionable claims by the IRS's other systems (*e.g.*, the Dependent Database or Electronic Fraud Detection System). It can include all such concerns in one pre-refund or post-refund contact with the taxpayer. This approach not only protects taxpayers' rights and comports with the law, but it is also a highly efficient use of IRS resources, and minimizes taxpayer burden.

Taxpayers Who Receive Certain Lump Sum Payments After Receiving APTC May Be Caught Off Guard by Having to Repay Large APTC Amounts As Well As Penalties and Interest

To be an eligible taxpayer for the PTC, a taxpayer's household income (HHI) for the taxable year should be between 100 to 400 percent of the federal poverty line (FPL) for their family size.[47] When the taxpayer applies for coverage, the Marketplace estimates the amount of the PTC that the taxpayer can claim for the year using information provided about family composition and projected HHI. Based upon that estimate, the taxpayer may decide to receive the amount of PTC in advance.[48] If the PTC and APTC were calculated based on projected income between 100 and 400 percent of FPL, but the taxpayer's actual HHI calculated on the tax return is more than 400 percent of the FPL, the taxpayer must repay the full amount of the excess APTC (the amount by which APTC exceeds the PTC allowed).[49]

When the IRS doesn't classify these tax Automated Questionable Credits adjustments as an examination, the IRS does not trigger the taxpayer's right to avoid unnecessary examinations.

The IRS and HHS remind taxpayers who receive APTC to report change in circumstances, including changes in income, to the Marketplace as soon as possible to prevent instances of having to repay APTC amounts.[50] It is likely that many taxpayers were not aware of the complex consequences of receiving lump sum amounts of certain types of income. It is our understanding that some taxpayers who receive lump sum amounts from retroactive awards of Social Security disability are required to repay the full amount of APTC because the lump sum amounts push HHI above the 400 percent FPL limit.[51] TAS is currently reviewing this issue to determine the need for increased outreach communications to alert appropriate APTC recipients to possible consequences of receiving large lump sum distributions.

The Absence of the SLCSP Amounts on Some Forms 1095-A Are Delaying the Processing of PTC Returns and Imposing Unnecessary Burden on Taxpayers

Taxpayers who receive coverage from the Marketplace receive Form 1095-A, *Health Insurance Marketplace Statement*. Part III of Form 1095-A should provide the SLCSP amount, which is used to calculate the PTC or reconcile the amount of

47 IRC § 36B(c)(1).

48 If the taxpayer is eligible for and decides to receive APTC, the Marketplace sends payments directly to the insurance provider on the taxpayer's behalf, reducing the taxpayer's out-of-pocket premium expense. If the taxpayer receives the APTC, the taxpayer must reconcile the payments made on his or her behalf with the actual PTC allowed on the tax return, as computed on Form 8962, *Premium Tax Credit (PTC)*. IRC § 36B(f).

49 The repayment cap in IRC § 36B(f)(2)(B) does not apply to taxpayers whose HHI exceeds 400 percent FPL.

50 *See* IRS Pub. 5152, *Report Changes to the Marketplace as They Happen: Important Reminder About Advance Payments of the Premium Tax Credit*.

51 Systemic Advocacy Management System (SAMS) entries, on file with the National Taxpayer Advocate. SAMS is a database of issues and information reported by IRS employees and the public. TAS reviews each SAMS submission and elevates them to the IRS for advocacy and resolution as appropriate.

It is our understanding that some taxpayers who receive lump sum amounts from retroactive awards of Social Security disablity are required to repay the full amount of Advanced Premium Tax Credit because the lump sum amounts push household income above the 400 percent Federal Poverty Line limit.

APTC received on Form 8962. However, if the taxpayer purchased insurance through the Marketplace, and chose not to receive the credit in advance, the Marketplace issued the TY 2014 Form 1095-A without the SLCSP information. When the taxpayer filed the TY 2014 tax return, with the Form 8962 to claim a PTC and filled in the SLCSP based on information from the Marketplace at the time of enrollment, it causes a mismatch to occur.

The absence of the SLCSP on Form 1095-A is very confusing to taxpayers. IRS Publication 974, *Premium Tax Credit,* directs the taxpayer to SLCSP premium tools on the Federally-facilitated or state Marketplace websites to look up the SLCSP premium that applies to the taxpayer's coverage family for each month.[52] The Internal Revenue Manual (IRM) is silent on supporting documentation employees can accept from taxpayers when the SLCSP information on Form 1095-A is blank or incorrect.[53]

The lack of procedural guidance on this issue could cause delays in processing returns even when taxpayers follow guidance provided in Publication 974 or on Healthcare.gov. TAS received reports regarding IRS employees refusing to accept taxpayer SLCSP documentation that was either not directly provided by the Marketplace or that couldn't be verified by IRS resources.[54]

Taxpayers need to go directly to the Marketplace to get that information on their own, but this is something that is available early on and the Marketplace should include it on all Forms 1095-A, regardless of whether the taxpayer received the APTC. Such a seemingly minimal effort on part of the Marketplace should significantly reduce burden on both taxpayers and the IRS. The IRS should reform its rules for exchange reporting on Forms 1095-A and require the Marketplace to provide the SLCSP amounts on all such forms.

The Inability of Health Insurers and Self-Insured Employers to Match TINs Before Filing Leads to Unnecessary Mismatches and Notices, Increasing Issuer Burden and Wasting IRS Resources

The IRS has not expanded the TIN matching program to ured employers that are required to file Form 1095-B, *Health Coverage* TIN Matching Program (TMP) allows participating payers of reportable payments subject to backup withholding under IRC § 3406(b) to match the TIN and name of payees subject to potential backup withholding with IRS

Is this an extra space after the comma?

52 IRS Pub. 974, *Premium Tax Credit*, 16 (rev. Mar. 2015).

53 IRM 3.12.3.75.9, *Error Code 198, Form 8962, Annual/Monthly SLCSP Amount(s) (ACA)* (Jan. 1, 2015), instructs the examiner to compare Form 1095-A data with taxpayer's SLCSP entries on Form 8962. If the amounts do not match or Form 1095-A is not present on the IRS system, the IRS sends correspondence to the taxpayer. If the taxpayer replies providing a Form 1095-A, the IRM instructs the examiner to compare the Form 1095-A provided by the taxpayer with taxpayer's entries on Form 8962.

54 SAMS entries, on file with TAS.

55 IRC § 6055. Currently, the law authorizes the IRS TIN Matching program only for payers of reportable payments subject to backup withholding. *See* IRC § 3406; Treas. Reg. § 31.3406(j)-1; Rev. Proc. 2003-9, 2003-8 I.R.B. 516 (Feb. 24, 2009).

records prior to filing the information report.[56] Using the TMP helps payers avoid penalties for submitting incorrect TINs on information returns.[57]

TMP would benefit the filers of Forms 1095-B which provide the names and TINs of all covered individuals and the months for which they had MEC. The IRS will use the forms to verify an individual's compliance with the ISRP. The reporting entities are required to begin filing the forms during FS 2016.[58]

Many Form 1095-B filers have never had to verify the accuracy of the name/TIN information and the inability to verify the information before issuing the forms could cause inaccurate TIN reporting. If information returns with incorrect or incomplete names or TINs are submitted (because the issuers are not able to run the numbers through the IRS TIN matching program before filing), the IRS will not be able to verify that individuals have MEC. Therefore, even covered individuals could receive notices imposing the ISRP.[59]

CONCLUSION

During FS 2015, the IRS faced a few unanticipated challenges that resulted in increased taxpayer burden with respect to the ACA. In general, the IRS has sufficiently addressed the issues as they arise in order to avoid similar issues in future filing seasons. The National Taxpayer Advocate remains concerned about the burdens imposed on taxpayers who received APTC, but failed to file their TY 2014 returns by the time the IRS must verify income and family size for re-enrollment in 2016. We are also concerned that AQC procedures for APTC mismatch and reconciliation issues are in fact an examination and therefore leave taxpayers at risk of multiple examinations of the same tax return. Taxpayers and the IRS are unnecessarily burdened when the Marketplace leaves the SLCSP amounts blank on Forms 1095-A for taxpayers that choose not to receive the APTC. Accordingly, TAS will work with the IRS and advocate to ensure the changes we recommend are adopted so that taxpayers are not burdened.

56 IRM 5.19.3.4.1.6, *e-Services Taxpayer Identification Number (TIN) Matching Program* (Apr. 23, 2014).

57 The TMP would also prevent the assessment of penalties on the businesses filing the forms. The penalty for failure to file a correct information return is generally $100 and the penalty for failure to furnish a correct payee statement is also generally $100. IRC §§ 6721, 6722. The IRS will not impose the penalty if the filer shows the failure was due to reasonable cause and not willful neglect. IRC § 6724. *See* Legislative Recommendation: *Affordable Care Act Information Reporting: Allow Taxpayer Identification Number Matching for Filers of Information Returns Under IRC §§ 6055 and 6056*, *infra*.

58 Notice 2013-45, 2013-31 I.R.B. 116 (July 29, 2013); T.D. 9660, 2014-13 I.R.B. 842 (Mar. 24, 2014).

59 IRC § 5000A. Insurers could also receive avoidable penalty assessments arising from such mismatches. Michael M. Lloyd and S. Michael Chittenden, *Expand TIN Matching Program to Avert Another ACA Debacle*, Tax Notes Today (Jan. 15, 2014).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Take preventative measures to avoid ISRP overpayments in the future, such as distributing educational notices about exemptions and exclusions to preparers associated with such overpayments and conducting a comprehensive review and testing of tax filing software to ensure that the problems that arose in FS 2015 do not recur.
2. Issue guidance to field compliance employees to assist them in identifying returns with a tax liability resulting from the correction of Forms 1095-A errors in the SLCSP information and not pursuing collection, including blocking the accounts from refund offsets.
3. Work with the National Taxpayer Advocate on revising Letters 5591, 5591A, and 5596 for FS 2016 to include the exact date by which the taxpayer needs to file in order to automatically re-enroll for the APTC the following year.
4. Conduct outreach and education to inform taxpayers early in FS 2016 about the consequences of filing for an extension if the taxpayer received APTC. In particular, the information should provide the taxpayer with a specific date in 2016 by which the taxpayer needs to file the TY 2015 return in order to automatically re-enroll to receive APTC in 2017.
5. Determine a method to identify all issues relating to a return, as selected by the various filters in the filing season, and include all of the issues in one notice to the taxpayer so that the taxpayer does not have multiple audits with respect to the same return.
6. Conduct outreach and education on the consequences of receiving large lump sum distributions to APTC recipients as well as other organizations making such distributions, such as the Social Security Administration.
7. Issue guidance to both taxpayers (on the IRS website as well as in the Form 1095-A instructions) and IRS employees (in the IRM) about how taxpayers can use the look-up tool on Healthcare.gov to find their SLCSP premium amount.
8. Provide a similar IRS tool to ensure IRS employees can look-up the SLCSP amount and verify the amount provided by the taxpayer. The IRS should provide employees training on the use of the tool.
9. Reform the rules for exchange reporting on Form 1095-A and require the Marketplace to provide the SLCSP amounts on all such forms.
10. Expand the TIN matching program to include health insurers and self-insured employers that are required to file Form 1095-B, *Health Coverage*.

MSP #16 IDENTITY THEFT (IDT): The IRS's Procedures for Assisting Victims of IDT, While Improved, Still Impose Excessive Burden and Delay Refunds for Too Long

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage and Investment Division
Glenn Coles, Director, Identity Theft Victim Assistance Unit

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Quality Service*
- *The Right to Finality*

DEFINITION OF PROBLEM

In general, tax-related identity theft (IDT) occurs when an individual intentionally uses the personal identifying information of another person to file a falsified tax return with the intention of obtaining an unauthorized refund.[2] Identity theft victims must substantiate their identity with the Internal Revenue Service (IRS), file various forms, and wait months or even years to receive their tax refunds and unwind the account issues.[3]

The National Taxpayer Advocate first raised concerns with the IRS's ability to resolve IDT cases in her 2004 Annual Report to Congress.[4] Since then, the IRS has grappled to find the best approach for working IDT cases. In fiscal year (FY) 2012, the IRS dispersed responsibility for working IDT cases by creating more than 20 specialized IDT units.[5] In FY 2015, the IRS changed course and reorganized its IDT victim assistance functions, centralizing them under one umbrella within the Wage and Investment (W&I) division.

The National Taxpayer Advocate is pleased with this reorganization, as she has long held the belief that a centralized approach to IDT victim assistance was necessary.[6] However, the National Taxpayer Advocate remains much more concerned with the IRS's IDT victim assistance *procedures* than she is with the *organizational structure* of the IDT victim assistance unit. Since 2004, the National Taxpayer Advocate has made 46 recommendations to the IRS in her Annual Reports to Congress on improving its IDT victim

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

2 This type of tax-related identity theft is referred to as "refund-related" identity theft. In "employment-related" identity theft, an individual files a tax return using his or her own tax identification number, but uses another individual's Social Security number (SSN) to obtain employment, and consequently, the wages are reported to the IRS under the SSN. The IRS has procedures in place to minimize the tax administration impact to the victim in these employment-related identity theft situations. Accordingly, we will focus on refund-related identity theft in this report.

3 National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 45-90 (*Identity Theft Case Review Report: A Statistical Analysis of Identity Theft Cases Closed in June 2014*).

4 National Taxpayer Advocate 2004 Annual Report to Congress 133-36.

5 National Taxpayer Advocate 2012 Annual Report to Congress 45-46.

6 The National Taxpayer Advocate stated in her 2013 Annual Report to Congress that "the IRS should set up a centralized identity theft unit similar to the centralized innocent spouse unit that assists taxpayers who may have been victims of domestic abuse." See National Taxpayer Advocate 2013 Annual Report to Congress 75.

assistance, over half of which the IRS has eventually adopted.[7] Although improvements have been made over the years, the IRS can still do much more to assist victims of IDT.

The continuing inadequacy of the IRS's IDT victim assistance is demonstrated by the growth in TAS IDT cases, which comprised 25 percent of TAS's case receipts for FY 2015.[8] This growth was caused, in part, by certain IRS screening mechanisms; in one program, approximately one out of three returns suspended by the IRS were legitimate returns.[9]

In Volume 2 of the National Taxpayer Advocate's 2014 Annual Report to Congress, she made numerous recommendations to improve the IRS's IDT victim assistance procedures, including:

1. IDT victims with multiple issues should be assigned a sole IRS contact person (and provided with a toll-free direct extension to this contact person) who would interact with them throughout and oversee the resolution of the case, no matter how many different IRS functions need to be involved behind the scenes.
2. The IRS should track IDT cycle time in a way that reflects the taxpayer's experience more accurately — from the time the taxpayer submits the appropriate documentation to the time the IRS issues a refund (if applicable) or otherwise resolves all related issues.
3. The IRS should review its global account review procedures to ensure all related issues are actually resolved (including issuance of a refund, if applicable) prior to case closure, and conduct appropriate training for its employees.[10]

Identity theft victims must substantiate their identity with the IRS, file various forms, and wait months or even years to receive their tax refunds and unwind the account issues.

The National Taxpayer Advocate believes adoption and implementation of these recommendations will improve the IRS's ability to effectively resolve IDT cases. In addition, the IRS should expand its Identity Protection Personal Identification Number (IP PIN) pilot to allow all taxpayers the option to receive an IP PIN. This would not only provide taxpayers a right to quality service, but also protect the federal fisc.

In October 2015, the IRS began re-engineering its IDT victim assistance procedures, and has included TAS among the stakeholders in this re-engineering effort. The Re-engineering Team plans to make significant improvements in IDT victim assistance; however, the IRS has not yet agreed to any of the recommendations listed above.

7 The IRS adopted (fully or in part) 25 of the 46 recommendations on improving IDT victim assistance made by the National Taxpayer Advocate. Some of the adopted recommendations include:
- Standardize procedures as to what information is required from taxpayers complaining of stolen identities (National Taxpayer Advocate 2004 Annual Report to Congress 142; adopted in 2009);
- The IRS should use an electronic indicator on its master files to mark the accounts of taxpayers who have verified that they have been victims of identity theft (National Taxpayer Advocate 2005 Annual Report to Congress 191; adopted in 2008);
- The IRS should develop a form that taxpayers can file when they believe they have been victims of identity theft (National Taxpayer Advocate 2007 Annual Report to Congress 115; adopted in 2009); and
- Require the Identity Protection Specialized Unit (or in the case of a single-issue case, the specialized function) to conduct final global account reviews on all identity theft cases (National Taxpayer Advocate 2012 Annual Report to Congress 67; adopted in 2013).

8 *See* TAS Business Performance Review (BPR), FY 2015 (Oct. 1, 2015).

9 *See* IRS, W&I BPR, CY 2015 Results through September (Nov. 2, 2015) (showing a false positive rate of 34.6 percent for the Dependent Database IDT filters).

10 *See* National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 45-90 (*Identity Theft Case Review Report: A Statistical Analysis of Identity Theft Cases Closed in June 2014*).

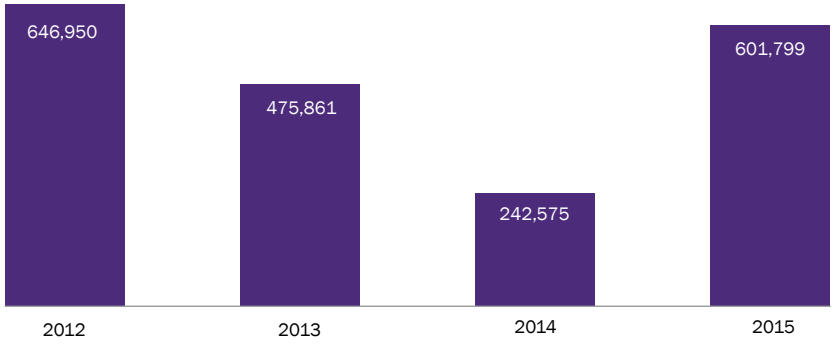
ANALYSIS OF PROBLEM

Background

The IRS continues to see a significant number of IDT cases. As of the end of September 2015, the IRS had over 600,000 IDT cases with taxpayer impact (excluding duplicates) in its inventory, up nearly 150 percent from September 2014.[11]

FIGURE 1.16.1[12]

IRS Identity Theft Inventory on September 30, 2012-2015



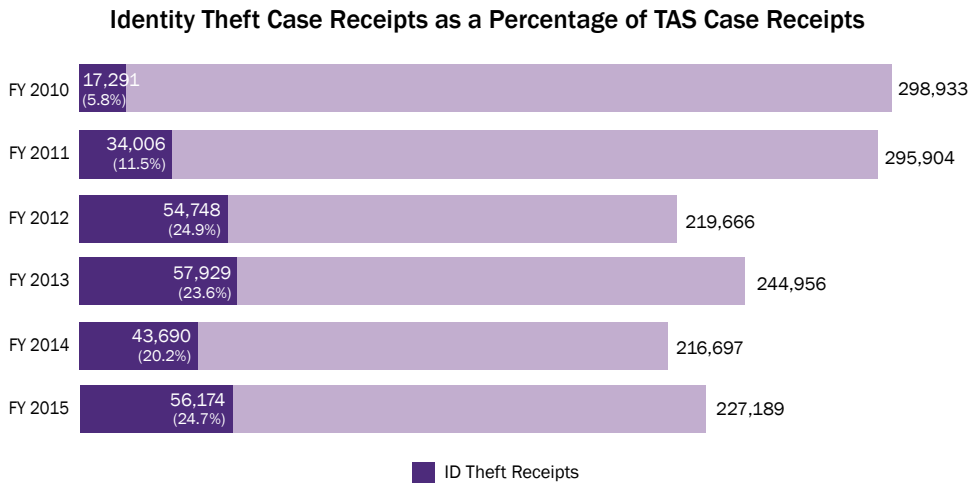
Identity theft cases continue to make up a significant percentage of TAS caseload as well. TAS IDT cases increased nearly 30 percent from FY 2014 to FY 2015. In FY 2015, TAS received more than 56,000 IDT cases representing 25 percent of all TAS cases. In FY 2014, TAS received nearly 44,000 IDT cases representing 20 percent of all TAS cases.[13]

11 IRS, *Global Identity Theft Report* (Sept. 30, 2015); IRS, *Global Identity Theft Report* (Sept. 30, 2014).

12 IRS, *Global Identity Theft Report* (Sept. 30, 2015); IRS, *Global Identity Theft Report* (Sept. 30, 2014); IRS, *Global Identity Theft Report* (Sept. 30, 2013); IRS, *Global Identity Theft Report* (Sept. 30, 2012).

13 TAS received 56,174 IDT cases in FY 2015 and 43,690 IDT cases in FY 2014. *See* TAS BPR, FY 2015 (Oct. 1, 2015); TAS BPR, FY 2014 (Oct. 1, 2014).

FIGURE 1.16.2[14]



A significant portion of the TAS IDT cases in FY 2015 is attributable to the failure of the IRS to properly administer its Taxpayer Protection Program (TPP).[15] The IRS uses advanced analytics to select and suspend the processing of tax returns it suspects were filed by identity thieves. When an IRS filter stops a return, the IRS sends the taxpayer a letter asking him or her to either call the TPP phone number or visit the Out-of-Wallet website to verify his or her identity. It turned out that approximately one out of three returns suspended by the TPP were legitimate returns,[16] resulting in a severe backlog of calls to the TPP toll-free phone line. As shown in this figure below, the level of service (LOS) on the TPP line was particularly poor during the 2015 filing season, when the LOS dipped below ten percent for three consecutive weeks.[17]

14 Taxpayer Advocate Management Information System (TAMIS), *Receipts – Core Issues by BOD & Criteria – Cumulative* (run dates Oct. 1, 2015; Oct. 1, 2014; Oct. 1, 2013; Oct. 1, 2012; Oct. 1, 2011; Oct. 1, 2010).

15 Of the 56,174 IDT cases (primary issue code 425) received by TAS in FY 2015, 37,686 (67 percent) involved issues stemming from the TPP. TAMIS (run date Oct. 1, 2015); IRS Compliance Data Warehouse (CDW), Individual Master File (Oct. 2015).

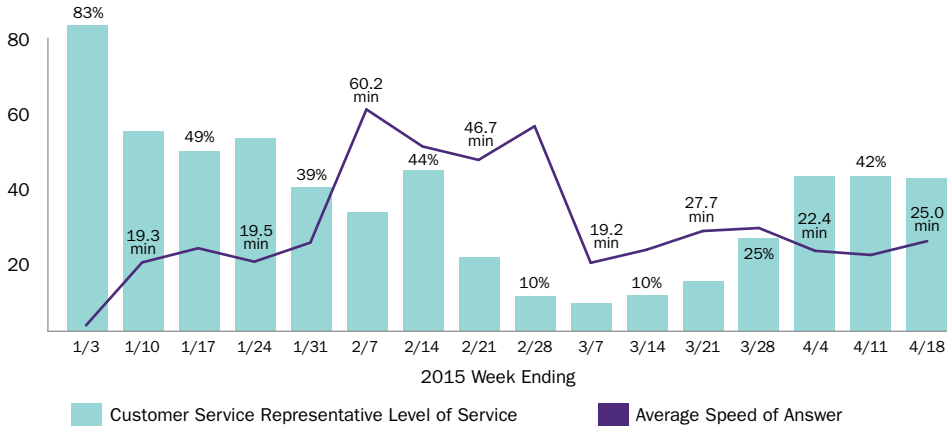
16 IRS, *IRS Return Integrity & Compliance Services (RICS), Update of the Taxpayer Protection Program (TPP)* 9 (June 24, 2015).

17 IRS, Joint Operations Center, *TPP Snapshot Reports* (Jan.–Apr. 2015). The IRS attributes the low LOS for the TPP line to a number of factors, including budget challenges that impacted all toll-free lines, problems with the Out-of-Wallet website, and multiple weather-related closures in TPP call sites. Additional staff for TPP were trained and added in late March to improve LOS. Email from Senior Tax Analyst, Business Performance Laboratory, Return Integrity and Compliance Services (July 6, 2015).

FIGURE 1.16.3[18]

Level of Service and Average Speed of Answer, TPP Line

Assistors conduct identity verification for returns halted in processing when the IRS determines there is a high risk of an identity thief filing the return rather than the actual taxpayer.



Reorganization

In February 2014, the IRS began to consider the feasibility of adopting a centralized approach to IDT victim assistance. As a result of this feasibility study, the IRS decided to take the following actions:

- Centralize Accounts Management (AM) IDT caseworkers, including the Identity Protection Specialized Unit (IPSU), in a single IDT Victim Assistance (IDTVA) organization;
- Centralize Small Business/Self-Employed and W&I Compliance specialized teams within IDTVA;
- Realign the Office of Privacy, Governmental Liaison, and Disclosure's Identity Protection analysts to W&I; and
- Realign Compliance headquarters analysts supporting IDT to the Customer Account Services (CAS) organization.

With this reorganization, the AM Director is now able to lead all IDT staff — including policy analysts — to ensure that IDT cases are worked consistently and tracked more easily. In addition, the IRS consolidated the Internal Revenue Manual (IRM) effective October 1, 2015, so that all IDT procedures fall under a single IRM chapter.[19]

The new IDT Victim Assistance unit will require its employees (including IDTVA Compliance employees) to use the Correspondence Imaging System (CIS) beginning in FY 2016. Documents and notes uploaded on CIS will allow any IRS employee with access to CIS to quickly get up to speed on a case. Using CIS will also allow the IRS the ability to balance the IDT work more effectively. Furthermore, having all IDT cases on one system will enable the IRS to more easily track the cycle time for IDT cases, which is something the National Taxpayer Advocate has pushed the IRS to do.[20]

18 IRS, Joint Operations Center, *TPP Snapshot Reports* (Jan.–Apr. 2015).

19 IRM 25.23, *Identity Protection and Victim Assistance* (Oct.1, 2015).

20 See National Taxpayer Advocate 2013 Annual Report to Congress.

Results of 2014 Research Study

To gain a better understanding of what is really going on in the IRS inventory of IDT cases, TAS conducted a research study in 2014 where we (in coordination with W&I) pulled a representative sample of IDT cases from IRS inventory.[21] The results of this comprehensive review confirmed many of the observations the National Taxpayer Advocate has shared over the past decade about how the IRS can improve its IDT victim assistance.

Here are three findings from the 2014 study that merit attention:

1. *Overall, about two-thirds (67 percent) of all IDT modules in our representative sample were either (1) worked in more than one function, or (2) reassigned to another assistor within a function*.[22] A typical IDT victim who receives assistance from the IRS will be forced to bounce around from one assistor to another. Without a sole contact person assigned, there is a concern that an IDT case may fall through the cracks. Forty-two percent of the IDT modules analyzed in our sample had periods of inactivity (*i.e.*, periods of time when no work was being performed on the case for more than 30 days), with an average (mean) period of inactivity was 78 days.[23]
2. *In 22 percent of IDT cases in our representative sample, the IRS closed an IDT module without taking the appropriate steps to fully resolve the victim's account*.[24] In our study, the IRS closed many IDT cases before all account actions were taken — for example, some IDT victims had not yet received their refund, the IRS failed to issue an Identity Protection Personal Identification Number (IP PIN), or update the victim's address.[25] This brings into question the effectiveness of the IRS's global account review process. Either the procedures are insufficient or the IRS needs to ensure its assistors are trained better.
3. *The average cycle time for the IDT cases in our representative sample was 179 days (nearly six months)*.[26] While some functions (such as AM) tracked how long IDT cases stayed in their inventory, there was no standard calculation of cycle time across the IDT functions. The cycle times reported by various IDT specialized units did not reflect the time that has passed since the taxpayer filed a return or the time spent interacting with other functions. We believe this measure of 179 days more accurately indicates how long the IRS takes to resolve IDT cases, from the perspective of the IDT victim.

The Senate Appropriations Committee agreed with the National Taxpayer Advocate that the IRS should create a sole point of contact to deal with identity theft victims with multiple tax issues.[27] The Committee

21 See National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 45-90 (*Identity Theft Case Review Report: A Statistical Analysis of Identity Theft Cases Closed in June 2014*).

22 See National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 52.

23 *Id.*

24 *Id.* at 53.

25 Of the 85 modules that we noted were prematurely closed, nine remained open as of Oct. 27, 2015.

26 See National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 52-53.

27 S. Rep. 114-97, at 34 (2015), *available at* www.congress.gov/114/crpt/srpt97/CRPT-114srpt97.pdf ("Some identity theft victims have only a single issue that requires resolution, but many victims have multiple issues that must be resolved before the IRS will issue their refunds. In addition, these victims often have to call the IRS numerous times and speak with numerous employees.... The Committee also directs IRS to report on the feasibility of assigning the cases of identity theft victims with multiple issues to a single IRS representative (and provide victims with a toll-free direct extension to this representative) who will manage the case, including coordinating the actions of different IRS functions, and work with the taxpayer until the case is fully resolved.").

further directed the IRS issue a report detailing procedural changes aimed to cut the cycle time of identity theft cases in half.[28]

Re-Engineering Team

In September 2015, the IRS convened the IDT Re-engineering Team, a group of employees from across various functions empowered to make recommendations to improve the processing of IDT cases.

The IDT Re-engineering Team has formed sub-teams, including ones focused on improving the content and format of the IDT Global Report, strengthening global review procedures to ensure all actions are taken prior to closing an IDT case, and revisiting the role and scope of the IPSU. The IDT Re-engineering Team is led by the Director of the IDTVA organization and expects to submit recommendations to the Director of Accounts Management in early 2016.

IP PIN Expansion

In December of each year, the IRS issues IP PINs to certain victims of IDT whose identities and addresses have been verified.[29] An IP PIN is a unique code that some taxpayers must use, along with his or her taxpayer identification number, to file electronically.[30] IP PINs are a very effective way to prevent refund-related IDT; a would-be identity thief simply cannot e-file a tax return on a protected account without entering the IP PIN (which changes every year).

The average cycle time for the Identity Theft (IDT) cases in our representative sample was 179 days (nearly six months).

In 2014, the IRS conducted a pilot to expand the issuance of IP PINs. Residents of the District of Columbia, Florida, and Georgia were given the opportunity to opt-in to receive an IP PIN, regardless of whether or not they were victims of IDT.[31] Although uptake was relatively low (0.08 percent), the IRS continued the IP PIN opt-in pilot for residents of these three high-risk states in 2015.[32] One possible reason for the low uptake is the lack of effective outreach or notice about the program. For example, the National Taxpayer Advocate is a resident of the District of Columbia; she received no communication from the IRS that she could apply for an IP PIN for the 2015 filing season. Whether it involves mailing notices to all eligible taxpayers, using traditional or social media, or working with third parties such as tax software companies, the IRS can and must do better than achieving an uptake rate of less than 0.1 percent for such a valuable, no-cost service.

The IRS is currently exploring the feasibility of expanding the IP PIN opt-in pilot to nationwide, but is concerned about the costs of administering the program. The IRS estimates that it costs as much as $36 per IP PIN over a three-year period (the costs of issuing replacement IP PINs are factored into this estimate).[33] For each taxpayer who opted to receive an IP PIN in 2014, $193 of revenue was protected.[34]

28 S. Rep. 114-97, at 34 (2015), *available at* www.congress.gov/114/crpt/srpt97/CRPT-114srpt97.pdf ("The Committee directs the IRS to institute, and share with the Committee within 90 days of enactment, an updated action plan and timetable predicated on a goal of reducing by half the average amount of time a taxpayer must await a disposition of a refund fraud claim.").

29 IRM 25.23.2.21, *Identity Protection Personal Identification Number (IP PIN)* (Sept. 8, 2015).

30 *Id*.

31 IRM 25.23.2.21.2, *IP PIN Opt-In Available for Designated Taxpayers Who Are Not ID Theft Victims* (Sept. 8, 2015).

32 *Id*.; W&I Research and Analysis, IP PIN Opt-in Pilot Executive Checkpoint (Sept. 2015).

33 W&I Research and Analysis, IP PIN Opt-in Pilot Executive Checkpoint (Sept. 2015).

34 $2.2 million net revenue protected / 11,400 opt-ins in 2014. *See* W&I Research and Analysis, IP PIN Opt-in Pilot Executive Checkpoint (Sept. 2015).

In other words, the IRS stopped $5.36 in fraudulent refunds for every dollar it spent issuing IP PINs.[35] This is a conservative estimate which does not account for dollars protected in the second and third year of IP PIN use, while including the administrative cost of issuing IP PINs for three years. Based on these calculations, the IRS should secure the needed funds from Congress to expand the IP PIN opt-in program.

CONCLUSION

The National Taxpayer Advocate is pleased that the IRS leadership has decided to adopt the recommendation to change to a centralized approach to IDT victim assistance. With a centralized approach, the IRS is better positioned to evaluate and act upon the recommendations we made in our 2014 Annual Report to Congress. We look forward to working cooperatively with the new IDTVA unit to further improve service to this vulnerable population of taxpayers. We note that many of the ideas now under consideration by this unit were recommended by the National Taxpayer Advocate as far back as a decade ago. Had the IRS adopted these recommendations at that time, millions of taxpayers would have been spared tremendous anxiety, economic harm, and burden. The IRS should learn from this past lesson and not delay another ten years before embracing the recommendations in this report.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. For identity theft victims with multiple issues, assign a sole IRS contact person (and provide with a toll-free direct extension to this contact person) to interact with identity theft victims throughout and oversee the resolution of the case. Alternatively, the IRS should conduct a pilot where selected identity theft victims with multiple issues are assigned a sole employee, and compare results (case resolution time, number of contacts, taxpayer satisfaction, quality, etc.).
2. Track identity theft cycle time in a way that reflects the taxpayer's experience more accurately — from the time the taxpayer submits the appropriate documentation to the time the IRS issues a refund (if applicable) or otherwise resolves all related issues.
3. Review and adjust its global account review procedures to ensure all related issues are actually resolved (including issuance of a refund, if applicable) prior to case closure, and conduct appropriate training for its employees.[36]
4. Expand its IP PIN pilot to allow taxpayers in every state the ability to receive an IP PIN, and convey this option to taxpayers using multiple modes of communication.

35 $193 revenue protected / $36 cost of IP PIN issuance = $5.36 revenue protected per IP PIN issued.

36 *See* National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 45-90 (*Identity Theft Case Review Report: A Statistical Analysis of Identity Theft Cases Closed in June 2014*).

MSP #17 AUTOMATED SUBSTITUTE FOR RETURN (ASFR) PROGRAM: Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden

RESPONSIBLE OFFICIAL

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

When a taxpayer who has a filing requirement fails to file a tax return, the IRS is authorized under Internal Revenue Code (IRC) § 6020(b) to use third-party information to determine and assess a tax liability.[2] This is principally worked through the Automated Substitute for Return (ASFR) program, the IRS's key program for enforcing filing compliance on taxpayers who have not filed individual income tax returns but appear to owe a tax liability.[3]

If a taxpayer has not filed a return and the IRS determines that a taxpayer has a filing requirement, it will typically select certain cases to prepare a Substitute for Return (SFR) and assess the liability based on information such as Forms W-2 and 1099 filed by employers, banks, and other third parties.[4] In preparing an SFR, the ASFR program generally treats the taxpayers as single (or married filing separately where there is evidence the taxpayer is married) with no dependents, allows one exemption and only a standard deduction (even where there is third-party documentation supporting deductions on file with the IRS).[5]

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

2 IRC § 6020(b).

3 Internal Revenue Manual (IRM) 5.18.1.2, *What Is ASFR?* (Oct. 1, 2005). *See also* Treasury Inspector General for Tax Administration, Ref. 2014-30-023, *Expansion of the Delinquent Return Refund Hold Program Could Improve Filing Compliance and Help Reduce the Tax Gap* (Mar. 14, 2014).

4 IRM 5.18.1.2, *What Is ASFR?* (Oct. 1, 2005).

5 IRM 5.18.1.3.5, *Tax Delinquency Investigation (TDI) Supplement Information* (Oct. 1, 2005); IRM 5.18.1.7.2, *Computing Taxable Income* (Oct. 1, 2005); IRM 5.18.1.7.3, *Computing Tax Due, Penalties and Interest* (Oct. 1, 2005). ASFR programming determines the filing status, taxable income, tax, interest, and penalties "systemically," *i.e.*, without an employee review.

The ASFR program has poor collection results and a high abatement rate:

- In fiscal year (FY) 2011 through FY 2014, the IRS assessed nearly $34 billion through its ASFR authority. The IRS collected less than one-third of this amount, nearly $11 billion.[6]
- For ASFR assessments made in FY 2011 through FY 2014, the IRS abated about $10 billion of the ASFR assessments — for a total of 29 percent of all ASFR assessments.[7]
- The ASFR program's return on investment (ROI) is small. In FY 2014, the ASFR program had revenue of $89.5 million, but spent $39.8 million operating the ASFR program, which does not include the costs of later abating liabilities or the expense of sending out notices or making collection attempts. This means the IRS generated net revenue of about $50 million when accounting for the cost of the program.[8]

The selection of these unproductive cases, which often result in abatement, cause rework for the IRS and potential harm to the taxpayer (*i.e.*, IRS attempts to collect the inflated liability by using its enforcement powers). The IRS could mitigate these outcomes by considering third-party documentation that supports deductions or credits when determining which cases to select for the program. Considering certain deductions and credits would result in a more accurate assessment, conserve IRS resources, and mitigate harm to taxpayers while protecting their rights.

ANALYSIS OF PROBLEM

Background

ASFR is the key IRS program for enforcing filing compliance by taxpayers who have not filed individual tax returns, but have incurred a "significant" tax liability.[9] The program estimates the liability by computing tax, penalties, and interest based upon information reported to the IRS by third parties.[10] When a taxpayer with reported income is delinquent in filing a return, the IRS attempts to secure the return

6 Individual Master File (IMF), Enforcement Revenue Information System (ERIS) on IRS Compliance Data Warehouse (CDW). The $34 billion assessed includes tax, penalties and interest. TAS Research worked closely with the ASFR Program Office to ensure that it was properly identifying ASFR cases. TAS and the IRS came very close in their data for ASFR cases and dollars collected through the ASFR program. However, there was a small difference in the number of cases and dollars collected. The numbers compiled by TAS Research showed about two percent fewer ASFR cases when compared to the ASFR Program Office's data, and showed about ten percent fewer dollars assessed compared to the ASFR Program Office's data.

7 IMF, ERIS on IRS CDW. Some ASFR abatements occur after the taxpayer files as the secondary taxpayer on a joint return; in such cases ERIS might not capture the tax assessed to and collected from a secondary taxpayer.

8 Office of the Chief Financial Officer, Financial Management, Office of Cost Accounting Cost-Based Performance Measures ASFR, FYs 2010 – 2014, *available at* http://cfo.fin.irs.gov/FinMgmt/Cost_Accounting/docs/Cost-Study-Reports/FY2014/ASFR-Cost_Study-FY_2014.doc (last visited May 28, 2015). The $89.5 million represents enforcement revenue collected by the ASFR program after an SFR notice has been issued and prior to the issuance of the first collection notice. Overall, IRS collected nearly $11 billion of assessments made in FY 2011 through FY 2014; however, the costs associated with the post-assessment collection, abatement, and other downstream tax account administration cannot be easily determined, making an accurate return on investment (ROI) calculation difficult.

9 IRM 5.18.1.2, *What Is ASFR?* (Oct. 1, 2005). To meet ASFR processing criteria, the proposed tax liability must meet or exceed a predetermined dollar threshold established by the IRS for the ASFR program.

10 *Id*. The IRS can use information returns (*e.g.*, Forms W-2 and 1099) filed by employers, banks, and other third parties to report various types of payments to individuals. These payments include wages, interest, and dividends, as well as payments to self-employed taxpayers for services rendered. The IRS collects and maintains this information through the Information Return Program (IRP).

through correspondence. If the attempt is unsuccessful, the IRS is authorized by IRC § 6020(b) to prepare a substitute return for the taxpayer.[11]

In FY 2011, there were 279,374 Automated Substitute for Return (ASFR) assessed modules in which IRS received a Form 1098 showing mortgage interest expense; 85,151 of these accounts, or 30 percent, had tax abated, which IRS might have anticipated since many were qualified to itemize deductions and thereby incur a lower tax.

Generally, a return delinquency meets ASFR criteria when income information obtained through Information Returns Processing (IRP) is available for the delinquent tax module, the module is no older than five years prior to the current processing year, there are no related taxpayer delinquent accounts (TDAs), and the proposed tax liability is over a certain dollar threshold.[12] When the IRS selects a return delinquency for ASFR processing, the program calculates an estimated tax liability based on available income information with an assumed filing status of "single" or "married filing separate" with one exemption.[13]

Generally, this proposed liability exceeds what the taxpayer actually would owe on a self-reported return, because the ASFR return does not take into consideration the taxpayer's actual filing status, dependency exemptions, and deductions or credits.[14] The IRS notifies the taxpayer of the proposed assessment via a "30-day letter."[15] The taxpayer may respond with an original return, an agreement to the proposed ASFR assessment, or a statement indicating disagreement with the assessment. If the taxpayer disagrees or fails to resolve the return delinquency during this 30-day period (*i.e.*, does not respond to the 30-day letter), the IRS sends a Statutory Notice of Deficiency (90-day letter) to the taxpayer by certified mail.[16] If the taxpayer does not resolve the return delinquency or petition the U.S. Tax Court for relief within 90 days, the ASFR program assesses the proposed tax, penalties and interest, and collection action proceeds on any unpaid balance due.[17]

11 IRC § 6020(b): "(b) Execution of return by Secretary. — (1) Authority of Secretary to execute return. — If any person fails to make any return required by any internal revenue law or regulation made thereunder at the time prescribed therefor, or makes, willfully or otherwise, a false or fraudulent return, the Secretary shall make such return from his own knowledge and from such information as he can obtain through testimony or otherwise. (2) Status of returns. — Any return so made and subscribed by the Secretary shall be *prima facie* good and sufficient for all legal purposes." IRM 5.18.1.2, *What Is ASFR?* (Oct. 1, 2005). Some of the third-party forms used to match taxpayer data include Forms W-2 and Forms 1099 for miscellaneous, brokerage, interest, dividend, and cancellation of debt income.

12 IRM 5.18.1.3.1, *ASFR Criteria* (Dec. 9, 2014).

13 IRS response to TAS information request (Sept. 15, 2015). "ASFR uses a single filing status unless the taxpayer account shows a previous joint filing. Taxpayers with a previous joint filing receive a married filing separate filing status, consistent with SFR procedures. Per IRC § 6013(a)." IRS clarification (Dec. 11, 2015): "CCNIP (Case Creation Nonfiler Process) creates the tax calculation used to identify the Nonfiler population, including proposed liability amount and filing status. The calculation is forwarded to ASFR."

14 Government Accountability Office, GAO-08-728, *IRS Has a Complex Process to Attempt to Collect Billions of Dollars in Unpaid Tax Debts* 15 (June 2008). "An example in which additional information leads to abatements involves ASFR assessments. The IRS uses the best information available when it prepares returns for taxpayers who failed to file returns. When responding to the IRS-prepared return, taxpayers may provide additional information, such as on deductions to which they are entitled, which would produce a lower tax assessment compared to the ASFR-generated assessment. Accordingly, the IRS abates any assessed taxes and any applicable penalties associated with the ASFR return."

15 IRM 5.18.1.7.5, *Letter 2566 SC/CG (30-Day Letter)* (Feb. 24, 2015). The ASFR "30-day letter" provides the taxpayer with the proposed assessment amounts, and gives the taxpayer 30 days to respond. At the conclusion of the 30-day letter suspense period, if there is no/insufficient response, ASFR generates a Statutory Notice of Deficiency (90-day letter).

16 IRM 5.18.1.7.6, *Statutory Notice of Deficiency (ASFR 90-Day Letter)* (Oct. 1, 2005). The ASFR "90-day letter" (*i.e.*, the statutory notice of deficiency) notifies a taxpayer that the IRS intends to assess a tax deficiency. The notice also informs the taxpayer of the right to petition the Tax Court to dispute the proposed adjustments. The taxpayer has 90 days from the date of the notice to file a petition in the Tax Court before the tax is assessed.

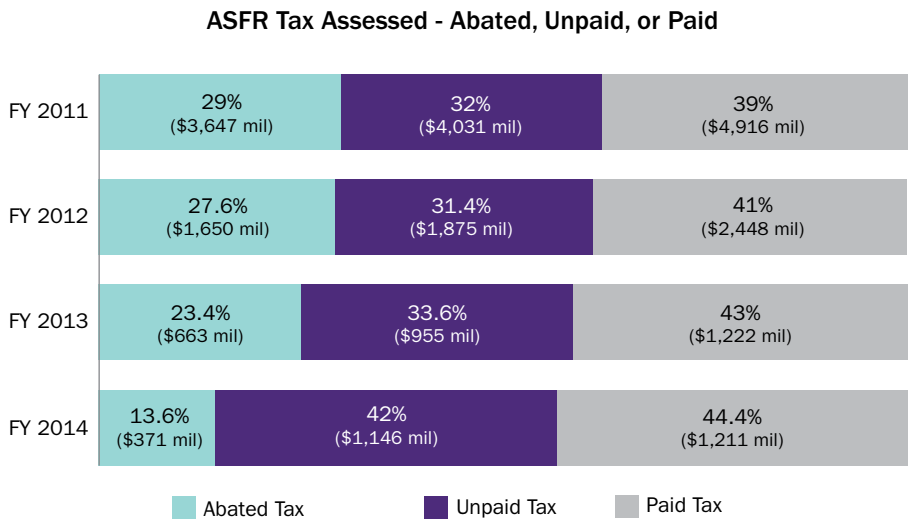
17 IRM 5.18.1.7(1) (Oct. 1, 2005).

Poor Collection Results and High Abatement Rates Show That ASFR's Selection Criteria Are Inefficient and Lead to Inflated Liabilities that Are Later Abated

Inflated Assessments Lead to Poor Collection Results

In FY 2011 through FY 2014, the IRS assessed nearly $34 billion through its ASFR authority.[18] The IRS collected nearly one-third of this amount, about $11 billion.[19] Figure 1.17.1 provides more specifics on the ASFR program's performance during FY 2011 through FY 2014.[20]

FIGURE 1.17.1



High Abatement Rate Is an Indication of Problematic Selection Criteria

In addition to the small percentage of dollars collected when compared to dollars assessed, the ASFR program's rate of abatement is significant. For ASFR assessments made in FY 2011 through FY 2014, the IRS abated nearly $1 for every dollar collected.[21] The high abatement rate can be attributed in part to the IRS not considering deductions and credits when selecting cases for ASFR. Figure 1.17.2 shows the percentage of assessed tax later abated for FY 2011 through FY 2014.

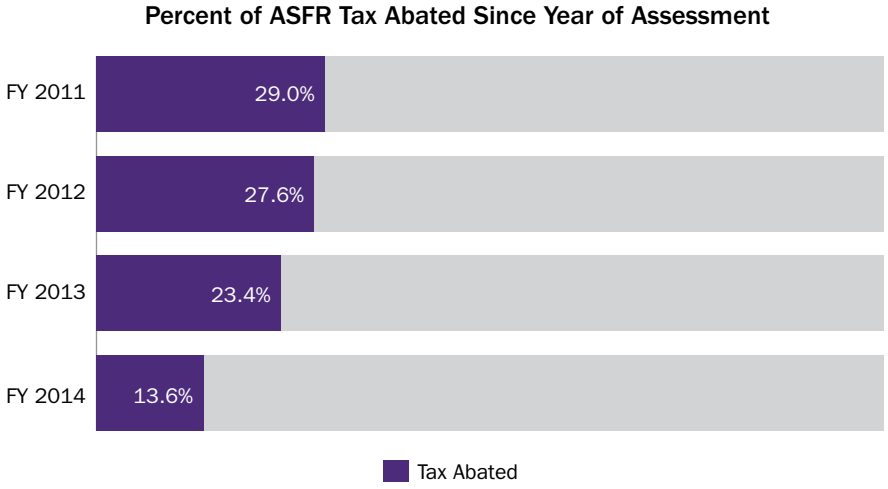
18 IMF, ERIS on IRS CDW.

19 *Id*. The $34 billion assessed includes tax, penalties and interest.

20 As noted above, some ASFR abatements occur after the taxpayer files as the secondary taxpayer on a joint return; in such cases ERIS might not capture the tax assessed to and collected from a secondary taxpayer.

21 IMF, ERIS on IRS CDW. Of the $34 billion of tax, interest, and penalty assessed, the IRS collected $10.7 billion and abated $9.8 billion.

FIGURE 1.17.2



As shown in the figure above, the amount of abatements is less in recent years, but these rates are likely to increase as time goes on, eventually reaching FY 2011 levels. As the IRS makes collection attempts (including refund offsets) on more recent ASFR assessments, taxpayers will file a return or provide documentation supporting deductions and credits, thereby resulting in a lower tax liability and abatement of the inflated ASFR liability. These abatement rates, coupled with the low collection results, indicate that the IRS should adjust its criteria for selecting cases for an ASFR assessment.

The approach of inflating a taxpayer's tax liability has several flaws. Inflating ASFR liabilities increases the number of ASFR cases that should not have been assessed in the first place. In other words, these cases only show a liability because the IRS did not consider deductions and credits. Specifically, the IRS could develop a selection algorithm that incorporates mortgage interest paid (as reported on Forms 1098), state income taxes paid (as reported on Forms W-2), and state sales tax per IRS tables. The IRS also could use historical data in the selection algorithm to include exemptions for dependents claimed on past returns and who were not claimed on another's return for the year in question. By including this information in the selection algorithm, the IRS will minimize the number of abatements, reducing both IRS rework and taxpayer burden.

The Low Return on Investment Raises Questions About the Usefulness of the ASFR Program

When taking into account the costs of the ASFR program, along with the collection results, and abatement rate, the usefulness of the program is questionable. According to an IRS report, the ASFR program cost $39.8 million in FY 2014. The $39.8 million does not include the costs of later abating liabilities, or the expense of sending out collection notices or making collection attempts. The revenue associated with the program prior to the IRS sending a first collection notice to the taxpayer was $89.5 million, which is a net gain of about $50 million.[22] Further, the report stated that it collected $2.25 for every $1 spent on the ASFR program.[23] This is a low ROI when compared to other IRS collection programs, and even then the ROI is overstated because it does not take into consideration the significant downstream costs

22 Office of the Chief Financial Officer, Financial Management, Office of Cost Accounting Cost-Based Performance Measures ASFR, FY 2010 – FY 2014.

23 *Id.*

attributable to abatement.[24] For example, for every dollar invested in other IRS programs, there can be monetary returns ranging from 6-to-1 and even up to 20-to-1.[25] Improving the selection criteria for the program would increase the return on investment; otherwise, the program as currently configured raises the question of whether the $39.8 million spent might be better applied elsewhere.

Considering Additional Information Prior to Selecting Cases for ASFR May Increase Program's Efficiency While Reducing Burden on Taxpayers

As noted above, the ASFR program could yield better results by carefully selecting which cases to pursue. This could be accomplished by considering third-party documentation (*i.e.*, documents the IRS has available to it that would support deductions and credits like the mortgage interest deduction or education deductions and credits) and prior year filing statuses.

In an effort to identify what generates abatements, and what type of information would be useful for the IRS to consider when selecting ASFR cases, TAS analyzed reason codes entered on abatements of ASFR liabilities for FY 2014. Unfortunately, the reason codes used are often vague and nondescript, and provide little information as to why the liability was abated. For example, the reason code most commonly entered was "reconsideration allowed in full." However, several of the codes did provide insight into what causes the abatement. The following are some of the most common reasons for abatement:

- Filing status (Married Filing Jointly);
- Filing status (Head of Household); and
- Itemized deductions.

In regards to the different filing statuses (*i.e.,* changing from married filing separately to married filing jointly or head of household), the IRS could look at the past three filed returns and, if the taxpayer elected married filing jointly or head of household on those past returns, it could at least consider the selected status for the purpose of determining if the case would be well suited for the ASFR program. This approach is particularly appropriate where the spouse from earlier years has not filed a return of his or her own for the ASFR year. If it would substantially reduce or eliminate the liability, the IRS could make a business decision to not prioritize this particular case for ASFR development, because there is a high probability of abatement.

Another common reason for abatement of ASFR assessments is application of itemized deductions. Unfortunately, the reason code does not specify what itemized deductions generated the abatement. However, TAS Research was able to identify ASFR assessments that were abated due to the mortgage interest deduction. In FY 2011, there were 279,374 ASFR assessed modules in which IRS received a Form 1098 showing mortgage interest expense; 85,151 of these accounts, or 30 percent, had tax abated, which IRS might have anticipated since many were qualified to itemize deductions and thereby incur a lower tax.[26] In fact, over 60 percent of all ASFR accounts with Form 1098 show mortgage interest expense amounts larger than the standard deduction, indicating these taxpayers likely qualify to itemize, yet the IRS calculates their tax at a higher rate.[27]

24 Also note that, overall, IRS collected nearly $11 billion of assessments made in FY 2011 through FY 2014.

25 Statement of the Commissioner of Internal Revenue John Koskinen on the FY 2016 Budget (Feb. 2, 2015).

26 IMF, ERIS on IRS CDW. There were 2,230 modules with abated tax of about $49 million attributable to TC 594 CC 84 (modules abated because the taxpayer filed as a secondary taxpayer on a joint return).

27 *Id*.

The IRS already possesses third-party documentation regarding the mortgage interest deduction, and for many other itemized deductions and credits. This documentation is just as reliable as the third-party documentation used to determine a taxpayer's income. If the IRS is confident using third-party documentation to determine income, it should also take into account third-party documentation that would support deductions or credits when making a determination as to the use of its SFR authority.

The following are examples of the type of information that should be considered when determining if a case should be selected for the ASFR program, or if an ASFR assessment would likely result in abatement:

> **EXAMPLE 1:** Taxpayer failed to file a return for tax year 2014. In the three tax years prior to 2014, the taxpayer elected married filing jointly (MFJ) status and for those years either owed zero tax or was due a refund. Further research shows that the taxpayer's spouse did not file a separate return for 2014. The IRS made an ASFR assessment on the 2014 return and used the married filing separately status. By using the married filing separately status, the taxpayer had an ASFR liability that would have been lessened or possibly eliminated if the IRS used the MFJ filing status.
>
> **EXAMPLE 2:** Taxpayer did not file a return for tax year 2014. For the past five years preceding 2014, the taxpayer has taken the mortgage interest deduction. By claiming this deduction, the taxpayer had a minimal tax liability. The IRS made an ASFR assessment on the 2014 return and did not include the mortgage interest deduction, even though the IRS has this information. As a result, the IRS assessed a liability that exceeded the minimal amount had the IRS considered the mortgage interest deduction.
>
> **EXAMPLE 3:** Taxpayer failed to file his 2014 tax return. For the past three years, taxpayer claimed the maximum amount allowed for the education deduction for those years. As a result, taxpayer typically received a refund ranging from $250 to $500. The IRS made an ASFR assessment for 2014 and did not consider the education deduction, even though it has that information available to it. As a result, taxpayer was assessed an ASFR liability that would have been eliminated if the IRS considered information available on third-party information reports.[28]

The examples above illustrate that if the IRS had considered the taxpayer's prior filing status history, or third-party documentation that support credits or deductions, it might have decided to not include the case in the ASFR program. Not only would this strike a fairer balance in the ASFR program, thereby upholding a taxpayer's *right to a fair and just tax system*, it would also prevent the IRS from using resources to conduct an ASFR assessment on an account that would likely result in abatement if the taxpayer contacted the IRS and submitted documentation substantiating deductions and credits.

Although the IRS may ultimately decide that the case should not be included in the ASFR program after considering third-party documentation, it could instead send the taxpayer a letter saying, "We have information that you may be able to claim a tax credit and we haven't received your return. Please file." This might bring in the return without doing an unproductive ASFR. This approach promotes the taxpayer's obligation to timely file a return without producing an incorrect assessment that requires abatement.

28 *See* IRS Form 1098-T *Tuition Statement*. "You, or the person who can claim you as a dependent, may be able to claim an education credit on Form 1040 or Form 1040A."

Narrowing the Field of ASFR Cases Will Improve Case Resolution

If the IRS reduced the number of ASFR cases by using additional third-party documentation, it could focus on the remaining ASFR cases and attempt to actually contact the taxpayer. More specifically, IRS employees could first send out a soft notice that provides information about the ASFR and how to contact the IRS. This notice could inform taxpayers of the amount the IRS believes the taxpayer owes but also acknowledges that the enclosed list of third-party documentation shows the taxpayer may be entitled to certain deductions and credits.

Currently, the IRS does not disclose in its notice that it possesses any third-party information indicating that the taxpayer might qualify for additional deductions or credits, much less share them to assist the taxpayer with preparing a return.

If the IRS does not hear back from the taxpayer in a specified period of time, an IRS employee would attempt a phone call to reach this taxpayer and discuss avenues for resolution, including collection alternatives. Going this extra step with a smaller batch of ASFR cases — chosen through refined selection criteria — would ensure that the taxpayer's failure to respond was not due to an undelivered notice.[29] This approach will improve case resolution by focusing on a smaller number of cases and adding the element of in-person contact with taxpayers. It will also reduce rework and use the IRS's most expensive touches (phone calls and actual proposed assessment letters) with a much smaller pool of potentially delinquent taxpayers.

CONCLUSION

It is critical that the IRS designs its programs and its interactions with the public to encourage voluntary filing. The IRS designed the ASFR program to motivate taxpayers who had not filed a return, but had a requirement to do so, to contact the IRS and file such a return. However, as discussed above, the ASFR program largely fails to drive such behavior. Further, enforced collection actions are harming taxpayers and tying up IRS's own resources with unproductive cases where after applying exemptions, deductions and credits, information about which the IRS has in its possession through third-party reporting, the liability would be reduced to zero. The taxpayers would be better served if the IRS used selection criteria that considered additional third-party documentation in calculating a taxpayer's liability. This would ensure that the ASFR cases were worthy of IRS resources.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Review annually where ASFR assessments have had the most success in getting taxpayers to file an original return and adjust the ASFR selection process to focus on similar types of cases.
2. Refine ASFR abatement reason codes, making them more specific, so the IRS can use this information when determining if a case should be selected for the ASFR program.
3. When selecting cases for ASFR, consider third-party documentation that supports exemptions, deductions, and credits before making ASFR assessments.

29 National Taxpayer Advocate 2010 Annual Report to Congress 21.

MSP #18 INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS (ITINs): IRS Processes Create Barriers to Filing and Paying for Taxpayers Who Cannot Obtain Social Security Numbers

RESPONSIBLE OFFICIAL

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

Problems obtaining Individual Taxpayer Identification Numbers (ITINs) have long plagued taxpayers who have a tax return filing requirement and need a taxpayer identification number, but are ineligible for a Social Security number (SSN).[2] ITINs play a vital role in the U.S. tax system. Without ITINs, approximately 4.6 million taxpayers would not be able to comply with their annual tax filing and payment obligations, or receive tax benefits to which they are legally entitled.[3] When taxpayers cannot obtain ITINs timely, or at all, they may face financial hardship and limitations on where and with whom they can do business. Some taxpayers may drop out of the tax system altogether.

ITIN applications and associated return filings have dropped precipitously, down 58 percent between 2011 and 2014.[4] While the general economic climate and immigration trends help explain this decline, IRS ITIN procedures have most certainly contributed to it. In 2012, in response to a Treasury Inspector General for Tax Administration (TIGTA) report alleging significant refund fraud connected to ITINs, the IRS made sweeping changes that require applicants to submit original identification documents (subject to a few alternatives) and has maintained its policy of generally requiring applicants to apply for an ITIN with a paper tax return during the filing season.[5] The requirements have led to extreme delays for ITIN

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

2 "Generally, noncitizens authorized to work in the United States by the Department of Homeland Security (DHS) can get a Social Security number." Social Security Administration, *Social Security Numbers for Noncitizens*, Publication No. 05-10096 (June 2015), *available at* http://www.socialsecurity.gov/pubs/EN-05-10096.pdf.

3 During processing years (PYs) 2012-2014 an average of 4.6 million Form 1040 returns were filed having an ITIN for either the primary or secondary (*e.g.*, spouse) filers or a dependent. IRS, Compliance Data Warehouse (CDW) (data retrieved on Dec. 15, 2015).

4 In PY 2011, the IRS received 2,317,374 ITIN applications (Form W-7), compared to 965,793 in PY 2014. IRS, *ITIN Comparative Reports* (Dec. 31, 2011; Dec. 31, 2014).

5 See IRS, IR-2012-98, IRS *Strengthens Integrity of ITIN System; Revised Application Procedures in Effect for Upcoming Filing Season* (Nov. 29, 2012), *available at* http://www.irs.gov/uac/Newsroom/IRS-Strengthens-Integrity-of-ITIN-System;-Revised-Application-Procedures-in-Effect-for-Upcoming-Filing-Season.

While concerns about refund fraud are legitimate, the IRS's solutions do not effectively target the fraud nor do they balance 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*.

applicants. During the 2015 filing season, the IRS advised taxpayers to wait up to 11 weeks,[6] and at one point had a backlog of nearly 120,000 ITIN applications with returns.[7] While concerns about refund fraud are legitimate, the IRS's solutions do not effectively target the fraud nor do they balance 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*. As a result, the IRS burdens legitimate taxpayers and harms global commerce. The advent of the Foreign Account Tax Compliance Act (FATCA) has exacerbated problems due to the greater impact of not timely receiving an ITIN.[8] The National Taxpayer Advocate is concerned that:

- The requirement to apply for an ITIN during the filing season burdens applicants, creates delays, leads to lost returns, and hampers the IRS's ability to detect and prevent fraud.
- ITIN applicants are subject to unnecessary burden and risk losing their identification documents while the IRS creates more work for itself by not providing adequate alternatives to applicants submitting original documents.
- Combined, the requirements for most applicants to apply during the filing season and send original documents contribute to errors on the parts of the ITIN unit and ITIN applicants, resulting in growing suspension and rejection rates.
- Taxpayers abroad needing ITINs for information reporting purposes are especially burdened by the ITIN requirements and procedures.
- Future requirements for deactivating ITINs will deprive some taxpayers of ITINs they need for tax administration purposes, and the IRS policy will undermine taxpayers' *right to be informed*.

6 See IRM Procedural Update WI-03-0215-0352 (Feb. 19, 2015), *available at* http://www.irs.gov/pub/foia/ig/spder/WI-03-0215-0352%5b1%5d.pdf.

7 IRS, *ITIN Production Report* (March 28, 2015) showed 119,409 "applications [with return] awaiting input." IRS, *ITIN Production Report* (Mar. 14, 2015) showed 3,075 "applications [without return] awaiting input." Internal Revenue Manual (IRM) 3.21.263.8.3.1, *Preliminary W-7 Application Data Screen* (Sept. 4, 2014) instructs examiners to input as the IRS received date the stamped date or, if missing, the postmark or signature date, or the current date minus ten days.

8 See National Taxpayer Advocate FY 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*). *See also* Legislative Recommendation: *Chapter 3 and Chapter 4 Credits and Refunds: Protect Taxpayer Rights by Aligning the Rules Governing Credits and Refunds for Domestic and International Withholding*, *infra*.

ANALYSIS OF PROBLEM

Background

Individuals ineligible for an SSN, including residents and nonresidents for tax purposes, need an ITIN to file a tax return or be claimed on another person's return.[9] Taxpayers without SSNs rely on ITINs to:

- File required tax returns if income is above the filing threshold and pay associated taxes;
- Claim tax benefits to which they are lawfully entitled, such as the dependency exemption[10] and the Child Tax Credit;[11]
- File joint returns or be claimed as dependents on the returns of primary taxpayers;
- Avoid mandatory withholding at the rate of 30 percent on certain payments of U.S. source income made by a foreign financial institution under the requirements of FATCA[12] and U.S. source income that is fixed, determinable, annual, or periodic;[13]
- File an election or apply for a withholding certificate under the Foreign Investment in Real Property Tax Act (FIRPTA) of 1980;[14]
- Claim tax treaty benefits to obtain reduced withholding rates; and
- Provide information to third parties such as financial institutions, requiring an ITIN for information reporting and withholding.

The ITIN population has changed significantly in recent years. In calendar year 2014, dependents comprised only 44 percent of ITIN applicants, compared to 68 percent of ITIN applicants in 2012.[15] Spouses, who made up about six percent of ITIN applicants in 2012, made up over 13 percent in 2014.[16]

9 Taxpayers are required by law to use a taxpayer identifying number on tax returns, statements, or other documents required to be filed, when prescribed by regulations, and the regulations specify that this number must be an SSN unless the individual is ineligible for an SSN or is required to use an employer identification number. Internal Revenue Code (IRC) § 6109(a)(1); Treas. Reg. § 301.6109-1(a)(1)(ii)(A). Form W-7, *Application for IRS Individual Taxpayer Identification Number*, is the application that taxpayers use to apply for an ITIN.

10 An individual may generally claim a dependency exemption amount for a child (or younger descendant or that of a sibling or step-sibling) under 19 (24 if a full-time student) sharing his or her home for over half the year and who is a U.S. citizen or national, or a resident of the U.S., Canada, or Mexico, or for a qualifying relative. *See* IRC §§ 151(c), 152(b), (c), (d). Note, however, that terms of tax treaties between the U.S. and foreign countries may provide for residents of those countries to claim a dependency exemption if they meet certain conditions. *See, e.g.*, U.S.- Republic of Korea Income Tax Convention, Art. 4(7).

11 The Child Tax Credit and the refundable portion of it, known as the Additional Child Tax Credit, are generally available for children who meet the dependency exemption rules, with the additional requirement that they must also reside in the United States. *See* IRC § 24(a), (c), and (d).

12 Pub. L. No. 111-147, Title V, Subtitle A, 124 Stat. 71, 97 (2010). Under FATCA, participating foreign financial institutions (FFIs) who have reached agreements with the IRS to avoid being subject to systematic withholding must impose withholding on any of their own customers defined as "recalcitrant account holders." IRC § 1471(b)(1)(D)(i). *See* IRC § 1471(d)(6) (definition of "recalcitrant account holder"). Financial customers must provide the FFI with either a Form W-9, to certify they are U.S. persons, or a Form W-8BEN, to certify they are foreign persons, both of which require an SSN or ITIN. Taxpayers without an SSN or an ITIN will generally be treated as recalcitrant account holders and will be subject to withholding undertaken by the FFI. IRS response to TAS information request (Nov. 1, 2013). *See also* Treas. Reg. § 1.1471-4.

13 *See* IRC § 1441.

14 Pub. L. No. 96-499, Subtitle C, 94 Stat. 2599, 2682 (1980). FIRPTA imposes income tax on foreign persons disposing of U.S. real property interests.

15 IRS, Compliance Data Warehouse (CDW), Form W-7 Database (data drawn Dec. 15, 2015). All numbers refer to year end data. *See* National Taxpayer Advocate 2013 Annual Report to Congress 216.

16 Detailed information from ITIN applications (Form W-7) for PY 2015 are not reported here due to a programming error that caused only about half of Form W-7 records being transferred to the IRS's CDW from the ITIN Real Time System (RTS). The IRS informed TAS that the corrected data for 2015 would not be available until early/mid 2016 and suggested that TAS exclude characteristics of 2015 Form W-7 applicants from this report. Form W-7 data for PY 2014 and prior years have been corrected.

ITIN applications submitted by nonresidents increased over eight percent between 2013 and 2014 (from 100,285 to 108,472), which might be driven in part by an increased number of taxpayers needing ITINs to comply with FATCA. ITIN filers were only slightly more likely to claim a refund than SSN taxpayers, and the average refund for ITIN filers was slightly less than the average refund for SSN filers during the last two years.[17] In 2015, 4.4 million ITIN filers paid over $5.5 billion in payroll and Medicare taxes and $23.6 billion in total taxes.[18]

FIGURE 1.18.1, Type of ITIN Applicant and Country of Origin

		Type of Applicant				Top Three Countries of Origin		
Year	Total	Primary	Spouse	Dependent	Other	Mexico	Guatemala	India
2013	1,175,422	417,747	129,037	614,849	13,789	695,268	78,485	42,742
	100%	36%	11%	52%	1%	59%	7%	4%
2014	924,507	383,069	124,487	403,434	13,517	466,314	63,043	54,542
	100%	41%	13%	44%	1%	50%	7%	6%

FIGURE 1.18.2, Residency Status of ITIN Applicants and Application Exceptions[19]

		Residency Status			Top Three Application Exceptions		
Year	Total	Resident	Non-Resident	Other	Passive Income	Other Income	FIRPTA
2013	1,175,422	1,044,126	100,285	31,011	36,348	10,818	8,171
	100%	89%	9%	3%	3%	1%	1%
2014	924,507	781,650	108,472	34,385	32,243	13,265	9,728
	100%	85%	12%	4%	3%	1%	1%

17 IRS, CDW, Form 1040 Database (data drawn Dec. 15, 2015). All numbers refer to year end data except for 2015, which includes data through October 2015.

18 IRS, CDW, Form W-2 Database, Form 1040 Database (date drawn Dec. 16, 2015) (reflects data available from January to November 2015). An "ITIN filer" is defined as a tax return on which an ITIN was used for either the primary or secondary (*e.g.*, spouse) filer or a dependent. The $5.5 billion figure includes Federal Insurance Contributions Act (FICA) and Medicare taxes reported on Form W-2 by primary filers with an ITIN and primary filers with an SSN if the secondary filer or a dependent used an ITIN. This figure does not include FICA and Medicare tax paid by Form 1040 ITIN filers who used a different taxpayer identification number (*e.g.*, SSN) on Form W-2. IRS, CDW, Form W-7 data.

19 IRS, CDW, Form W-2 Database, Form 1040 Database (date drawn Dec. 16, 2015).

FIGURE 1.18.3, Summary Characteristics of ITIN and Non-ITIN Filers[20]

	2014		2015	
	ITIN	non-ITIN	ITIN	non-ITIN
Total Tax Returns	4,509,722	142,887,720	4,351,220	143,715,543
Returns with a Refund	3,582,839	111,415,130	3,429,365	110,734,488
	79%	78%	79%	77%
Returns with Balance Due	680,761	26,182,800	710,505	27,937,064
	15%	18%	16%	19%
Average Refund	$2,904	$3,321	$2,896	$3,363
Average Balance Due	$2,011	$5,332	$2,089	$5,566
Total Refund Amt ($M)	$10,405	$370,040	$9,931	$372,429
Total Taxes Paid ($M)	$22,505	$1,575,328	$23,601	$1,673,228
Taxes Withheld ($M)	$12,582	$1,042,237	$13,200	$1,097,267

The inability to obtain ITINs leads to negative consequences for taxpayers, international businesses, and the IRS, as illustrated by the following examples:

1. A foreign individual on a temporary (nonimmigrant) visa correctly obtains an SSN and pays taxes, as required, on the income earned working in the United States. His family undergoes financial hardship when he must forgo claiming the dependency exemption for his child and filing a joint return with his spouse, both residing in Mexico, because IRS procedures create barriers to them obtaining ITINs.[21]
2. A foreign investor who owns U.S. property applies for an ITIN six months in advance of an upcoming sale, leaving ample time for the IRS to process the ITIN and issue a withholding certificate. The IRS suspends her ITIN application without explaining why her supporting documents were insufficient. The investor delays the sale while she resubmits the same documents. By the time the IRS approves the ITIN application and the investor applies for and receives a withholding certificate, the sale has fallen through.
3. A resident for tax purposes, who is ineligible for an SSN, works as an independent contractor. He chooses not to file a tax return and pay taxes because he has witnessed others in his community who were unsuccessful in obtaining ITINs, even after paying certifying acceptance agents to assist them.

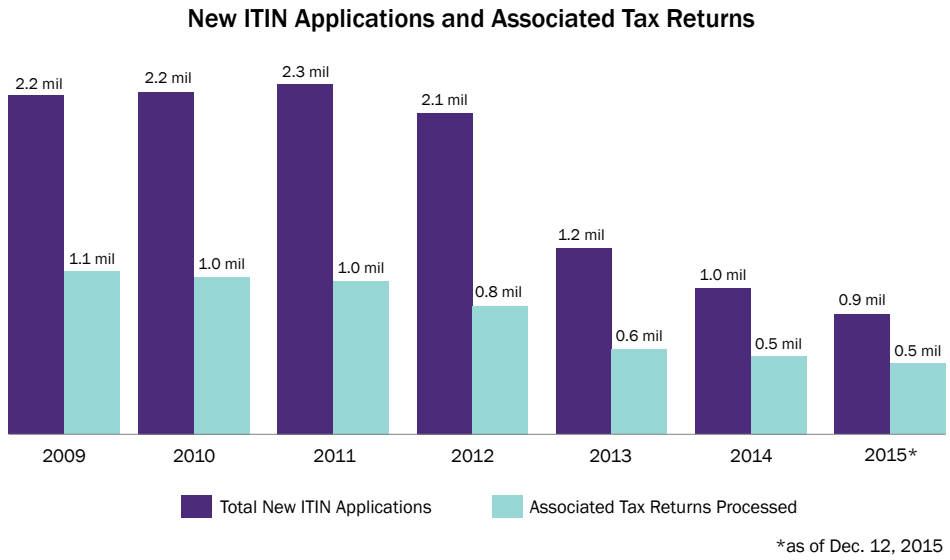
In 2012, TIGTA found the IRS's ITIN process was "so deficient that there is no assurance that ITINs are not being assigned to individuals submitting questionable applications."[22] While concerns about refund fraud are legitimate, the IRS's disproportionately restrictive approach to issuing ITINS does not effectively target the fraud while needlessly burdening taxpayers and preventing those with a legitimate need for an ITIN from obtaining one. Beginning in 2012, the numbers of new ITIN applications and associated returns have fallen significantly as shown in Figure 1.18.4.

20 IRS, CDW, Form 1040 Database (date drawn Dec. 16, 2015).

21 The documentation requirements for ITIN applications will be discussed below.

22 TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpaer Identification Number Program to Detect Fraudulent Applications* 6 (July 16, 2012).

FIGURE 1.18.4, New ITIN Applications and Associated Returns in PYs 2009–2015[23]



The Requirement to Apply for an ITIN During the Filing Season Burdens Applicants, Creates Delays, Leads to Lost Returns, and Hampers the IRS's Ability to Detect and Prevent Fraud

In 2003, despite the National Taxpayer Advocate's concerns about creating unnecessary administrative burden, the IRS began requiring most ITIN applications to be filed with a paper tax return during the filing season.[24] There are exceptions for nonresident individuals claiming the benefits of a tax treaty and having income, payments, or transactions subject to third-party reporting or withholding,[25] but these applicants are a minority.[26] ITIN applicants only have a short time to gather supporting documents and in many cases must give up original documents such as passports.[27] Some may not be able to apply for an ITIN at all if they are out of the country during the filing season and cannot send in their documents. Furthermore, filing an ITIN application with a return means applicants cannot electronically file their annual returns in the calendar year the ITIN is issued.

While this policy was ill-considered at its inception, the consequences have grown significantly worse. In 2003, the IRS processed ITIN applications in four to six weeks, and following the policy change, committed to two weeks.[28] During the 2015 filing season, the IRS advised taxpayers to wait up to 11 weeks,[29]

23 IRS, *ITIN Comparative Reports* (weeks ending Dec. 12, 2015; Dec. 31, 2014; Dec. 31, 2013; Dec. 29, 2012; Dec. 31, 2011, Dec. 30, 2010, and Dec. 31, 2009).

24 *See* National Taxpayer Advocate 2003 Annual Report to Congress 60-86 (Most Serious Problem: *Individual Taxpayer Identification Number (ITIN) Program and Application Process*).

25 *See* Form W-7 instructions (Dec. 2014).

26 In PY 2014, about 56,700 out of 924,500 ITIN applicants (six percent) claimed an exception to filing with a tax return. IRS, CDW, Form W-7 Database (data drawn Oct. 19, 2015).

27 The documentation requirements for ITIN applications will be discussed below.

28 *See* National Taxpayer Advocate 2003 Annual Report to Congress 79.

29 *See* IRM Procedural Update WI-03-0215-0352 (Feb. 19, 2015), *available at* http://www.irs.gov/pub/foia/ig/spder/WI-03-0215-0352%5b1%5d.pdf.

and at one point had a backlog of nearly 120,000 ITIN applications with returns.[30] This results in ITIN taxpayers waiting up to 14 weeks to receive their refunds, contrasted with the up to three weeks taxpayers with SSNs must wait.[31] The backlog also affected applicants who were exempt from the requirement to apply with a tax return.[32]

When questioned about the cause of the extended timeframe and backlog, the IRS cited funding decreases, which resulted in the delayed return of seasonal tax examiners by 30 days, a shorter filing season, an inability to provide overtime pay, and an overall decrease in employees.[33] However, seasonal employees and overtime would not be necessary and the length of the season would be irrelevant if the IRS were to process ITIN applications throughout the year.[34] The IRS maintains, "Associating the issuance of the ITIN with the filing of a tax return is the only reliable method for the IRS to verify the number is being requested and properly used for tax administration purposes."[35] However, in the case of a Form W-7 and Form W-2 name mismatch,[36] the IRS accepts copies of pay stubs or bank accounts as proof the income belongs to the applicant.[37] The IRS could accept these documents to determine that the taxpayer had a filing requirement and a proper tax administration purpose for an ITIN, throughout the year. This approach would acknowledge the need for a tax filing requirement, but balance the anti-fraud regime with the taxpayer's need for a process no more intrusive than necessary.

Requiring ITIN applications to be filed with returns results in lost returns, and until a recent policy change, it also led to unprocessed returns. More than one Low Income Taxpayer Clinic (LITC)[38] has reported instances where the IRS processed an ITIN application, but lost the associated return, which was submitted shortly before the refund statute of expiration date (RSED).[39] Although the IRS does not keep records of lost return complaints,[40] allowing taxpayers to apply for an ITIN earlier, and later file annual returns, including the option to electronically file, would reduce the opportunity for returns to be lost.[41]

As a result of TAS's advocacy, the IRS recently agreed to change its ITIN guidance and process all valid returns filed with an ITIN application. Prior to these changes, the Internal Revenue Manual (IRM) advised

30 IRS, *ITIN Production Report* (Mar. 28, 2015) showed 119,409 "applications [with return] awaiting input." IRS, *ITIN Production Report* (Mar. 14, 2015) showed 3,075 "applications [without return] awaiting input." IRM 3.21.263.8.3.1, *Preliminary W-7 Application Data Screen* (Sept. 4, 2014) instructs examiners to input as the IRS received date the stamped date or, if missing, the postmark or signature date, or the current date minus ten days.

31 *See* 2015 Tax Season Refund Frequently Asked Questions, *available at* http://www.irs.gov/Refunds/Tax-Season-Refund-Frequently-Asked-Questions (last updated Apr. 22, 2015).

32 The backlog led to a spike in the processing time for applications submitted without returns. At one point during the 2015 filing season, the IRS took approximately 35 days to process these ITIN applications, compared to 23 days in 2014. *See* IRS, *ITIN Production Report* (June 13, 2015).

33 *See* IRS response to TAS information request (Sept. 17, 2015).

34 IRS, *ITIN Production Report* (Mar. 28, 2015) showed 119,409 "applications [with return] awaiting input." IRS, *ITIN Production Report* (March 14, 2015) showed 3,075 "applications [without return] awaiting input." IRM 3.21.263.8.3.1, *Preliminary W-7 Application Data Screen* (Sept. 4, 2014) instructs examiners to input as the IRS received date the stamped date or, if missing, the postmark or signature date, or the current date minus ten days.

35 *See* National Taxpayer Advocate FY 2015 Objectives Report to Congress vol. 2, 87.

36 *See* Form W-7, *Application for IRS Individual Taxpayer Identification Number*, and Form W-2, *Wage and Tax Statement*. A name mismatch occurs when the taxpayer's name on the Form W-7 is different from the taxpayer's name on Form W-2.

37 *See* IRM 3.21.263.5.10.8, *Correspondence Inventory Procedures* (Aug, 18, 2014).

38 *See* IRC § 7526.

39 TAS conference call with LITCs (Nov. 19, 2014).

40 *See* IRS response to TAS information request (Sept. 17, 2015).

41 After an ITIN is assigned, the accompanying tax return is sent for processing and follows the same path as returns with SSNs, suggesting there may be a breakdown in the process between the time the ITIN is processed and the return is sent for processing. *Id*.

Accepting Individual Taxpayer Identification Number (ITIN) applications throughout the year would allow the IRS to apply greater scrutiny to applications where an ITIN is not needed until the filing season.

that if the income and identity cannot be validated, the return will not be processed,[42] even if the return was a valid return under the *Beard* test.[43] This practice infringed a *taxpayer's right to pay no more than the correct amount of tax* because a properly executed return can constitute a claim for refund, and if the ITIN unit failed to send the return for processing and assign an identification number, the IRS may be unable to locate the return and thus argue no claim for refund was timely filed if the RSED has passed.[44] Furthermore, the IRS's prior practice impaired a taxpayer's *right to be informed* because the IRS did not notify taxpayers that their returns were not being processed. TAS persuaded the IRS to protect these rights by revising the IRM to process tax returns with an Internal Revenue Service Number (IRSN)[45] when they are received with an ITIN application and the IRS cannot verify that the applicant has satisfied the requirements to be assigned an ITIN.[46]

Accepting ITIN applications throughout the year would allow the IRS to apply greater scrutiny to applications where an ITIN is not needed until the filing season. The IRS could prioritize those applications where an ITIN is needed immediately, such as for FATCA purposes. The IRS could prevent more fraud by having two separate opportunities to detect fraudulent income or identity theft — one at the time of the ITIN application, and again at the time of return filing. Currently, the IRS misses out on the benefit of identifying trends throughout the year and applying rules to detect later returns that are part of fraudulent schemes.

ITIN Applicants Are Subject to Unnecessary Burden and Risk Losing Their Identification Documents While the IRS Creates More Work for Itself By Not Providing Adequate Alternatives to Applicants Submitting Original Documents

Some of the most restrictive elements of the ITIN application procedures were implemented in 2012 in response to TIGTA's fraud concerns.[47] Applicants must either mail in original identification documents or copies certified by the issuing agency, use a Taxpayer Assistance Center (TAC) to certify their

42 IRM 3.21.263.5.10.8, *Correspondence Inventory Procedures* (Aug. 18, 2014). See also IRM 3.21.263.5.4.1, *Temporary W-7 Status and Final W-7 Status Screen* (Oct. 25, 2013); IRM 3.21.263.5.2.3.7, *Final Status Determination Used in Stripping Process* (Jan. 2, 2015); IRM 3.21.263.5.2.9. *Clerical Handling of Reject Status 98 Flagged 65 Day Purge, Reject Status 99 ITIN 0099 Report, Hard Reject 1 Letter 4939 Cases, and Form 4442* (Sept. 30, 2013).

43 For the tax return to be valid, it must: contain sufficient data to calculate a tax liability, purport to be a return, include an honest and reasonable attempt to satisfy the requirements of the tax law, and be signed under penalties of perjury. *See Beard v Commissioner*, 82 T.C. 766, 777 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986).

44 IRM 3.21.263.7.3, *Refund Inquiries Involving ITIN Issues* (June 29, 2015) advises employees working refund inquiries where the ITIN application was rejected to research an internal database to locate an assigned IRSN, which is an identification number that would not be assigned if the return was not forwarded for processing.

45 An IRSN is a temporary number used in place of a taxpayer identification number such as an SSN or ITIN in order to process a return. IRM, 3.21.263.4.5, *Internal Revenue Service Number (IRSN)* (Jan. 1, 2015). An IRSN is used for processing purposes only and is not a substitute for an SSN or ITIN. IRM 3.13.5.73, *When IRSNs Are Needed* (Jan. 1, 2015).

46 *See* IRS response to TAS information request (Nov. 20, 2015). The IRS revised the following IRMs: IRM 3.21.263.4.8.3, *Hard Reject Reason Codes* (Nov. 25, 2015); IRM 3.21.263.5.4.1, *Temporary W-7 Status and Final W-7 Status Screen* (Nov. 25, 2015); IRM 3.21.263.5.10.8, *Correspondence Inventory Procedures* (Nov. 25, 2015); IRM 3.21.263.5.2.3.7, *Final Status Determination Used in Stripping Process* (Nov. 25, 2015); IRM 3.21.263.5.10.5, *Suspense Inventory Procedures* (Nov. 25, 2015). ITIN applicants whose ITIN applications are rejected and whose returns are processed with an IRSN receive a letter notifying them that an IRSN was assigned, as well as a letter explaining that a refund cannot be released for a taxpayer using an IRSN. *See* Letter 685C, *SSN Invalid* (Rev. Oct. 2007); IRM 3.13.5.72, *Assignment of Internal Revenue Service Numbers (IRSNs)* (Apr. 3, 2015). *See also* CP 54B, *Inquiry Regarding Name and SSN - Refund Delayed* (July 2013); IRM 3.13.5.127.1, *CP 54 Notices B, E, G and Q* (Jan. 1, 2015).

47 *See* TIGTA, Ref. No, 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications* (July 16, 2012).

documents, or use a third-party certifying acceptance agent (CAA).[48] Mailing original documents is impractical for many applicants who cannot go without their original identification documents for multiple months. Furthermore, it results in some taxpayers not receiving their identification documents back. Although TAS receives cases from taxpayers trying to locate lost original documents, the ITIN unit does not track the volume of undeliverable or returned mail, the number of claims for lost documents, the success rate for finding them, or the cycle time for returning them to taxpayers.[49] Passports are especially problematic due to the need for taxpayers to have them back. In recent years, the number of original passports submitted with ITIN applications has skyrocketed, from about 55,000 in 2012, to approximately 334,000 in 2013, and approximately 390,000 in 2014.[50] From July 2014 to July 2015, the IRS returned 4,318 original passports to embassies, for which the IRS could not locate a better mailing address.[51]

The IRS is imposing a hardship on any ITIN applicant who is required to send original identification documents to the IRS and who does not have reasonable and accessible alternatives. Examples of the harm taxpayers face include a taxpayer who cannot travel abroad for a medical emergency[52] or a taxpayer who risks detention because he is unable to provide his identification documents to local law enforcement.[53] The IRM only provides for the expedited return of original documents in cases where TAS issues a request to the ITIN Unit based on the taxpayer's hardship.[54] Requiring a taxpayer to work with TAS to provide evidence of a hardship is unnecessary and a waste of time and resources because any taxpayer who is forced to give up his or her original identification documents experiences a hardship as a matter of policy. The IRS has objected to returning all original documents via expedited mail due to the additional cost, which it estimates to be in the millions of dollars.[55] However, if the IRS were to provide reasonable and accessible alternatives to sending in original documents, additional costs would be minimal due to the small number of applicants required to send their original documents to the IRS.

ITIN Authenticating TACs, which provide an alternative to giving up original documents, are a poor option for many because they can only approve two types of supporting documentation — passports and national identification cards.[56] As of September, 2015, there were 186 TACs offering ITIN authentication, with seven temporarily unavailable.[57] Some states had no TACs offering ITIN document

48 *See* IRS, IR-2012-98, *IRS Strengthens Integrity of ITIN System; Revised Application Procedures in Effect for Upcoming Filing Season* (Nov. 29, 2012), *available at* http://www.irs.gov/uac/Newsroom/IRS-Strengthens-Integrity-of-ITIN-System;-Revised-Application-Procedures-in-Effect-for-Upcoming-Filing-Season. However, CAAs may not certify documents for dependents, who comprise the bulk of ITIN applicants.

49 Claims for lost identification documents are processed by the IRS Office of Chief Counsel, General Legal Services. IRS response to TAS information request (Sept. 17, 2015).

50 IRS, CDW, Form W-7 Visa Database (data drawn Oct. 20, 2015).

51 *See* IRS response to TAS information request (Sept. 17, 2015).

52 *See* National Taxpayer Advocate 2013 Annual Report to Congress 223.

53 See *id.*

54 *See* IRM 3.21.263.4.10, *Taxpayer Advocate Service (TAS) Assistance* (Oct. 19, 2015); IRM 3.21.263.5.3.4.2.4, *Returning Original Supporting Identification Documents to Applicant* (Oct. 19, 2015).

55 *See* conference call between TAS and IRS Wage and Investment, discussing *Authenticating Identification Documents at SPEC CAA VITA Sites* (Oct. 29, 2015).

56 IRS, Individual Taxpayer Identification Number (ITIN) Authenticating Taxpayer Assistance Centers, *available at* http://www.irs.gov/uac/ITIN-Authenticating-TACs-Link (last updated Dec. 7, 2015).

57 IRS, Taxpayer Assistance Center Locations Where In-Person Document Review Is Provided, *available at* http://www.irs.gov/uac/TAC-Locations-Where-In-Person-Document-Verification-is-Provided (last updated September 28, 2015).

Under the IRS's one-size-fits-all approach for Individual Taxpayer Identification Numbers (ITINs), a taxpayer trying to open a bank account abroad must meet the same arduous requirements for original documents (without the benefit of Taxpayer Assistance Centers and certifying acceptance agents) and wait just as long for an ITIN as a taxpayer claiming refundable credits, whose income and filing requirement would be subject to greater scrutiny.

authentication services,[58] and some larger states only had them located in a single metropolitan area.[59] Furthermore, taxpayers may face extreme waits at TACs, having to line up hours before they open to receive service.[60] Some taxpayers may not receive ITIN service from a TAC at all, due to reduced hours and appointment times, and limitations on how many new ITIN applications will be worked.[61] Many TACs require a valid U.S.-issued ID just to enter the building, making them completely unavailable to many applicants.[62] Qualified Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites also certify ITIN documents for free, but they have only 117 locations with CAAs, they cannot certify for dependents, and may operate only a few months each year.[63]

Using CAAs is not only cost-prohibitive for some,[64] but completely unavailable to approximately 44 percent of ITIN applicants because they cannot be used by dependents.[65] Allowing dependents to use CAAs may actually reduce fraud because CAAs often have specialized knowledge of identification documents used in certain communities and regions, and can assist the IRS in identifying fraud. Furthermore, it would save the IRS resources because applications would likely have fewer errors as a result of the CAA's expertise, thus reducing the number of applications that must be suspended and that require correspondence with the taxpayer. Increasing eligibility for CAA services would also reduce the burden on TACs, allowing them to refocus scarce resources.

In 2015, the IRS initiated a pilot to test allowing three VITA CAA sites to certify documents for dependents, limited to only passports and national I.D. cards.[66] Although the National Taxpayer Advocate is encouraged that the IRS is exploring alternative methods for dependents to have their documents certified, the pilot is structured such that its effect on applicants, and specifically on the number of applicants who submit original documents, will be minimal.

Even if the pilot is successful and leads to the IRS allowing all 128 VITA/TCE sites with CAAs to certify dependent documents, the pilot would likely only provide significant benefits to the IRS by reducing

58 Neither Montana nor Wyoming have any TACs offering ITIN certification.

59 For example, the only TACs offering ITIN services in Minnesota were in Minneapolis, St. Paul, or Bloomington, which are all part of the Minneapolis metropolitan area.

60 The IRS Commissioner expressed dismay upon hearing reports of taxpayers lining up hours before TACs opened in order to receive service during the 2015 filing season. *See Hearing before the H. Ways and Means Comm., Subcomm. on Oversight on the 2015 Tax Filing Season*, 114th Cong. (2015) (Statement of John Koskinen, IRS Commissioner).

61 One submitter to TAS's Systemic Advocacy Management System (SAMS) reported that the local TAC only gives out 12-15 tokens for new ITIN applications per day, which can only be used on weekdays and would require the submitter to pull children out of school to apply for an ITIN. SAMS Submission # 32537 (submitted March 9, 2015) (on file with TAS).

62 See National Taxpayer Advocate 2012 Annual Report to Congress 176. Representatives of LITCs raised concerns about the requirement of many TACs or federal buildings in which some TACs are located to produce a valid, U.S.-issued ID to enter the building. 2013 Annual LITC Grantee Conference, Recent Developments in IRS Policies and Procedures Related to ITIN Applications, panel discussion (Dec. 6, 2012).

63 See IRS, *List of SPEC Acceptance Agents*, *available at* http://win.web.irs.gov/spec/spec_ITIN.htm (last updated Dec. 5, 2015).

64 According to CAA websites with fee schedules posted, fees for ITINs applications prepared by CAAs can range in the hundreds of dollars for a single ITIN application.

65 IRS, CDW, Form W-7 Database for PY 2014 (data drawn Dec. 15, 2015).

66 See IRS, Authenticating Identification Documents for Dependents at SPEC CAA VITA Sites (Oct. 29, 2015) (on file with TAS).

the strain on TACs. While it may reduce burden for taxpayers who are already eligible to use TACs, the pilot is unlikely to decrease the number of taxpayers forced to send in original identification documents. Under the current system, dependent applicants are likely to send in original documents because either they live in a location where there is not an accessible TAC (making it unlikely there is an accessible VITA/TCE site), or they need to use documents other than a passport or national I.D. card to prove their identities. Without expanding the pilot to include all CAAs (not just VITA/TCE sites), and without allowing CAAs to approve all 13 types of documents for dependents, these applicants will still need to mail in original documents. Furthermore, because ITIN applicants in the pilot must meet the income eligibility requirements for the VITA sites, the benefits are further limited to only those taxpayers who generally make $54,000 or less, have a disability, are elderly, or have limited English.[67] Because dependent applicants are required to file ITIN applications with a tax return,[68] and generally do so during the filing season, the National Taxpayer Advocate hopes the IRS will extend the pilot through the filing season in order to obtain a full picture of how the pilot will affect dependent applicants.

In late December of 2015, Congress amended Internal Revenue Code (IRC) § 6109 to provide special rules for the issuance of ITINs.[69] The new law provides that the IRS may issue an ITIN to an applicant residing in the United States 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.[70] For applicants residing outside the United States, they must submit their applications either by mail, to an IRS employee, or to a designee of the Secretary at a U.S. diplomatic mission or consular post.[71] It allows the IRS to establish documentation requirements for ITIN applicants to prove identity, foreign status, and residency.[72] However, the IRS may only accept "original documents or certified copies meeting the requirements of the Secretary."[73] This language gives the IRS the latitude to provide a number of alternatives to accepting only original documents or copies certified by the issuing agency. When implementing the law, the IRS should use this opportunity to study the additional types of certified copies that may meet its requirements; for example, copies certified by state or other federal agencies other than the issuing agency, clerks of courts, notarized copies, and copies that are properly apostilled and authenticated by U.S. diplomatic missions abroad.[74]

Furthermore, the law provides no limitations on what documents can be certified by a CAA and whether a CAA can certify dependents' documents. Finally, the law envisions an expansion of the CAA program, which the National Taxpayer Advocate hopes the IRS will fully carry out.[75] The law lists persons eligible to be acceptance agents, which includes among others, state and local governments, federal agencies, and

67 See IRS, Free Tax Return Preparation for Qualifying Taxpayers, *available at* https://www.irs.gov/Individuals/Free-Tax-Return-Preparation-for-You-by-Volunteers (last updated Oct. 26, 2015).

68 See Form W-7, *Application for IRS Individual Taxpayer Identification Number Instructions* (Dec. 2014). The pilot was originally scheduled to run from September through December 2015. See IRS, Authenticating Identification Documents for Dependents at SPEC CAA VITA Sites (Oct. 29, 2015) (on file with TAS).

69 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 203(a) (2015) (to be codified at IRC § 6109(i)).

70 See *id.* (to be codified at IRC § 6109(i)(1)(A)).

71 See *id.* (to be codified at IRC § 6109(i)(1)(B)).

72 See *id.* (to be codified at IRC § 6109(i)(2)(A)).

73 See *id.* (to be codified at IRC § 6109(i)(2)(B)).

74 For detailed information, see U.S. Department of State, Authentications and Apostilles, *available at* http://travel.state.gov/content/travel/en/legal-considerations/judicial/authentication-of-documents/notarial-and-authentication-apostille.html (last visited on Dec. 18, 2015). See *also* Convention of 5 October 1961 Abolishing the Requirement of Legalization for Foreign Public Documents, *available at* https://www.hcch.net/en/instruments/conventions/full-text/?cid=41 (last visited Dec. 18, 2015).

75 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 203(c) (2015).

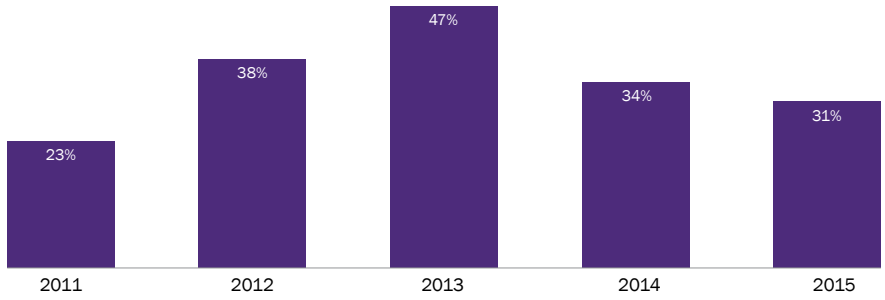
other persons or categories authorized by regulations or IRS guidance.[76] In addition, as part of a required study on the effectiveness of the application process for ITINs, the IRS must evaluate ways to expand the geographic availability of CAAs and strategies to work with other federal agencies, state and local governments, and other organizations to encourage participation in the CAA program.[77] The IRS should use the study to explore accessible alternatives to submitting original documents under its current policy. The IRS also should collaborate with TAS on developing criteria for this study, and include a TAS representative on the study team.

Combined, the Requirements for Most Applicants to Apply for an ITIN During the Filing Season and Send Original Documents May Contribute to Errors on the Parts of the ITIN Unit and Applicants, Resulting in Growing Suspension and Rejection Rates

The compressed timeline for reviewing documents during the filing season encourages errors by the ITIN unit and leads to the use of seasonal employees, who may have less experience and expertise in reviewing ITIN applications. The timeline also leads to errors by applicants who have less time to put together applications. The rate for ITINs rejections is unacceptably high, with almost a third of applications rejected during the past two years, as shown in Figure 1.18.5.

FIGURE 1.18.5[78]

Percent of Rejected ITIN Applications in PYs 2011-2015



It is likely that the original documents requirement contributed to the spike in rejections in 2013, as a result of taxpayers sending in incomplete applications or failing to meet the IRS's standards for original documents. During the last two processing years, the number one reason for suspended applications was documentation that did not meet IRS criteria as shown in Figure 1.18.6.

76 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 203(c) (2015).

77 *See id.* at § 203(d).

78 IRS, *ITIN Comparative Reports* (Nov. 21, 2015, Dec. 31, 2014; Dec. 29, 2012).

FIGURE 1.18.6, Top Five Reasons for Suspended ITIN Applications[79]

Suspense Codes	2014	Jan. 1 - July 31, 2015
S02 – Valid documentation (*i.e.*, didn't meet IRS criteria)	97,762	70,259
S26 – Passport	33,543	26,469
S03 – Identification documents must be an original or certified by the issuing agency	31,218	22,317
S36 – School Record	29,442	20,337
S30 – Medical Record (under 6)	28,826	19,003

A frequent practitioner complaint is the IRS's suspending or rejecting applications with legitimate supporting documents. One LITC reported that over 25 percent of its ITIN applications were either suspended or rejected outright, despite being reviewed and certified by an on-site CAA and having no errors.[80] In one case the IRS asked for a passport to be resubmitted, even though a valid passport was certified by a CAA, meaning an original passport did not need to be submitted. Although the rejection rate has improved since 2013, errors by applicants and the IRS are likely as long as most ITIN applications must be filed during the filing season and include original documents.

Taxpayers Abroad Needing ITINs for Information Reporting Purposes Are Especially Burdened by the ITIN Requirements and Procedures

As a result of the procedures, ITIN applicants abroad often must mail their documents internationally and go without them for an extended time. Taxpayers abroad do not have the benefit of TACs, which allow applicants in the United States to avoid sending in original documents. The IRS attaché offices abroad used to be able to certify ITIN applications, but all four were closed in 2015.[81] Currently, applicants abroad have limited CAA options, with CAAs in only 18 countries (Macau and Hong Kong are counted as part of China) and one U.S. territory as shown in Figure 1.18.7.[82]

79 IRS response to TAS information request (Sept. 17, 2015). Data for PY 2015 was only available for the first half of the year.

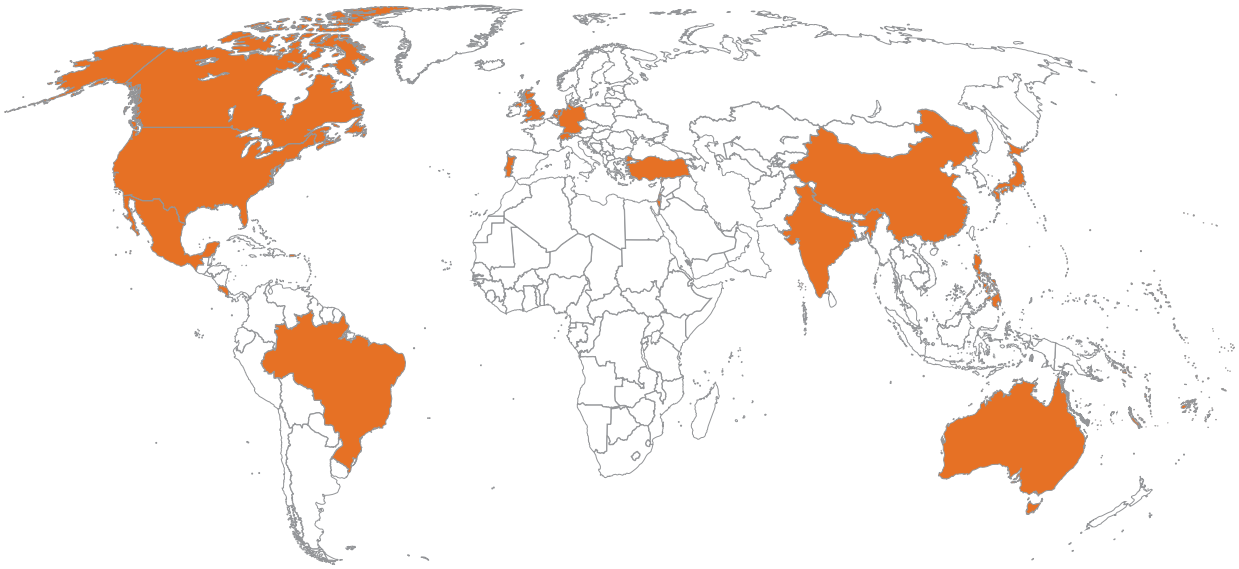
80 The Clinic reported this information on TAS's SAMS. *See* SAMS Issue # 33030 (submitted June 1, 2015) (on file with TAS).

81 *See* Most Serious Problem: *International Taxpayer Service: The IRS's Strategy for Service on Demand Fails to Compensate for the Closure of International Tax Attaché Offices and Does Not Sufficiently Address the Unique Needs of International Taxpayers*, *supra*.

82 The IRS has indicated that there are 18 countries (Macau and Hong Kong are counted as part of China) and one U.S. territory with a CAA. However, the irs.gov website only lists 17 countries outside the United States with CAAs because the irs.gov website is available to the general public, and only CAAs requesting to be posted on this website are listed. *See* IRS response to TAS fact check (Dec. 11, 2015). *See* IRS, *available at* https://www.irs.gov/Individuals/Acceptance-Agent-Program (last visited Nov. 23, 2015).

FIGURE 1.18.7[83]

Map of Countries with CAAs



Furthermore, some of the largest countries with CAAs only have one or two in the entire country.[84] The recently passed law amending IRC § 6109, referenced above, includes federal agencies in its list of persons eligible to be CAAs,[85] but the law also dictates that applicants residing abroad will not have the option of submitting their applications through a CAA at all because they are limited to submitting them by mail, to an IRS employee, or to a designee of the Secretary at a U.S. diplomatic mission or consular post.[86] Furthermore, the expanded program for training and approving CAAs under the new law is only for the purposes of applicants residing in the United States.[87] It is incumbent upon the IRS to provide alternatives for applicants residing abroad to provide certified copies outside of using a CAA.

The recent law authorizes the IRS to accept ITIN applications at a U.S. diplomatic mission or consular post.[88] The National Taxpayer Advocate hopes the IRS will start allowing U.S embassies and consulates abroad to certify documents in a manner similar to a CAA. Currently, there are 275 U.S. consulates and embassies that provide a similar service for SSN applicants by conducting an in-person interview, certifying original identification documents such as birth certificates and passports, and referring the

83 IRS, *available at* https://www.irs.gov/Individuals/Acceptance-Agent-Program (last visited Nov. 23, 2015). The figure only shows 17 of the 20 countries (in addition to the United States) that have CAAs because the other three countries with CAAs are those where the CAAs have not requested to be posted on the irs.gov website available to the public.

84 Brazil has only one CAA and India has only two. IRS, Acceptance Agent Program, *available at* https://www.irs.gov/Individuals/Acceptance-Agent-Program (last visited Nov. 23, 2015).

85 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 203(c) (2015). This section defines federal agencies according to the definition in IRC § 6402(h), which provides "the term 'Federal agency' means a department, agency, or instrumentality of the United States, and includes a Government corporation (as such term is defined in section 103 of title 5, United States Code).

86 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 203(a) (2015) (to be codified at IRC § 6109(i)(1)(B)).

87 *Id.*

88 *Id.*

applications with copies of the documents to a Federal Benefits Unit.[89] Thus, the Department of State could certify documents for ITIN applicants in its missions abroad following established procedures.[90]

Applicants abroad also face the same timeframe as applicants applying during the filing season, which was 11 weeks in 2015, even if they are subject to an exception such as for FIRPTA or FATCA purposes and apply for an ITIN outside the filing season.[91] Under the IRS's one-size-fits-all approach for ITINs, a taxpayer trying to open a bank account abroad must meet the same arduous requirements for original documents (without the benefit of TACs and CAAs) and wait just as long for an ITIN as a taxpayer claiming refundable credits, whose income and filing requirement would be subject to greater scrutiny. This process creates unnecessary barriers to commerce.

Future Requirements for Deactivating ITINs Will Deprive Some Taxpayers of ITINs They Need for Tax Administration Purposes, and the IRS Policy Will Undermine Taxpayers' *Right to Be Informed*

The IRS's deactivation plan will seriously infringe a taxpayer's *right to be informed* because the IRS will not provide advanced notification to taxpayers' last known address prior to deactivating their Individual Taxpayer Identification Numbers (ITINs).

The National Taxpayer Advocate has long advocated for the IRS to create a process for de-activating ITINs that are no longer used for tax administration purposes and is pleased the IRS and Congress have finally adopted her recommendation.[92] However, she has concerns about how the deactivation plan will be carried out according to the requirements of the recently passed law and the IRS's implementation plans. Under the new law, ITINs issued during 2013 and later will remain in effect unless the individual to whom the ITIN was issued fails to file a tax return or be claimed as a dependent on another's tax return during a period of three consecutive years.[93] Before this law was passed, the IRS had announced its own deactivation plan, which would deactivate ITINs after five consecutive years of non-use.[94] The National Taxpayer Advocate was concerned that the IRS refused to clarify whether ITINs included on a third-party information return would constitute use for tax purposes during the period, such that it would prevent deactivation.[95] She is equally concerned that the new law does not take into account an information return filed by a third party that lists an individual's ITIN. The deactivation requirements included in the amendment to IRC § 6109 will lead to countless problems down the road for individuals who need an ITIN in order to provide it to a third party for information reporting purposes, but who may not have a tax return filing obligation and thus would not file during a three-year period. For example, the ITIN may be used on an interest-bearing financial account, but the taxpayer's income is below the filing threshold.

89 See email from Department of State governmental liaison to TAS (Sept. 9, 2015) (on file with TAS); email from Social Security Administration governmental liaison to TAS (Sept. 23, 2015) (on file with TAS).

90 For detailed information, see U.S. Department of State, Authentications and Apostilles, *available at* http://travel.state.gov/content/travel/en/legal-considerations/judicial/authentication-of-documents/notarial-and-authentication-apostille.html (last visited Dec. 18, 2015). Foreign Public Documents, *available at* https://www.hcch.net/en/instruments/conventions/full-text/?cid=41 (last visited Dec. 18, 2015).

91 See IRM Procedural Update WI-03-0215-0352 (Feb. 19, 2015), *available at* http://www.irs.gov/pub/foia/ig/spder/WI-03-0215-0352%5b1%5d.pdf.

92 See, *e.g.*, National Taxpayer Advocate 2010 Annual Report to Congress 333; National Taxpayer Advocate 2008 Annual Report to Congress 130.

93 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 203(a) (2015) (to be codified at IRC § 6109(i)(3)).

94 See IRS, IR-2014-76, *Unused ITINS to Expire After Five Years; New Uniform Policy Eases Burden on Taxpayers, Protects ITIN Integrity* (June 30, 2014), *available at* https://www.irs.gov/uac/Newsroom/Unused-ITINS-to-Expire-After-Five-Years%3B-New-Uniform-Policy-Eases-Burden-on-Taxpayers,-Protects-ITIN-Integrity

95 See IRS response to TAS information request (Sept. 17, 2015).

The IRS's deactivation plan will seriously infringe a taxpayer's *right to be informed* because the IRS will not provide advanced notification to taxpayers' last known address prior to deactivating their ITINs.[96] Although the IRS will communicate information on its website and to CAAs about the deactivation plan, it will only notify taxpayers of a deactivated ITIN and provide guidance about how to reactivate it upon submission of a return and on settlement notices.[97] This shortsighted policy will undoubtedly harm taxpayers who will not learn that they need to reapply for an ITIN until after they have already filed their returns and are awaiting refunds. Taxpayers who are traveling away from a CAA or TAC, or who do not have in their possession or cannot give up their original identification documents, may be unable to reapply for ITINs and receive their refunds. If these taxpayers were notified in advance, they could plan accordingly, or challenge the deactivation if they believed it was in error. This policy will result in more work for the IRS because it will need to process the returns under IRSNs and later merge them to the taxpayers' reactivated ITINs.

CONCLUSION

The IRS continues to make it exceedingly difficult for taxpayers needing ITINs to comply with their tax filing and payment obligations. Until the IRS makes some significant changes in how applicants apply and how it processes ITIN applications, taxpayers may be further encouraged to stop filing returns or be prevented from receiving tax benefits to which they are lawfully entitled. Furthermore, barriers to commerce will only grow as more people will need ITINs to comply with FATCA.[98] Increased enforcement as a result of FATCA necessitates better ITIN procedures that encourage, not hamper, taxpayers' ability to comply with the tax laws.

96 *See* IRS response to TAS information request (Sept. 17, 2015).

97 *See id*.

98 *See* National Taxpayer Advocate FY 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*). *See also* Legislative Recommendation: *Chapter 3 and Chapter 4 Credits and Refunds: Protect Taxpayer Rights by Aligning the Rules Governing Credits and Refunds for Domestic and International Withholding*, *infra*.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Allow all ITIN applicants to apply for an ITIN at any time of the year without submitting a tax return as long as they provide other evidence of a legitimate tax administration purpose for the ITIN.
2. Accept documentation such as pay stubs or bank statements as evidence of a filing requirement and thus evidence of a legitimate tax administration purpose for an ITIN.
3. Return by expedited mail all original identification documents sent to the IRS.
4. Allow TACs to certify all types of identification documents for ITIN applicants.
5. Allow CAAs to certify all types of identification documents for dependent ITIN applicants.
6. Expand the VITA CAA pilot to include CAAs who are not VITA/TCE sites and allow them to certify all types of identification documents for all ITIN applicants.
7. Partner with the Department of State to provide certification of ITIN applications at U.S. embassies and consulates abroad.
8. Collaborate with TAS on developing criteria for the ITIN study required by law, and include a TAS representative on the study team.
9. Notify all taxpayers at their last known address at least three months prior to the deactivation of their ITINs and provide guidance for how to reactivate the ITIN or challenge a deactivation the taxpayer believes is in error.

MSP #19 PRACTITIONER SERVICES: Reductions in the Practitioner Priority Service Phone Line Staffing and Other Services Burden Practitioners and the IRS

RESPONSIBLE OFFICIAL

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

As the Internal Revenue Code (IRC) gets more complex, taxpayers are increasingly turning to practitioners to assist them with meeting their tax obligations and to represent them in their disputes with the IRS. During the 2015 fiscal year (FY), there were over one million Forms 2848, *Power of Attorney and Declaration of Representative*, filed by practitioners on behalf of taxpayers with matters before the IRS.[2] Tax practitioners have become key IRS partners in achieving voluntary tax compliance and settling disputes.

The IRS created the Practitioner Priority Service (PPS) line to serve as the first line of contact for practitioners to resolve account related issues for their clients.[3] This line is intended to provide practitioners with improved overall consistency and quality of service while reducing wait time.[4]

However, reductions in staffing and available services on the PPS line have resulted in increased wait times and limited services for practitioners. Over the past five years, the IRS has gone from answering about 80 percent of PPS calls in FY 2011 to less than 50 percent in 2015.[5] In FY 2011, the average speed of answer (ASA) was 13.3 minutes compared to 46.6 minutes for FY 2015.[6] For a four-week period in FY 2015, the average wait time for the PPS line was in excess of one hour.[7] In contrast, the ASA for the

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

2 Email from the IRS Centralized Authorization File unit stating the number of Forms 2848s filed for FY 2015 (Nov. 25, 2015).

3 Internal Revenue Manual (IRM) 21.3.10.1, *Practitioner Priority Service (PPS) Overview* (Oct. 1, 2015).

4 IRM 21.3.10.1, *Practitioner Priority Service (PPS) Overview* (Oct. 1, 2015).

5 IRS, Joint Operations Center (JOC), *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2012). Level of Service (LOS) was 78.3 percent in FY 2011. IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015). LOS was 47.6 percent as of September 30, 2015.

6 IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2012). ASA was 13.3 minutes in FY 2011. IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015). ASA was 46.6 minutes, representing a 250 percent increase from FY 2011.

7 IRS, JOC, *Snapshot Reports: Product Line Detail* (weeks ending Aug. 15, 2015 through Sept. 5, 2015).

Accounts Management (AM) toll-free lines during FY 2015 was 30.5 minutes.[8] It is ironic to use the term "priority" for the practitioner line when a practitioner could call the general phone lines and have a shorter hold time.

The National Taxpayer Advocate is concerned that the IRS's lack of commitment to PPS increases the overall compliance burden on taxpayers, not limited to the increased cost of representation, and creates downstream costs for the IRS when practitioners are unable to timely resolve their clients' tax issues. Specifically, we have identified the following problems with the IRS's current approach to the PPS:

- The reduction of staffing results in an increased number of disconnected calls and a significant increase in wait time;
- The reduction in services on the PPS places an increased burden on practitioners that is passed to taxpayers; and
- The IRS does not collaborate with or collect suggestions from the practitioner community before making changes to the PPS.

ANALYSIS OF PROBLEM

Background

The PPS was designed to be the first point of contact with the IRS for practitioners.[9] Practitioners with questions have a designated professional support line they can call to receive guidance and answers regarding their clients' account related issues. IRS customer service representatives (CSRs) trained to handle practitioners' account questions staff the toll-free line.[10]

Over the course of the 2015 filing season, the IRS answered only about 45 percent of practitioner calls on the Practitioner Priority Service, and the hold time averaged over 45 minutes.

When a practitioner calls the toll-free number, the call is routed to one of nine PPS locations.[11] The routing is based on an evaluation of the shortest expected wait times and whether the inquiry is regarding individual tax accounts or business accounts.[12] If a practitioner's inquiry is outside the scope of the PPS's authority to answer, the assistor will provide the practitioner with the appropriate telephone contact number for his or her inquiry.

The Reduction of PPS Staffing Results in an Increased Number of Disconnected Calls and Significant Increase in Wait Time

Practitioners rely upon IRS assistors on the PPS line to help them effectively represent their clients. The *right to retain representation* is negatively affected when the representative cannot reach the IRS in a reasonable amount of time and is unable to resolve issues with his or her clients' accounts.

8 IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (Sept. 30, 2015) (source of AM and Enterprise Total data). The AM ASA of 30.5 minutes is a combined figure reflecting 30 customer service lines.

9 IRM 21.3.10.1, *Practitioner Priority Service (PPS) Overview* (Oct. 1, 2015).

10 The toll-free number 1-866-860-4259 is available from 7:00 a.m. to 7:00 p.m. local time (Alaska and Hawaii follow Pacific Time) and 8:00 a.m. to 8:00 p.m. for Puerto Rico, *available at* http://www.irs.gov/Tax-Professionals/Practitioner-Priority-Service.

11 The nine locations are: Brookhaven, NY; Buffalo, NY; Memphis, TN; Nashville, TN; Philadelphia, PA; Pittsburgh, PA; Cincinnati, OH; Oakland, CA; and Ogden, UT, *available at* http://www.irs.gov/Tax-Professionals/Practitioner-Priority-Service.

12 The toll-free number when last called on October 23, 2015, listed a menu of several options to direct callers to the proper assistors.

The IRS has reduced the staffing on the PPS line from 98 employees solely devoted to the PPS in the FY 2011 filing season to 66 in the FY 2015 filing season, about a 30 percent decrease, as seen in Figure 1.19.1. At the end of FY 2015, the IRS had 140 employees staffing the PPS, 57 fewer employees than in FY 2011.[13]

FIGURE 1.19.1, Staffing Levels of Practitioner Priority Services[14]

Accounts Management PPS			
Fiscal Year	Staffing (as of 3/31) AM Direct FTEs	Staffing (as of 9/30) AM Direct FTEs	FY Total Calls Transferred Out
2011	98	197	254,073
2012	92	193	205,540
2013	99	203	211,330
2014	79	168	149,791
2015	66	140	116,174

The PPS line transferred out nearly 138,000 fewer practitioners' calls to other IRS functions in FY 2015 compared to FY 2011.[15] This transferred figure represents all PPS transfers and is not limited to transfers outside the scope of provided services. For example, the PPS line does not handle calls from the general public and those calls would be transferred out or directed to the appropriate function for resolution. Most significant for practitioners, a call would be transferred if the issue is a compliance issue and came into the PPS; it would need to be transferred to the proper compliance application.

With fewer staff dedicated to the PPS, the average hold times are lengthening.[16] Over the course of the 2015 filing season, the IRS answered only about 45 percent of practitioner calls on the PPS, and the hold time averaged over 45 minutes.[17]

13 Response to TAS research request from Wage and Investment (W&I) (Oct. 20, 2015). The 57 fewer employees was reached by the following computation, 197-140= 57.

14 Response to TAS research request from W&I (July 27, 2015). Staffing data (AM Direct FTE) pulled from ETD Half Hourly Adherence Reports (AM FTE = total ready agent ½ hours in AM PPS agent groups divided by 2 divided by 2,080). Transfer data is from the ETD Agent Transfers Report.

15 This number is derived by subtracting the FY 2015 number of calls from the FY 2011 number of calls (254,073 (FY 2011) – 116,174 (FY 2015) = 137,899). The data shows reduced resource expenditure from 2013, the resources expended were based on the planned LOS for each year which is driven by allocated funding.

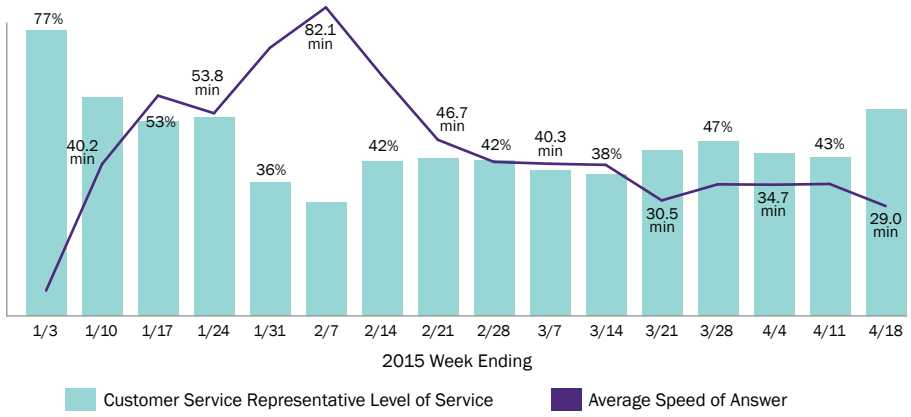
16 IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2012). ASA was 13.3 minutes in FY 2011. IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015). ASA was 46.6 minutes.

17 IRS, JOC, *Snapshot Reports: Product Line Detail* (Apr. 18, 2015).

FIGURE 1.19.2[18]

Filing Season 2015 Weekly Service Levels for the Practitioner Priority Service Line

This line provides tax professionals a dedicated channel to resolve taxpayer-client account issues.



While the number of attempted practitioner calls increased in FY 2015 compared to FY 2014, the percentage of answered calls decreased by more than 30 percent over the same period, from about 70 percent CSR level of service (LOS) in FY 2014 to less than 48 percent LOS in FY 2015, as shown in Figure 1.19.3. The average wait time (ASA) for the same period increased by 70 percent.[19]

FIGURE 1.19.3, FYs 2014 and 2015 Call Information for the PPS Line[20]

Fiscal Year	Dialed Attempts	Assistor Calls Answered	Level of Service	Average Speed of Answer (Minutes)	Average Speed of Answer Change
2014	1,884,497	1,148,997	70.4%	27.4	n/a
2015	2,056,376	851,716	47.6%	46.6	70%

During the summer of 2015, TAS conducted focus group interviews at the IRS Nationwide Tax Forums, which provide an opportunity for enrolled agents, CPAs, and other tax professionals to earn Continuing Professional Education credits. TAS learned that practitioners calling the PPS are experiencing such large increases in wait times that they look for other avenues for resolution of their issues.[21] During these discussions, one practitioner stated that he called into the PPS and was placed on hold. He promptly got into his car and drove to the local taxpayer assistance center, took a number, met with an assistor, got the issue resolved, and drove back to his office before being removed from hold on the PPS line.[22]

18 IRS, JOC, *Snapshot Reports: Product Line Detail* (weeks ending Jan. 3, 2015, through Apr. 18, 2015).
19 IRS, JOC, *Snapshot Reports: Product Line Detail* (Sept. 30, 2015).
20 *Id.*
21 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *IRS's Practitioner Priority Telephone Service* 8 (Nov. 2015).
22 *Id.*

Practitioners also reported extreme frustration with being placed on hold for over an hour, only to abruptly be disconnected.[23] Over 415,000 calls to the PPS were disconnected before the practitioner was even able to reach an assistor.[24] This "courtesy disconnect" occurs when the IRS switchboard is overloaded and cannot handle additional calls. The IRS allows practitioners to remain on hold on the PPS lines longer than other phone lines.[25]

Generally, practitioners bill their clients by the hour for their services and this may include any time waiting on hold to resolve issues.[26] As the wait times increase, taxpayers may pay considerably more for resolution of their tax issues. More significantly, if practitioners are unable to get through on the PPS line to resolve tax account issues, there could be serious consequences for the taxpayer. Moreover, each missed contact with practitioners to resolve account issues is a missed opportunity for the IRS to ensure that taxpayers remain compliant with their tax obligations.

…One practitioner stated that he called into the Practitioner Priority Service and was placed on hold. He promptly got into his car and drove to the local taxpayer assistance center, took a number, met with an assistor, got the issue resolved, and drove back to his office before being removed from hold on the Practitioner Priority Service line.

The Reduction in Services on the PPS Places an Increased Burden on Practitioners That Is Passed on to Taxpayers

PPS is available for practitioners requesting assistance with a variety of tax issues including understanding IRS notices and letters, correcting processing errors, locating and applying payments, securing installment agreements, and assisting with tax account adjustments. Over the last several years, the IRS has reduced the number of services provided by the PPS which impacts both practitioners and taxpayers.[27]

Practitioners report they were previously able to call the PPS with tax law questions and resolve multiple client account issues with one call.[28] Practitioners are reporting that even when they get through to an assistor they are only able to address one client's issues at a time, rather than five as specified in the Internal Revenue Manual.[29] If a practitioner wants to address issues for additional clients, they have to hang up and call back, enduring the extensive wait time all over again.

Starting in 2014, the IRS limited the PPS scope to practitioners working on resolving their clients' active tax account issues. The IRS no longer services

23 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *IRS's Practitioner Priority Telephone Service*. (Nov. 2015). IRS, JOC, Custom Report RRC 1623 (including weekly data on the number of courtesy disconnects from FY 2011 through FY 2015).

24 IRS, JOC, Custom Report RRC 1623 (including weekly data on the number of courtesy disconnects from FY 2011 through FY 2015). This figure can be influenced by a number of factors including caller behavior. For example, during periods of high demand, a caller might make multiple calls to the PPS simultaneously in hopes of increasing the chance of getting through for a single issue.

25 IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015). ASA was 46.6 minutes. IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (Sept. 30, 2015) (source of AM and Enterprise Total data). The AM ASA of 30.5 minutes is a combined figure reflecting 30 customer service lines.

26 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *IRS's Practitioner Priority Telephone Service* 8 (Nov. 2015).

27 IRM 21.3.10.2, *Scope of Service* (Aug. 14, 2009). Through the PPS IRM of August 14, 2009, practitioners were not limited to the number of client accounts they could address per call to the PPS. As of the same IRM dated October 1, 2010, and in the current IRM, practitioners are limited to addressing five client accounts per call to the PPS.

28 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *IRS's Practitioner Priority Telephone Service* 7 (Nov. 2015).

29 *Id.*; IRM 21.3.10.2.1(2) (Sept. 16, 2015). PPS toll-free CSRs resolve inquiries by taking the appropriate action and providing an accurate response. CSRs will limit the tax practitioner to no more than five (5) clients per call. CSRs will provide complete and accurate information and advise tax practitioners to provide their clients with the appropriate toll-free non-PPS customer service number.

calls from tax practitioners or other third parties for non-tax matters, such as transcript requests for monitoring clients' financial history. Other areas that are no longer addressed by the PPS include: general tax law questions, accounts assigned to the Automated Collection System (ACS), Automated Under Reporter (AUR) cases, Automated Correspondence Examination (ACE) situations, or when a case is assigned a Revenue Officer or Revenue Agent. [30]

FIGURE 1.19.4, Scope of Practitioner Priority Services

Services Provided by PPS	Services Not Provided by PPS
Understanding IRS's notices and letters	Answers to tax law questions
Correcting processing errors	Assistance with accounts assigned to Automated Collection System
Locating and applying payments	Assistance with accounts assigned to Automated Under Reporter
Requesting installment agreements	Accounts assigned to Correspondence Examination
Requesting tax account adjustments	Accounts assigned to a Revenue Officer or Revenue Agent

Instead, these types of calls are transferred or referred to other IRS functions. When practitioners call the PPS about customer accounts that are being handled by the ACS unit, the practitioner is transferred to the respective compliance area, resulting in additional wait time and risk of being disconnected before assistance can be offered. Litigation demonstrates that taxpayers are more likely to prevail against the IRS when represented by a tax professional.[31] By reducing practitioners' ability to timely reach the IRS, they are likely impacting taxpayers' ability to satisfactorily resolve their case.

Finally, as the IRS continues to reduce taxpayer services for the general taxpayer population, it drives that work, such as answering complex tax law questions, to practitioners.[32] This shifting of more responsibility to practitioners to resolve taxpayer issues means it is more critical than ever that the PPS provide the services practitioners need to resolve them.

The IRS Does Not Collaborate With or Solicit Suggestions From the Practitioner Community Before Reducing the Scope of the PPS

During FY 2013, an internal IRS review of the PPS revealed that the customer base of the PPS had expanded from practitioners working on actual account issues to include businesses providing third-party tax account monitoring services.[33] These services included monthly monitoring and compliance checks of current and potential clients via monthly calls to the PPS requesting verbal account information and multiple transcripts. Based upon this review, the IRS elected to restrict access to PPS so that only practi-

30 The ACS is a computerized inventory system that sends taxpayers notices demanding payment, issues liens and levies, and answers telephone calls in an effort to resolve balance due accounts and delinquencies. The AUR is an automated program that identifies discrepancies between the amounts that taxpayers reported on their returns and what payers reported via W-2, Form 1099, and other information returns. ACEs are automated from the initiation, aging and closing of certain Earned Income Tax Credit (EITC) and non-EITC cases. Using the ACE, Correspondence Exam can process specified cases with minimal to no tax examiner involvement until a taxpayer reply is received.

31 *See* Most Litigated Issues, *infra*. *See also* National Taxpayer Advocate 2014 Annual Report to Congress 426 (Most Litigated Issues).

32 R-Mail was originally deployed as a tool to send referrals to complex tax law questions that would require research by more experienced assistors. The IRS is no longer answering complex tax law questions. SERP Alert 15A0442, *Post R-Mail Guidance* (Oct. 5, 2015). *See also* Most Serious Problem: *Compliance Capabilities Vision*, *infra/supra*.

33 W&I response to TAS information request (July 27, 2015).

tioners who provide tax advice, prepare income taxes or act on behalf of taxpayers with regards to active account related issues will be assisted. These changes were included in the implementation of the 2014 Service Approach.

Now the IRS directs non-practitioners to use the Income Verification Express System or the Form 4506-T to secure account information. While this change reduced the burden placed upon the PPS by eliminating a subset of calls, the IRS neglected to reach out to practitioners to discuss the change and solicit what other types of changes could be beneficial for practitioners.

Practitioners participating in the National Taxpayer Advocate Tax Forums focus groups overwhelmingly stated that the PPS is worse than it was five years ago and that none of them have noticed any improvements to service on the line.[34] Despite the overall lack of service and satisfaction with the PPS, the majority of practitioners would like to continue using the line as a resource when encountering tax issues.[35] Suggestions on how to improve the line from practitioners include: giving the caller the option to be disconnected prior to receiving a courtesy disconnect; leaving a phone number for an assistor to call back rather than having practitioners wait on hold; using more detailed prompt questions; offering a specific dedicated phone number for transcript requests; and having knowledgeable assistors who have the authority to correct issues and solve problems.

For a number of years, the National Taxpayer Advocate has recommended that the IRS develop online services for taxpayers and practitioners.[36] Online account access was recently listed as one of the top ten initiatives needed to achieve the IRS's compliance vision.[37] As the IRS begins to evaluate how to move towards a more interactive format of online account access allowing taxpayers, preparers, and authorized third parties to securely interact with the IRS to obtain return information, submit payments, and receive status updates, specific attention should be paid to incorporating the needs of the practitioner community while protecting taxpayers.[38]

Even with the onset of increased online account services, it will not replace the need for the PPS.[39] Practitioners need to have an avenue by which they can discuss tax account issues with a live IRS employee and seek resolution and clarification on how to solve outstanding problems. Access to accounts online will help practitioners identify and isolate the problem, but will not always allow for solving of the account issues. Thus, the IRS should consult with practitioners, via their membership bodies and focus groups at the Tax Forums and other annual meetings of tax professionals, about what services the PPS should provide when an online account is available.

34 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *IRS's Practitioner Priority Telephone Service* 6 (Nov. 2015).

35 *Id.* at 8.

36 *See, e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

37 Draft IRS Compliance Concept of Operations (CONOPS) 3, 19-22 (June 2014).

38 See Most Serious Problem: *Preparer Access To Online Accounts: Granting Uncredentialed Preparers Access to an Online Taxpayer Account System Could Create Security Risks and Harm Taxpayers, supra; Most Serious Problem: Taxpayer Service: The IRS Has Developed a Comprehensive "Future State" Plan That Aims to Transform the Way It Interacts with Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet, supra; Most Serious Problem: Taxpayer Access To Online Account System: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak with an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online, supra.*

39 *Id.*

CONCLUSION

As originally intended, PPS was a useful tool for practitioners that facilitated fast resolution of their clients' tax issues. The limitations in the scope of provided services combined with increased hold time have eroded its usefulness. Practitioners calling the PPS line spend more time on hold, have a lower chance of getting through to a live IRS CSR and use the PPS for fewer services than in previous years.[40] The IRS's lack of commitment to either restore the full suite of services originally available or offer a viable alternative for practitioners erodes several taxpayer rights, including *the right to quality service*, *the right to challenge the IRS's position and be heard*, *the right to retain representation*, *the right to pay no more than the correct amount of tax*, and *the right to a fair and just tax system*. Failure to promptly address practitioner access to the IRS results in increased cost of representation to taxpayers and downstream costs, as well as exposing the IRS to a possible increase in litigation over those unresolved issues.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Restore staffing levels to FY 2011 levels on the PPS to decrease wait time and eliminate disconnects for the practitioners.
2. Allow the resolution of complex tax law issues by asking questions and receiving answers from assistors.
3. Allow practitioners to resolve as many as five client account issues during one call as stated in the IRM.
4. Consult with and survey the practitioner community to find out their needs and preferences before making changes to the PPS.
5. Retain the PPS even as online account systems are developed to assist practitioners with account issues that cannot be solved through online channels, and consult with practitioners about the design of a post-online account PPS.

40 2015 IRS Nationwide Tax Forums TAS Focus Group Report, *IRS's Practitioner Priority Telephone Service* (Nov. 2015).

MSP #20 IRS COLLECTION EFFECTIVENESS: The IRS's Failure to Accurately Input Designated Payment Codes for All Payments Compromises Its Ability to Evaluate Which Actions Are Most Effective in Generating Payments

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage and Investment Division

Robin L. Canady, Chief Financial Officer

Karen M. Schiller, Commissioner, Small Business/Self-Employed

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

IRS guidance instructs revenue officers (ROs) to designate every payment they receive from a taxpayer with a specific code.[2] ROs are directed to input a two-digit Designated Payment Code (DPC) to help identify payments, indicate application of the payment to a specific liability, and identify the event that primarily precipitated the payment (*e.g.*, liens, levies, offers in compromise, and installment agreements).[3] Congress has mandated such accounting for all federal payments.[4]

As discussed previously in the National Taxpayer Advocate's 2009 Annual Report to Congress, the IRS is not consistently or accurately applying DPCs, which reduces the IRS's ability to assess the effectiveness of its collection actions.[5] In calendar year (CY) 2014, 87 percent of payments either had no DPC or defaulted to DPCs of "00" (undesignated payment) or "99" (miscellaneous).[6] A 2012 Treasury Inspector General for Tax Administration (TIGTA) report raised similar concerns. Specifically, the report showed that 77 percent of payments reviewed were processed without the required DPC, including payments received after a Notice of Federal Tax Lien (NFTL) was filed.[7] Additionally, 34 percent of payments that did have a DPC placed on the payment had an incorrect DPC.[8] A recent IRS study also found that

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

2 Internal Revenue Manual (IRM) 5.1.2.8.1, *Designated Payment Codes* (Sept. 26, 2014).

3 IRM 5.1.2.8.1, *Designated Payment Codes* (Sept. 26, 2014).

4 *See generally* 31 U.S.C.A. §§ 3512, 3513; 31 U.S.C.A. § 3302(e).

5 National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*).

6 IRS, Compliance Data Warehouse (CDW), Individual Masterfile (IMF) Transaction History Table, Major Transaction Codes, Transaction File Cycle 201508, Transaction Dates from Jan. 1 to Dec. 31, 2014.

7 TIGTA, Ref. No. 2012-30-026, *Designated Payment Codes Are Inaccurate and Ineffective* (Mar. 28, 2012).

8 *Id*.

Adopting a consistent and accurate use of Designated Payment Codes (DPCs) would better ensure that attempts to collect an outstanding tax are useful, effective, and do not compromise a taxpayer's *right to a fair and just tax system* by taking actions that financially harm the taxpayer and have little chance of yielding the desired result.

certain DPCs were too vague to be helpful, that IRS DPC guidance is inconsistent, and that an absence of a systemic review of DPCs impedes the IRS's ability to obtain useful information.[9]

The input of DPCs provides a way to track taxpayer behavior and future compliance but is ineffective when the IRS does not consistently or accurately apply the codes to all subsequent payments. Such failure prevents the IRS from measuring what actions, including processes such as the notice stream and the filing of an NFTL, were most successful in getting the taxpayer to pay on a balance due account. As a consequence, the IRS is blindly applying its broad collection powers and resources rather than analyzing accurate information to determine funding priorities (*i.e.*, what actions — sending a letter, making a phone call, or taking collection action — would yield the best return on investment).

The study recommended several common sense improvements, which IRS Collection officials rejected as too costly. In other words, the IRS determined it was better to continue to operate under a collection strategy conceived in a vacuum rather than adopt an approach that increases collection effectiveness and minimizes harm to the taxpayer. Adopting a consistent and accurate use of DPCs would better ensure that attempts to collect an outstanding tax are useful, effective, and do not compromise a taxpayer's *right to a fair and just tax system* by taking actions that financially harm the taxpayer and have little chance of yielding the desired result.

ANALYSIS OF PROBLEM

Background

The IRS receives taxpayer payments for several reasons and through various methods. For example, some payments are voluntary, such as payments submitted with a timely filed tax return. Other payments are submitted in response to IRS activities, such as receipt of an IRS notice or the filing of a lien, when the taxpayer has a balance due account. The IRS established two-digit DPCs to identify the event (*e.g.*, lien, levy, seizure) that was primarily responsible for the subsequent payment.[10] The DPCs are applied at the time the subsequent payment is processed.[11]

Congress has mandated using payment codes and tracking on a national basis to determine the revenue effectiveness of specific collection activities.[12] Congress's mandate to use such codes was largely designed to ensure that agencies having custody of public money kept accurate records of amounts received,

9 IRS, *Designated Payment Code Review Report* (Dec. 17, 2012). This report was conducted in response to concerns expressed by the National Taxpayer Advocate and TIGTA. *See* National Taxpayer Advocate 2010 Annual Report to Congress 250-66; National Taxpayer Advocate 2009 Annual Report to Congress 17-40; National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18. *See also* TIGTA, Ref. No. 2012-30-026, *Designated Payment Codes Are Inaccurate and Ineffective* (Mar. 28, 2012).

10 These are generally balance due payments. Other payments, such as Estimated Tax Payments, Federal Tax Deposits, and payments with filed returns are designated by the nature of the payment, whether received in paper or electronic form.

11 *See* IRM 5.1.2.8.1, *Designated Payment Codes* (Sept. 26, 2014). *See also* IRM 3.11.10.5.10, *Designated Payment Code* (Jan. 1, 2015); IRM 21.3.4.7.1.3, *Designated Payment Code* (Oct. 1, 2014).

12 *See generally* 31 U.S.C.A. §§ 3512, 3513; 31 U.S.C.A. § 3302(e).

transferred, and paid, and to provide the President, Congress, and the public annual updates on the financial condition of the United States government.[13]

A DPC serves a three-fold purpose. The code:

- Facilitates identification of payments designated to trust fund or non-trust fund employment taxes;
- Indicates application to a specific liability when a civil penalty includes a Trust Fund Recovery Penalty and other penalties; and
- Identifies the event that resulted in payment.

The IRS requires ROs to assign the appropriate DPC to subsequent payments on the payment voucher documents Form 809, *Receipt for Payment of Taxes*, and Form 3244, *Payment Posting Voucher*. These forms are then forwarded to an IRS submission processing center, where the payment is applied to the taxpayer's balance due account. Although IRS procedures require employees to code the sources of payments received when certain transaction codes (TCs) apply, the use of DPCs is not mandatory in all other situations.[14]

The Lack of Specific and Consistent Guidance on How DPCs Are Applied Throughout the IRS Reduces the Reliability and Usefulness of the DPC Data

Accurate DPCs are important for drawing meaningful conclusions about the effectiveness of IRS activities and making data-driven policy decisions about service, enforcement, and resource allocation. Currently, the majority of DPCs are input manually, which make the DPCs subject to human error.[15] This manual selection process is open to interpretation and may result in unreliable data and may account, in part, for the high percentage of DPCs that are either undesignated payments or miscellaneous. For instance, in CY 2014, 87 percent of payments either had no DPC or defaulted to DPCs of "00" (undesignated payment) or "99" (miscellaneous).[16] A 2012 TIGTA report showed that 106 (77 percent) of the 138 subsequent payments reviewed were processed without the required DPC. In addition, 11 (34 percent) of the 32 subsequent payments that had a DPC were not accurate.[17] Employees may resort to DPC 00 or 99, or inputting no DPC at all, because they cannot identify a DPC specific enough to match the payment.

The DPC 06 is an example of a DPC that is not specific and may lead to inaccurate coding of a payment. The IRM 3.11.10.5.10 states that the DPC 06 is to be used to identify proceeds received from a "seizure or sale." The failure to provide a more specific definition of DPC 06 may result in the mislabeling of a payment. For instance, an employee may think that the DPC is only appropriate to use for property that is seized and sold, but not for seized cash. This may ultimately result in the employee inputting a DPC 00 or 99, or no DPC at all.

13 *Id.*

14 IRM 5.1.2.8, *Designated Payment Codes* (June 20, 2013); IRM 3.11.10.5.10, *Designated Payment Code* (Jan. 1, 2015); IRM 21.3.4.7.1.3, *Designated Payment Code* (Oct. 1, 2014). The use of a DPC on all posting documents/vouchers is mandatory when the following TCs are involved: "640" Advance Payment of Determined Deficiency or Underreporter Proposal; "670" Subsequent Payment; "680" Designated Payment of Interest; "690" Designated Payment of Penalty; "694" Designated Payment of Fees and Collection costs; and "700" Credit Applied. For other TCs (*e.g.*, "610" Remittance with Return; "611" Dishonored Remittance with Return; "612" Correction of TC 610 Processed in Error; "641" Dishonored Advance Payment), DPCs are not required. TCs are numeric codes for all system actions on the IRS Integrated Data Retrieval System (IDRS). IRS, Document 6209, *IRS Processing Codes and Information* (2010), 8-1 - 8-42.

15 Manually-input DPCs are determined using the source document that accompanies the payment. The source document may be the tax return, taxpayer letter, taxpayer correspondence, or a posting voucher.

16 IRS, CDW, IMF Transaction History Table, Major Transaction Codes, Transaction File Cycle 201508, Transaction Dates from Jan. 1 to Dec. 31, 2014.

17 TIGTA, Ref. No. 2012-30-026, *Designated Payment Codes Are Inaccurate and Ineffective* (Mar. 28, 2012).

Additionally, IRS guidance on when to use a particular DPC is insufficient, resulting in inconsistent and inaccurate determinations. For example, the definition of DPC 99 is both inconsistent and vague in the Collection (Part 5), Submission Processing (Part 3), and Accounts Management (Part 21) IRM sections. Definitions vary from:

- Miscellaneous payment (do not use if another DPC Code is applicable);[18]
- Miscellaneous payment other than above;[19]
- Miscellaneous;[20] and
- Miscellaneous payment other than 01 through 14.[21]

The IRS should develop consistent guidance throughout the IRM as to when IRS employees should use DPC 99, rather than having different instructions for employees working in different divisions in the IRS. The lack of specificity and consistency in how DPCs are applied reduces the reliability and usefulness of the DPC data.

Accurate Designated Payment Codes (DPCs) are important for drawing meaningful conclusions about the effectiveness of IRS activities and making data-driven policy decisions about service, enforcement, and resource allocation.

Transitioning From Mostly Manual to Systemic Input of DPCs Would Allow Regular Reviews and Improve Accuracy

Regular review of DPCs is important for verifying the input. However, two-thirds of all DPCs, or about 69 percent, are input manually and only 23 percent of DPCs are input systemically and are subject to review.[22] Thus, the majority of DPCs are not routinely reviewed. As discussed above, the reliability of manually-entered DPCs is questionable. Because of this unreliability, DPC information is often not taken into consideration when evaluating the effectiveness of IRS activities that supposedly led to a payment. Increasing the systemic input of DPCs may reduce errors and improve the integrity of the DPC data, simultaneously enhancing the reliability of DPC information for determining the effectiveness of specific IRS enforcement or taxpayer service activities.

Several state revenue departments use a systemic input method. These states have noticed considerable improvement in the accuracy of payment codes. The State of New York has developed a series of analytic measures that capture systemic payment data that allows for determining the best collection stream for taxpayer accounts.[23] Additionally, New York uses the codes that are input systemically to distinguish between a wage levy and a bank levy, and uses this information for determining which is more effective. The analysis of systemically input payment data showed a significantly higher case resolution rate for wage levies compared to bank levies.[24] Transitioning from a manual input of a majority of DPCs to a mainly systemic DPC process would increase the accuracy of payment data and would allow meaningful analysis of IRS activities that led to a payment.

18 IRM 5.1.2.8.1.3.1.1(1), *Examples – Using DPCs* (Aug. 15, 2008).

19 IRM Exhibit 21.1.7-5, *Designated Payment Code (DPC)* (July 17, 2014); IRM 3.11.10.5.10(8), *Designated Payment Code* (Jan. 1, 2015); IRM 3.12.10.3.23(3), *Field 01DPC – Designated Payment Code (DPC)* (Jan. 1, 2015); Exhibit 3.17.278-1, DPC Codes (Oct. 1, 2014).

20 IRM 21.3.4.7.1.3(2), *Designated Payment Code (DPC)* (Oct. 1, 2014).

21 IRM 3.8.45.9.1(3), *Designated Payment Codes (DPCs)* (Nov. 13, 2014).

22 IRS, *Designated Payment Code Review Report* (Dec. 17, 2012). No DPC was used at all for eight percent of the payments reviewed in this report.

23 IRS, *Designated Payment Code Review Report* (Mar. 11, 2013). *See also* Memorandum from Alan Gilds, IRS Senior Program Analyst for Field Operations, Review, and Enforcement, to New York Department of Revenue (May 14, 2014).

24 IRS, *Designated Payment Code Review Report* (Dec. 17, 2012).

Even if the IRS is unable to immediately transition to a systemic process for the input of all DPCs, it should require regular reviews to verify that manually-input DPCs are correct. These regular reviews would also identify common errors that the IRS can address through additional guidance to employees.

The input of a Designated Payment Code provides a way to track taxpayer behavior and future compliance but is ineffective when the IRS does not consistently or accurately apply the codes to all subsequent payments. Such failure prevents the IRS from measuring what actions… were most successful in getting the taxpayer to pay on a balance due account. As a consequence, the IRS is blindly applying its broad collection powers and resources rather than analyzing accurate information to determine funding priorities.

Implementing IRS DPC Study Recommendations is a Good Starting Point to Improve DPC Input Accuracy and Reliability

The IRS has acknowledged some of the problems discussed above in a recent report that was conducted in response to concerns expressed by the National Taxpayer Advocate and TIGTA.[25] This study made a number of recommendations, which were presented to an IRS review implementation team and the Director of Collection Policy.[26] On March 11, 2013, the DPC review implementation team and the Director of Collection Policy finalized which recommendations would be implemented and which would not.[27] The most significant findings and recommendations include the following:

1. Consider using two DPCs to distinguish between wage levies and non-wage levies and use a systemic timing approach rather than manual input;
2. Multiple DPCs can apply to one type of payment. This requires a systemic or manual determination to use one DPC rather than another. DPCs should be reviewed to ensure that they are specific enough that they can only be applied to one payment situation; and
3. DPC analysis program owners should conduct periodic accuracy reviews of the DPC selection criteria.[28]

The IRS refused to adopt these recommendations primarily because of a lack of resources. The first recommendation listed above was rejected by the DPC implementation team and the Director of Collection Policy, because it determined that creating two separate DPCs, one for wage levies and one for non-wage

25 IRS, *Designated Payment Code Review Report* (Dec. 17, 2012). *See* National Taxpayer Advocate 2010 Annual Report to Congress 250-66 (Most Serious Problem: *The IRS Should Accurately Track Sources of Balance Due Payments to Determine the Revenue Effectiveness of Its Enforcement Activities and Service Initiatives*); National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS's Use of Notices of Federal Tax Lien*). *See also* TIGTA, Ref. No. 2012-30-026, *Designated Payment Codes Are Inaccurate and Ineffective* (Mar. 28, 2012).

26 IRS response to TAS information request (Sept. 1, 2015).

27 *Id.*

28 IRS, *Designated Payment Code Review Report* (Dec. 17, 2012).

levies, would only be feasible if a systemic approach could be used rather than inputting the codes manually.[29] The explanation of this determination went on to say that the manual input of these two different DPCs would have to be reviewed manually, which would be time-consuming, and the IRS currently does not have enough resources to devote to such a review. The only other alternative would be to adopt a systemic approach, which the review team and the Director of Collection Policy deemed too costly.[30] The remaining two recommendations were also rejected because they were too costly.[31] They would both depend on the IRS adopting a systemic approach to DPCs rather than its current manual input approach.

The decision to reject these recommendations on the basis of a lack of resources was never shared with the IRS Commissioner, Deputy Commissioner for Services and Enforcement, or the National Taxpayer Advocate. Failing to adopt these recommendations because of resources is shortsighted and inexcusable, perpetuating the IRS's conduct of collection actions in a vacuum. Improving the accuracy and reliability of the DPCs can lead to the most efficient use of IRS resources based on knowing what IRS activities most likely resulted in a payment from the taxpayer. Moreover, a collection strategy based on ignorance and guesswork increases the risk of taking collection actions that are more intrusive than necessary, thereby undermining taxpayer trust in the system and undermining taxpayers' *right to privacy*.

CONCLUSION

The IRS is not consistently or accurately applying DPCs, which reduces its ability to assess the effectiveness of collection actions and service initiatives. Without accurately coding all the payments it receives, the IRS cannot fully meet its legal requirements to measure its business results.[32] It also cannot meet its strategic objective of developing a data-driven approach to allocating resources and making effective service, enforcement, and resource allocation decisions.[33] Finally, internal and external stakeholders are unable to accurately assess the effectiveness of IRS enforcement activities and service initiatives.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Revise IRM guidance and guidelines for lockbox receipts to require the entry of specific DPCs on all balance due payments.
2. Require Submission Processing employees to verify the presence of an appropriate DPC on payments by conducting regular quality reviews.
3. Provide clear and specific guidance about the circumstances under which employees can use a miscellaneous DPC.
4. Implement systemic input of most payment codes.

29 IRS response to TAS information request (Sept. 1, 2015).

30 *Id.*

31 *Id.*

32 *See, e.g.*, Treas. Reg. § 801.6(d)(1).

33 IRS Strategic Plan 2014-2017, *available at* http://core.publish.no.irs.gov/pubs/pdf/p3744–2014-06-00.pdf. *See also* U.S. Department of Treasury, *Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance* (July 8, 2009), Component 2: *Make a Multiyear Commitment to Research*, *available at* http://www.irs.gov/pub/newsroom/tax_gap_report_-final_version.pdf.

MSP #21 EXEMPT ORGANIZATIONS (EOs): The IRS's Delay in Updating Publicly Available Lists of EOs Harms Reinstated Organizations and Misleads Taxpayers

RESPONSIBLE OFFICIAL

Sunita B. Lough, Commissioner, Tax Exempt and Government Entities Division

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

The IRS maintains a list of tax exempt organizations (EOs) on two publicly accessible online databases, the Exempt Organizations Business Master File (EO BMF)[2] and the Exempt Organizations Select Check (EO Select Check).[3] When an organization 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. The IRS updates its databases only monthly, on the second Monday of every month, except in January when the databases are not updated at all. As a result, EOs reinstated (as well as those that receive initial exemption approval) in mid-to-late December will not appear on publicly available IRS databases until mid-February, which is well after the critical year-end fundraising season. Reinstated EOs may lose out on donations or grants they would have received had IRS databases accurately reflected their status. The number of automatic revocation reinstatement cases during this gap period exceeded 2,500

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

2 The EO BMF, *available at* 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, *Overview* (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).

in both fiscal years (FYs) 2014 and 2015, and more than 70 percent of these cases were IRC § 501(c)(3) organizations.[6]

ANALYSIS OF PROBLEM

Background

Potential Donors and Grantors Rely on IRS Online Databases to Verify Exempt Status

The National Taxpayer Advocate has repeatedly raised concerns about IRS delays in updating its public databases relied upon by potential donors and grantors.[7] These databases, EO BMF and EO Select Check, are of critical importance for two reasons. First, they allow potential individual donors to verify before making a donation that their contributions will be tax deductible.[8] Second, they allow private foundations to verify that they are making a grant to a qualifying public charity.[9]

As a result, Exempt Organizations (EOs) reinstated (as well as those that receive initial exemption approval) in mid-to-late December will not appear on publicly available IRS databases until mid-February, which is well after the critical year-end fundraising season. Reinstated EOs may lose out on donations or grants they would have received had IRS databases accurately reflected their status.

IRS guidance provides that grantors and contributors may rely on an organization's listing on EO Select Check or EO BMF.[10] In addition, grantors and contributors may, in some situations, rely on EO BMF information provided by a third party.[11]

One well-known third-party provider of EO Select Check and EO BMF data is GuideStar.[12] GuideStar's website contains free and subscription content. One feature available to GuideStar subscribers is Charity Check, which allows potential donors or grantors to conduct due diligence by obtaining a report that contains both EO Select Check and EO BMF data.[13] The report will also note if an organization has been automatically revoked.[14]

In FAQs on its website regarding due diligence and its Charity Check reports, GuideStar makes clear that it does not modify any IRS data, including data from EO Select Check, EO BMF, or the automatic revocation list.[15] In one FAQ regarding potential grantees whose organization does not appear in the EO BMF section of the Charity Check report,

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

7 *See* National Taxpayer Advocate FY 2015 Objectives Report to Congress 59; National Taxpayer Advocate 2012 Annual Report to Congress 199-200 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*).

8 A charitable contribution deduction is allowed for donations to organizations described in IRC § 170(c). These are most commonly IRC § 501(c)(3) organizations.

9 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.

10 *See* Rev. Proc. 2011-33, 2011-25 I.R.B. 887.

11 *Id.*

12 *See* www.guidestar.org. GuideStar is an IRC § 501(c)(3) public charity that provides information and reports about nonprofit organizations registered with the IRS.

13 For a sample Charity Check report, see http://www.guidestar.org/downloadable-files/sample-guidestar-charity-check-report.pdf.

14 *See FAQs: Due Diligence and GuideStar Charity Check Overview*, FAQ #15, *available at* http://www.guidestar.org/rxg/help/faqs/guidestar-charity-check/overview.aspx.

15 *See FAQs: Due Diligence and GuideStar Charity Check Overview*, FAQs #16 and #17, *available at* http://www.guidestar.org/rxg/help/faqs/guidestar-charity-check/overview.aspx.

GuideStar advises these organizations to "work directly with the IRS to ensure that their information is updated and accurately reflected in the IRS database."[16] Understandably, GuideStar emphasizes that it "cannot and will not modify the IRS BMF database in any way" and directs these organizations to contact the IRS EO toll-free number.[17] Thus, GuideStar (or any third-party) data is only as good as the source data from the IRS's online databases.

Other organizations highlight the importance of the EO Select Check and EO BMF databases to potential donors and grantors that are conducting due diligence and vetting organizations. For example, the Council on Foundations, a nonprofit leadership association of grantmaking foundations and corporations, has information on its website advising grantmakers of the EO Select Check search tool and referencing the EO BMF.[18] Another organization, Grants Managers Network, advises grantors that are conducting due diligence and vetting potential grantees that "the best practice, if you have doubts about a potential grantee's tax status, is to check it online using the IRS's free Exempt Organizations search or a third-party source."[19]

Finally, a grantmaking foundation may require potential grantees to be listed on the EO BMF. For example, one private foundation's website explains in great detail the nature of the EO BMF and requires potential grantees to have an accurate EO BMF listing.[20]

The IRS Recognizes the Reliance of the Public and Potential Grantors on Its Online Databases Yet It Fails to Update Them Timely

The IRS Recognizes Reliance on the Information Contained in Its Online Databases

The Internal Revenue Manual (IRM) discussing EO Select Check notes:

> The exempt organization (EO) community has become increasingly dependent upon their listings in the CL [EO Select Check] to prove to potential contributors that contributions to them are deductible. The fact that an organization may hold a favorable determination letter is often not sufficient to satisfy some contributors, especially in those cases where the Service issued an organization's letter many years ago.[21]

Similarly, a Tax Exempt/Government Entities (TE/GE) IRM section discussing the EO BMF notes that "many grantors rely on the information contained in the online EO BMF to determine the eligibility of

16 *See FAQs: Due Diligence and GuideStar Charity Check Overview*, FAQ #17, *available at* http://www.guidestar.org/rxg/help/faqs/guidestar-charity-check/overview.aspx.

17 *Id*. This number is 877-829-5500.

18 *See* Council on Foundations, *IRS Search Tool: Select Check*, *available at* http://www.cof.org/content/irs-search-tool-select-check.

19 *See Project Streamline: Guide to Due Diligence*, p. 6, *available at* http://gmnetwork.org/wp-content/uploads/2014/07/Due-Diligence.pdf. This document discusses five myths about due diligence. Myth #3 is that grantmakers need to have a copy of a grant seeker's IRS determination letter and Form 990 in every file. The document provides that a copy of the IRS determination letter only indicates that the grantee was tax-exempt at a certain point in time and the original determination may have been rescinded or modified. Therefore, grantors should verify a potential grantee's tax status online with the IRS or a third-party source. Grants Managers Network is a national association of philanthropy professionals.

20 *See* Mathile Family Foundation, *FAQs – Tax Information*, *available at* http://www.mathilefamilyfoundation.org/grantmaking/faqs/tax-information/. These FAQs discuss in great detail the grantmaking restrictions on private foundations and the severe penalties that the foundation and its managers are subject to 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).

21 IRM 25.7.6.1(3) (Jan. 1, 2015). The same language is also used in IRM 21.3.8.12.12(3) (June 18, 2012).

their applicants."[22] Yet in the same IRM section the IRS disavows responsibility if an organization loses a grant due to not being included in the EO BMF, noting:

> The IRS cannot control how grantors and contributors use these data. It is not Service error if an organization fails to receive a grant because it is not included in the online EO [B]MF, or because some of the information contained therein is out-of-date. Possession of a valid determination letter is the ultimate legal proof of tax-exempt status.[23]

Despite Recognition of the Reliance on Its Online Databases, the IRS Fails to Timely Update Them, Causing Harm to EOs and Their Contributors

Although the IRS recognizes that a listing on its online databases can be critical for an EO, it does not update these databases in a timely manner, causing reinstated automatically revoked organizations (as well as those organizations receiving exempt status for the first time) to potentially lose out on donations or grants.[24] Currently, EO Select Check and EO BMF are only updated monthly, on the second Monday of every month.[25] 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.[26] 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 ranged from 1,353 to 2,792 in FYs 2012 to 2015, exceeding 2,500 in both FYs 2014 and 2015, as shown in Figure 1.21.1. Significantly, more than 70 percent of these cases from the last two fiscal years are IRC § 501(c)(3) organizations.

22 IRM 21.3.8.12.13(3) (Nov. 16, 2012).

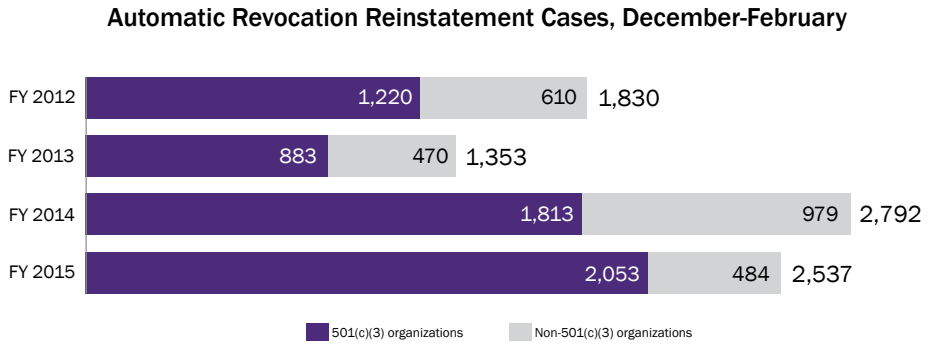
23 *Id*.

24 This delay may also affect newly-recognized tax EOs 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.

25 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, as mentioned earlier, the EO BMF is an extract of information regarding EO accounts from the larger Business Master File (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).

26 *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).

FIGURE 1.21.1[27]



This potential month or two delay also impairs an EO's *right to quality service*, which includes taxpayers' right to receive prompt assistance in their dealings with the IRS.

The IRS's Suggestions for Those Impacted By the Updating Delay Miss the Mark

The IRS website notes that an automatically revoked organization that has had its exempt status reinstated will experience a delay from the time of reinstatement until EO Select Check and EO BMF are updated.[28] The IRS website explains the reason for this delay and advises the following to reinstated organizations who are not yet listed:

> Between updates to Select Check (Pub. 78 Data) and EO BMF, donors can rely on your organization's determination letter from the IRS as proof of your exempt status. Even if your organization remains on the list of automatically revoked organizations, donors can rely on an IRS determination letter dated on or after the effective revocation date. Donors also can confirm an organization's status by calling the IRS (toll-free) at 1-877-829-5500.[29]

However, the IRS's advice that donors can rely on an IRS determination letter or call the IRS for confirmation of an organization's status belies the IRS's own recognition that donors, particularly large donors and corporate or foundation grantors, often look *solely* to the IRS online databases to determine whether or not to make a donation or grant to an organization. A determination letter from the IRS (and, by extension, a phone call to the IRS) will in many cases not satisfy a potential donor or grantor. Many donors or grantors may simply "move on" and make a donation or grant to an organization that does appear on EO Select Check and EO BMF.

Further, the IRS's failure to timely update its online databases places the onus for proving exemption on the organization and causes a burden for potential grantors or donors to have to contact an organization and ask for a determination letter or contact the IRS and deal with lengthy telephone hold times, on a general TE/GE phone line that is not dedicated specifically to EO matters, to request confirmation

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

28 *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.

29 *Id*.

In fact, the IRS has stated that its future efficiency lies in providing taxpayers with "self-service" electronic options; thus, Tax Exempt and Government Entity's (TE/GE) strategy to drive grantors and donors to the phone for Exempt Organization (EO) verification is out of step with the IRS's own Concept of Operations.

of exempt status.[30] In FY 2015, callers to the TE/GE toll-free line waited an average of 23.4 minutes to speak to an IRS representative, an increase of almost five minutes from the 18.7 minute average hold time in FY 2014.[31] In addition, the number of IRS "courtesy disconnects" for the TE/GE phone line increased dramatically, from 4,380 in FY 2014 to 23,871 in FY 2015, a 445 percent jump.[32] Finally, the IRS customer service representative (CSR) level of service for this phone line dropped from 68 percent in FY 2014 to 60 percent in FY 2015.[33] As the IRS is expected to experience continued budget and hiring constraints, TE/GE telephone hold times and courtesy disconnects will likely continue to increase and the CSR level of service will likely continue to decrease. In fact, the IRS has stated that its future efficiency lies in providing taxpayers with "self-service" electronic options; thus, TE/GE's strategy to drive grantors and donors to the phone for EO verification is out of step with the IRS's own Concept of Operations.[34]

Finally, the IRS's delay in updating its online databases undermines the public's (*i.e.*, potential donors or grantors) *right to be informed*, which includes taxpayers' right to know what they need to do to comply with the tax laws. The IRS's delay prevents the public from finding out about certain organizations that are tax exempt and eligible to receive tax deductible contributions.

This problem is magnified for an organization that has had its exemption automatically revoked in error, as the organization should never have been removed from the IRS's online lists and now may face a significant delay getting back on them, thereby hampering its fundraising efforts.[35] In sum, the failure to

30 In addition, a reinstated automatically revoked organization may be reluctant to show its new determination letter to potential donors or grantors as it draws attention to the fact that the organization was automatically revoked.

31 IRS, Joint Operations Center (JOC), *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015).

32 IRS, *Custom Joint Operations Center Report* (Oct. 30, 2015). The term "courtesy disconnect" is used when the IRS essentially hangs up on a taxpayer because its switchboard is overloaded and cannot handle additional calls.

33 *Id*. IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2015).

34 *See* Most Serious Problem: *Taxpayer Service: The IRS Has Developed a Comprehensive "Future State" Plan That Aims to Transform the Way It Interacts with Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*, *supra*; Most Serious Problem: *Taxpayer Access To Online Account System: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak with an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues that Are Not Conducive to Resolution Online*, *supra*. In describing the future vision of the IRS, IRS Commissioner John Koskinen stated, "Most things that taxpayers need to do to fulfill their obligations could be done virtually, and there would be much less need for in-person help, either by waiting in line at an IRS assistance center or calling the IRS." *Prepared Remarks of John A. Koskinen, Commissioner, Internal Revenue Service, Before the National Press Club* (Mar. 31, 2015), *available at* https://www.irs.gov/uac/Newsroom/Commissioner-Koskinen-Speech-before-the-National-Press-Club.

35 The IRS states that "erroneous revocations are identified through taxpayer correspondence and referrals from the call-site." TE/GE response to TAS research request (July 31, 2015). In other words, the onus is on the erroneously automatically revoked organization to contact the IRS to correct the issue. Once the IRS is contacted about an erroneous automatic revocation, the Employee Plans/Exempt Organizations (EP/EO) Determinations Processing Unit ("Correspondence") will conduct research to determine if the revocation was indeed erroneous. The Correspondence Unit will then send the organization a letter affirming that it was erroneously revoked or that the revocation was correct. If the organization was erroneously revoked, the Correspondence Unit places the name of the organization on a spreadsheet, which it sends weekly to Ogden to remove the organizations listed from the EO Select Check list of automatically revoked organizations. The IRS indicates that these correspondence inquiries are typically completed in 30-45 days. TE/GE response to TAS research request (July 31, 2015). Regarding the reinstatement process for organizations that were erroneously automatically revoked, the IRS states that it generally does not request manual updates to EO Select Check data unless it identifies an organization (for example, through an inquiry) that should be listed but for some reason is not picked up by the automated updating process. If the IRS does not do a manual update, then the organization must go through the normal monthly updating process for both EO Select Check and EO BMF after an internal record correction is made. TE/GE response to TAS research request (Dec. 1, 2015).

list a reinstated automatically revoked organization in its online databases in a timely manner can cause an organization to lose critical donations or grants, which may be an existential issue for some organizations.

The IRS also acknowledges these delays in its TE/GE IRM. For example, the IRS instructs its employees who are responding to a telephone call regarding an organization's omission from the EO BMF to "advise the customer that due to a systemic problem, the online 'lists' were not updated to reflect the exempt [sic] recognition."[36] The IRS also instructs its employees to advise organizations that it can take up to two months for a record of an organization's exempt status to be reflected on the online list and to offer to send an affirmation letter to the organization.[37] However, an affirmation letter is similar to a determination letter, and may not be sufficient to satisfy potential donors or grantors that rely solely on the IRS's online databases.

The IRS's delay in updating the online lists of Exempt Organizations (EOs) that are relied upon by both individuals and organizations harms reinstated organizations and misleads taxpayers, thereby abridging core taxpayer rights. This problem can be significantly mitigated if the IRS updates these lists more frequently.

More Frequent Updates to EO Online Databases Are a Simple Solution

The solution to this problem is simple — the IRS must update its online databases of EOs more frequently. The monthly updating (except for January) of EO Select Check is a great improvement over the quarterly updating of the old Publication 78 and the IRS is to be commended for this. However, more frequent updating of EO Select Check and EO BMF is now needed. The IRS updates other EO online lists more frequently than once a month (or once every two months). For example, the IRS updates its online list of Form 990-N (e-Postcard) filers weekly.[38] The IRS should similarly update EO Select Check and EO BMF, or provide an online addendum to these databases, on a weekly basis. The IRS should be able to change the programming of the databases from monthly to weekly, just as it made the change from quarterly to monthly updating.[39] However, until this change can be implemented, the IRS should manually update its online databases.

Currently, in between its regular online updating schedule, the IRS can manually update its EO Select Check listings of organizations eligible to receive tax deductible contributions and automatically revoked organizations by sending a request to the TE/GE Business Systems Planning Submission Processing Programs unit and this process can be as short as a day.[40] In fact, the National Taxpayer

36 IRM 21.3.8.3.8(1)(d) (Oct. 1, 2015).

37 IRM 21.3.8.3.8(1)(f) (Oct. 1, 2015); IRM 21.3.8.12.13(5) (Nov. 16, 2012). An affirmation letter, Letter 4168-C, *Letter Affirming 501(c) Exemption*, is a letter sent to organizations that call the IRS wishing to obtain written confirmation of their exemption.

38 *See* IRS, *Exempt Organizations Select Check: Frequently Asked Questions*, FAQ #5, *available at* http://www.irs.gov/pub/irs-tege/faqs_eo_selectcheck.pdf.

39 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).

40 TE/GE response to TAS research request (July 31, 2015). Organizations have come to TAS for assistance when they are at risk of losing grants because they are not listed in the IRS's online databases and TAS successfully advocates for a manual EO Select Check update.

Advocate has directed TAS employees to require the IRS to do these updates manually within 24 hours.[41] However, the IRS states that it cannot update the EO BMF manually.[42]

CONCLUSION

The IRS's delay in updating the online lists of EOs that are relied upon by both individuals and organizations harms reinstated organizations and misleads taxpayers, thereby abridging core taxpayer rights. This problem can be significantly mitigated if the IRS updates these lists more frequently.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Update EO BMF and Select Check on a weekly basis as is the case for Form 990-N updates.
2. Until appropriate programming changes can be made, update EO Select Check manually.
3. 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.

41 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).

42 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 timeframe 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).

INTRODUCTION: The IRS Can Do More to Improve Its Administration of the Earned Income Tax Credit and Increase Future Compliance Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights

The Earned Income Tax Credit (EITC), enacted as a work incentive in the Tax Reduction Act of 1975, has become one of the government's largest means-tested anti-poverty programs.[1] Unlike traditional anti-poverty and welfare programs, the EITC was designed to have an easy "application" process by allowing an individual to claim the benefit on his or her tax return. This approach dramatically lowered administrative costs, since it did not require an infrastructure of case workers and local agencies. For instance, the EITC has less than one percent in administrative costs.[2] This is compared to administrative costs of 41.8 percent for the Women, Infants, and Children (WIC) program.[3]

To effectively administer the EITC, the IRS must understand the characteristics of EITC taxpayers. Generally speaking, low income taxpayers share a unique set of attributes compared to the average U.S. taxpayer. For instance, the low income taxpayer is more likely to be less educated. Of all able-bodied adults between the ages of 25 and 55 living in the bottom third of income distribution, 23 percent had less than a high school education, compared to five percent of the comparable group living in the top two-thirds of the income distribution.[4] Nearly two-thirds of working-age adults who experience consistent income poverty have one or more disabilities.[5] Low income families experience lower literacy rates.[6] Twenty-four percent of working-age adults with limited English proficiency live below the poverty line, whereas 13 percent of the comparable group of English speakers live below the poverty line.[7]

Low income households are more likely to be unbanked than middle to upper-income households. In fact, approximately 39 percent of households with income below $30,000 per year do not have a bank account.[8] Approximately 28 percent of households with an income below $15,000 do not have a bank account.[9] The absence of a bank account can impact a taxpayer's ability to substantiate their income and expenses for an EITC claim.

Lack of transportation and accessible child care services limit the ability of low income taxpayers to earn income.[10] Many low income taxpayers are often juggling competing obligations at one time, such

1 Pub. L. No. 94-12, § 204, 89 Stat. 26 (1975).

2 General Accounting Office (GAO), *Tax Administration Earned Income Noncompliance* 6 (May 8, 1997).

3 *WIC Program: Nutrition Service and Administrative Costs* (Mar. 6, 2015).

4 Isabel Sawhill and Quentin Karpilow, The Social Genome Project at Brookings, *Strategies for Assisting Low-Income Families* 4-5 (June 28, 2013).

5 Shawn Fremstad, Center for Economic and Policy Research, *Half in Ten: Why Taking Disability into Account Is Essential to Reducing Income Poverty and Expanding Economic Inclusion* 2 (Sept. 2009). Consistent income poverty is measured as more than 36 months of income poverty during a 48-month period. *Id*.

6 The Urban Child Institute, *Poverty Can Jeopardize the Development of Literacy and Early Reading Habits* (Aug. 30, 2012), *available at* http://www.urbanchildinstitute.org/articles/research-to-policy/policy/poverty-can-jeopardize-the-development-of-literacy-and-early.

7 Brookings Institute, *Investing in English Skills: The Limited English Proficient Workforce in U.S. Metropolitan Areas* (Sept. 24, 2014), *available at* http://www.brookings.edu/research/reports2/2014/09/english-skills#/M10580.

8 Federal Deposit Insurance Corporation (FDIC), *2013 FDIC National Survey of Unbanked and Underbanked Households* 17 (Oct. 2014). For the purposes of this survey, "unbanked" means that no one in the household had a savings or checking account. *Id*. at 4.

9 *Id*.

10 David K. Shipler, *The Working Poor, Invisible in America* 45, 52 (Alfred A. Knopf, 2004).

as multiple jobs, child care, health problems, and financial strains. These taxpayers may not be able to dedicate their time to an audit of their EITC claim even if they have a legitimate claim. In addition, low income taxpayers tend to be more transitory. Between 2012 and 2013, 20.5 percent of those below 100 percent poverty changed residences, while only 11.7 percent of the general population moved during the same time.[11] The transiency of this taxpayer population negatively affects their ability to respond to IRS correspondence in a timely manner. The "Characteristics of Taxpayers Claiming the Earned Income Tax Credit" infographic illustrates the general characteristics of taxpayers claiming the EITC.

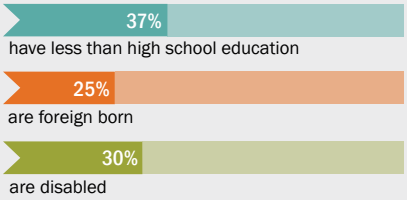
11 U.S. Census Bureau, *Current Population Survey, 2013 Annual Social and Economic Supplement* (Nov. 2013).

Characteristics of Taxpayers Claiming the
EARNED INCOME TAX CREDIT

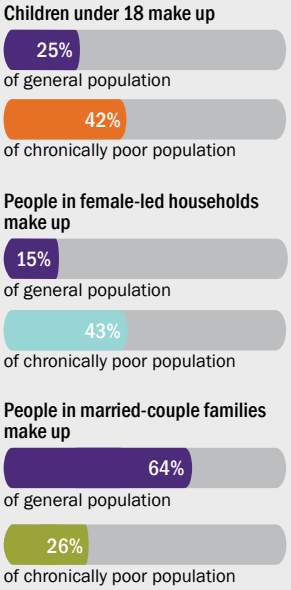
Low income taxpayers are more likely to have:

- Limited English proficiency
- Limited computer access
- Lower education levels
- Lower literacy rates
- Higher level of disabilities

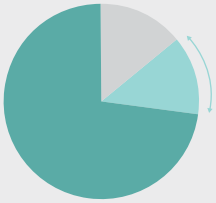
Low income taxpayers living under 125% of poverty levels



Comparison of the general and chronically poor populations



73-87% of qualifying children claimed for EITC are claimed correctly



Low income taxpayers are more likely to face specific limitations

Absence of a bank account hinders ability to verify income and expenses

About 39% of households with income below $30,000 per year do not have a bank account.

About 28% of households with income below $15,000 per year do not have a bank account.

Changing residences hinders ability to respond timely to IRS correspondence

From 2012 to 2013, over 20% of taxpayers below poverty level moved compared to less than 12% in the general population.

A 2004 TAS study found 43% of taxpayers had valid or partially valid EITC claims but couldn't successfully complete the correspondence exam process

The poor spend a higher percent of their income on transportation costs

Individuals below poverty spend over four times as much of their wage income on transportation as those who are above poverty level.

Low income families spend a considerably higher portion of their income on child care

On average, families with employed mothers spent about 7.2% of their income on child care; however, families with income less than $1,500 per month spent 39.6% of their family income on child care.

Limited English proficiency: www.brookings.edu/research/reports2/2014/09/english-skills#/M10580. Limited computer access: Forrester, North American Consumer Technographics Online Benchmark Survey (Part 2), 2014. Lower education levels: Isabel Sawhill and Quentin Karpilow, The Social Genome Project at Brookings, *Strategies for Assisting Low-Income Families* 4-5 (June 28, 2013). Lower literacy rates: www.urbanchildinstitute.org/articles/research-to-policy/policy/poverty-can-jeopardize-the-development-of-literacy-and-early. Higher levels of disability: http://talkpoverty.org/2014/09/19/disability-cause-consequence-poverty/. Comparisons of the general and chronically poor populations: Edwards, A. N. (Jan. 2014), *Dynamics of Economic Well-Being: Poverty 2009-2011*, United States Census Bureau. Children claimed for EITC: IRS, Research, Analysis and Statistics, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008* Returns 5 (Aug. 2014). Low income taxpayers living under 125% of poverty levels: (U.S. Census Bureau, 2015). Absence of a bank account: Federal Deposit Insurance Corporation (FDIC), 2013 FDIC National Survey of Unbanked and Underbanked Households 17 (Oct. 2014); Households moving: U.S. Census general mobility 2012-2013; At least partially valid EITC claims: National Taxpayer Advocate 2004 Annual Report to Congress vol. 2. Lack of transportation: www.urban.org/research/publication/impact-rising-gas-prices-below-poverty-commuters. Child care: www.pewresearch.org/fact-tank/2014/04/08/rising-cost-of-child-care-may-help-explain-increase-in-stay-at-home-moms/.

The EITC is a sizable credit, with approximately 26.7 million people receiving over $65 billion in EITC for tax year (TY) 2014.[12] Taxpayers use the credit to supplement their wages to pay for basic living expenses such as food, housing, and transportation costs. In 2013, the EITC lifted about 6.2 million people out of poverty.[13]

The EITC is associated with a high improper payment rate.[14] The IRS currently estimates that the EITC improper payment rate is 27 percent (which accounts for an estimated $17.7 billion in improper payments).[15] Despite much attention to this issue, the current improper payment rate has increased slightly from the improper rate measured in 2004, when it was 25 percent.[16] However, for context, EITC overclaims account for just seven percent of gross individual income tax noncompliance, while business income underreported by individuals accounts for 51.9 percent.[17] Improper EITC payments nonetheless continue to present a problem that cannot be ignored.

As Professor Leslie Book points out, EITC noncompliance is actually "a series of problems reflecting very different types and degrees of noncompliance."[18] As a result, proposals and programs to address EITC noncompliance must avoid a one-size-fits-all approach and instead "properly reflect the true dimensions of noncompliance within the EITC program, including ever-changing substantive rules, a fairly complex enforcement process, and the characteristics and circumstances of the appropriate taxpaying community."[19] Professor Book defines eight types of noncompliance, which he argues should serve as the basis for the IRS's action.[20]

Three types of noncompliance that are particularly pertinent to EITC compliance include: procedural noncompliance, unknowing noncompliance, and brokered noncompliance.[21] Procedural noncompliance occurs when the taxpayer cannot follow the EITC rules. In terms of an EITC claim, you may see procedural noncompliance when the IRS requests substantiating documentation from the taxpayer during an audit and the taxpayer responds with incorrect paperwork. Unknowing noncompliance occurs when an error is attributable to the complex and changing EITC rules. This error could occur when a taxpayer who was previously eligible for the EITC is no longer eligible because of a change in circumstances that he or she does not realize makes the taxpayer currently ineligible. Last, brokered noncompliance occurs

12 IRS, *About EITC*, *available at* https://www.eitc.irs.gov/EITC-Central/abouteitc (last visited Dec. 9, 2015).

13 Center on Budget Policy and Priorities, *New Research: EITC Boosts Employment; Lifts Many More Out of Poverty Than Previously Thought*, *available at* http://www.cbpp.org/blog/new-research-eitc-boosts-employment-lifts-many-more-out-of-poverty-than-previously-thought (last visited Sept. 23, 2015).

14 An improper payment is defined as "any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements" and "any payment to an ineligible recipient." *Improper Payments Elimination And Recovery Act of 2010*, Pub. L. No. 111-204, § 2(f)(2) (2010).

15 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance with the Improper Payment Reporting Requirements in Fiscal Year 2014* 9 (Apr. 27, 2015).

16 *Id*. The lowest improper payment measurement since 2004 was 23 percent, which occurred in 2012. *Id*.

17 IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012). The IRS estimates $235 billion in individual income tax underreporting for tax year (TY) 2006 with $122 billion of this amount attributable to business income underreported by individuals as sole proprietors on Schedule C (Profit or Loss from Business) or as farmers on Schedule F (Profit or Loss from Farming). Department of the Treasury, *Fiscal Year 2014 Agency Financial Report* 197 (Nov. 17, 2014). The IRS provided a lower bound estimate of $16.2 billion in EITC overclaims for TY 2014 ($16.2 billion / $235 billion is about seven percent).

18 Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 Kan. L. Rev. 1145, 1147 (2003).

19 *Id*. at 1147-48.

20 *Id*. at 1166. Mr. Book relies on the work of sociologists Robert Kidder and Craig McEwen in this analysis.

21 *Id*. at 1167-73.

when the taxpayer receives inaccurate advice or assistance from a tax professional. In our Most Serious Problems below, we discuss each of these types of noncompliance.

The Office of Management and Budget (OMB) recently requested that the Department of Treasury (Treasury) analyze the problem of EITC improper payments. The OMB encouraged Treasury to "continue to explore new and innovative ways to address the problem and to continue to attack this challenge with every tool at our disposal."[22] OMB requested an action plan from Treasury to meet improper payment reduction targets. One pertinent issue OMB wanted addressed included the question: What are the one or two actions you are not already engaged in (but could realistically engage in) that would lead to a significant decrease in improper payments in the EITC program?[23] In the material below, the National Taxpayer Advocate will recommend several actions that can be realistically adopted to improve EITC compliance and reduce improper payments.

Improvement to the EITC audit program is also an important step to meeting Congress's expectations to "engage in the first top to bottom review since 1996 of how federal policies can better support work, strengthen families, and move America forward."[24] Based on this expectation, the National Taxpayer Advocate provides her concerns and recommendations for improving EITC compliance in the Most Serious Problems described below:

- *The IRS Does Not Do Enough Taxpayer Education in the Pre-Filing Environment to Improve EITC Compliance and Should Establish a Telephone Helpline Dedicated to Answering Pre-filing Questions From Low Income Taxpayers About Their EITC Eligibility;*
- *The IRS Is Not Adequately Using the EITC Examination Process as an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance;* and
- *The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*

We believe that if the IRS and Congress adopt the recommendations set forth in these discusisons, we will achieve improved EITC voluntary compliance. Some of our proposals call for innovation, improved training, person-to-person contact, and staffing the program with employees that have a different set of skills. In order to improve the future compliance and protect the taxpayer rights of low income individuals, these resources are a necessary investment.

22 Shaun Donovan, Director, OMB, *Letter to Honorable Jacob J. Lew, Secretary of the Treasury* (Feb. 26, 2015).

23 *Id*.

24 *Challenges Facing Low-Income Individuals and Families in Today's Economy: Hearing Before the Subcomm. on Human Resources of the H. Comm. on Ways and Means*, 114th Cong. (2015) (statement of Subcommittee Chairman Charles Boustany).

MSP #22 EARNED INCOME TAX CREDIT (EITC): The IRS Does Not Do Enough Taxpayer Education in the Pre-filing Environment to Improve EITC Compliance and Should Establish a Telephone Helpline Dedicated to Answering Pre-filing Questions From Low Income Taxpayers About Their EITC Eligibility

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The Earned Income Tax Credit (EITC) is a complicated tax law that depends on many factors, including a taxpayer's income, marital status, and relationship to children claimed. As discussed in the introduction to this section, the target population for the EITC shares a unique set of attributes that create inherent challenges for EITC compliance.[2] Additionally, the population claiming the EITC is constantly changing, with approximately one-third of the eligible population changing every year.[3]

The churning of the eligible population occurs because EITC eligibility requirements include the type of issues that change frequently, such as living and parenting arrangements and the gain or loss of a job. However, when one-third of the EITC population cycles in and out each year, it is very difficult for taxpayers to understand what the rules are and how the rules apply to the taxpayer's particular circumstances.

The IRS does not accommodate low income taxpayers' communication behaviors and largely ignores what channels these taxpayers need or prefer to use. As a consequence, taxpayers make avoidable errors and inaccurate EITC claims, driving up the improper payment rate.[4]

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

2 See Introduction: *The IRS Can Do More To Improve Its Administration of the Earned Income Tax Credit (EITC) and Increase Future Compliance Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights*, *supra*.

3 IRS, *EITC Fast Facts*, *available at* http://www.eitc.irs.gov/Partner-Toolkit/basicmaterials/ff (last visited Sept. 16, 2015). For more information on the changing population of taxpayers eligible for EITC, see National Taxpayer Advocate 2013 Annual Report to Congress 109-10.

4 For a more detailed discussion of the EITC improper payment rate, see Introduction: *The IRS Can Do More To Improve Its Administration of the Earned Income Tax Credit (EITC) and Increase Future Compliance Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights*, *supra*.

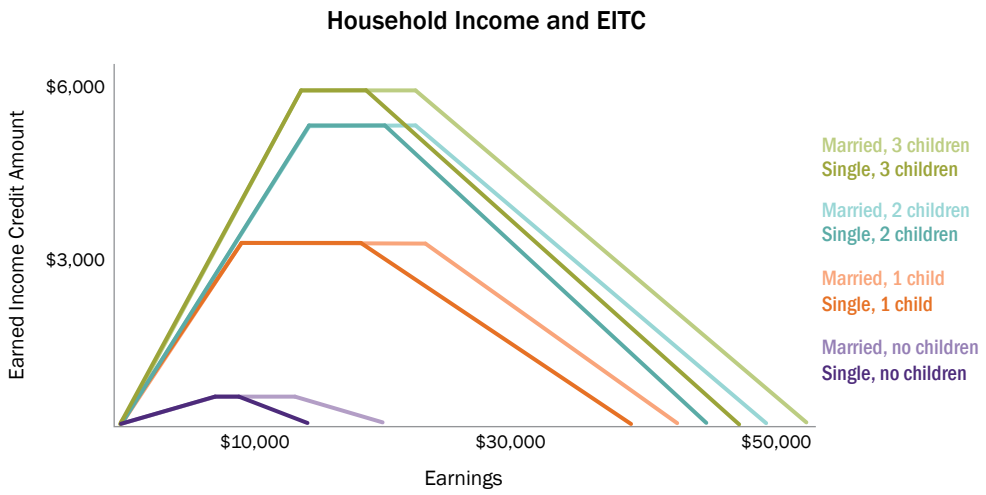
ANALYSIS OF THE PROBLEM

Background

Generally, the amount of the EITC increases with earned income, creating an incentive to work.[5] The credit has a phase-in range (increasing the credit as the taxpayer's wages go up), a plateau range, and a phase-out range (decreasing the credit as the taxpayer's wages continue to increase, eventually making the taxpayer ineligible). The EITC amount also increases if a worker has one, two, or three qualifying children, but is disallowed if the worker has more than $3,350 of investment income.[6] For tax year (TY) 2014, the EITC phases out at an income ceiling of $52,427 (for a married couple filing jointly with three or more qualifying children), and this number changes annually.[7]

Figure 1.22.1 demonstrates the plateau effect of the EITC based on income, filing status, and number of children.

FIGURE 1.22.1, Amount of EITC Based on Earnings



The information listed above only covers income eligibility. The requirements when claiming a child are even more detailed. To have a qualifying child for EITC purposes, the child must meet three tests: age, relationship, and residence.

- Under the *age* requirement, the child being claimed must be younger than the taxpayer and must be under the age of 19 at the end of the calendar year. The child can be under the age of 24 if he or she is a full-time student, and if the child is permanently and totally disabled, then he or she can be any age.[8]

5 See Stacy Dickert, Scott Houser & John Karl Scholz, *The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program Participation*, 9 Tax Policy and the Economy (James M. Porterba ed., 1995); Janet Holtzblatt, *Trade-offs Between Targeting and Simplicity: Lessons from the U.S. and British Experiences with Refundable Tax Credits* 13 (2004) (citing Dickert, Houser & Scholz among academic economists who "estimated that expansions of the EITC between 1993 and 1996 would induce more than half a million families to move from welfare to work").

6 *See generally* IRC § 32(i); Instructions for Form 1040, *U.S. Individual Tax Return* 53 (Jan. 26, 2015).

7 Internal Revenue Code (IRC) § 32(b); IRS, *Publication 596, Earned Income Credit (EIC)* 4 (Dec. 18, 2014).

8 IRC § 152(c)(3).

- Under the *relationship* requirement, the taxpayer generally may claim the EITC for a child who is his or her son or daughter, stepchild, foster or adopted child, or a descendant of any of them (*e.g.*, a grandchild), or a child who is a sibling, stepsibling, or half-sibling of the taxpayer, or a descendant of any of them (*e.g.*, a nephew or grandnephew).[9]
- Under the *residence* requirement, a taxpayer generally may claim the credit only with respect to a child who lives with the taxpayer for more than half the calendar year.[10]

Taxpayers without children have separate requirements. First, they must live in the United States for more than half of the year.[11] The taxpayer (or his or her spouse if filing jointly) must be at least 25 years old but below 65 years old.[12] Last, the taxpayer cannot be claimed by someone else as a dependent.[13]

The struggle that low income taxpayers face in trying to navigate the complex EITC rules is not just a theoretical problem. The recent case of *Cowan v. Commissioner* demonstrates the severity of the situation.[14] In this case, the state of Ohio appointed Ms. Cowan to be the guardian of a child, Marquis, from 1991 until 2004. Under state law, the guardianship automatically terminated when Marquis turned 18, which occurred in 2004. However, Ms. Cowan continued to provide Marquis a home after he turned 18, and they continued to regard themselves as a family unit. Ms. Cowan never adopted Marquis, the legal significance of which she did not understand. She stipulated for trial that had she known of the importance of adoption, she would have adopted Marquis.

Later, Marquis had a daughter, and they both lived with Ms. Cowan. In 2011, Ms. Cowan claimed Marquis's daughter as her granddaughter for the EITC. The court disallowed this claim since she and Marquis legally are not related. However, Ms. Cowan and Marquis *believe* and *act* as if they are family. And it was based on that belief that Ms. Cowan filed her 2011 tax return. Had Ms. Cowan understood the legal significance of the terminated guardianship and of adopting Marquis, she could have taken steps to ensure the outcome was in her favor.

In situations where taxpayers are operating under a complex system of rules without the necessary tools, the concept of procedural justice is impacted. "Procedural justice" (or fairness) is a concept that considers how a taxpayer is treated by the IRS. It looks to more than just the outcome of the interaction; it also considers if the interaction was "nonjudgmental, polite, and respectful of the individual's rights."[15] Procedural justice is an important concept to consider when discussing EITC cases because a taxpayer's perception of procedural fairness will affect his or her perception of the agency's fairness and legitimacy, as well as his or her willingness to comply with the tax laws.[16] The process of establishing EITC compliance can seem unjust if it is designed in a way that all but ignores the needs and limitations of the population being served.[17]

9 IRC § 152(c)(2).

10 IRC § 152(c)(1)(B).

11 IRC § 32(c)(1)(A)(ii)(I).

12 IRC § 32(c)(1)(A)(ii)(II).

13 IRC § 32(c)(1)(A)(ii)(III).

14 T.C. Memo. 2015-85.

15 Nina E. Olson, *Procedural Justice for All: A Taxpayer Rights Analysis of IRS Earned Income Credit Compliance Strategy*, 22 Advances in Taxation 3 (John Hasseldine ed., 2015).

16 *Id.* at 3-4.

17 For information on how the EITC audit process in particular can be improved, see Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS Is Not Adequately Using the EITC Examination Process as an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance, infra.*

In the current customer service environment, procedural justice is undermined by the IRS's failure to provide tailored education and assistance to low income taxpayers, coupled with an examination strategy that creates significant burdens for EITC taxpayers trying to prove their eligibility.[18] As a consequence, EITC noncompliance continues at a high level, resistant to the IRS's present actions.

The IRS Needs to Establish a Dedicated Helpline for EITC Taxpayers During the Filing Season to Improve Filing Compliance and the Improper Payment Rate

During the filing season, the IRS provides toll-free assistance for answering basic tax law questions from any taxpayer and only rudimentary help for taxpayers with EITC questions. The IRS also uses an outreach and education strategy directed toward both preparers and taxpayers. For instance, on the IRS website, taxpayers are able to use a tool to see if they qualify for the EITC.[19] The website also offers links that contain a wealth of information according to topic. For instance, the taxpayer can find information pertaining to the income limits, credit amounts, and special rules.[20]

… TAS research… has shown that taxpayers claiming the Earned Income Tax Credit (EITC) need additional assistance to understand EITC eligibility and avoid noncompliance. Accordingly, the National Taxpayer Advocate recommends the IRS establish a dedicated helpline for EITC questions during the filing season to meet that need.

The IRS also makes available bilingual pamphlets and publications. Publication 962, *Earned Income Tax Credit*, is a pamphlet that addresses the main requirements for EITC and provides the taxpayers with additional resources if they have questions. These publications are often disseminated throughout the community at government offices and nonprofit agencies. The IRS takes advantage of TV, radio, and social media to present public service announcements. The best example of this outreach is EITC Awareness Day, which is a "one-day blitz in mainstream and social media to reach the broadest possible range of potentially eligible taxpayers."[21]

Despite all this important high-level outreach activity, TAS research, discussed below, has shown that taxpayers claiming the EITC need additional assistance to understand EITC eligibility and avoid noncompliance.[22] Accordingly, the National Taxpayer Advocate recommends the IRS establish a dedicated helpline for EITC questions during the filing season to meet that need. Assistors servicing the helpline should receive training to improve interviewing and listening skills similar to those used by social workers administering a social benefit program.[23] Taxpayers could explain their circumstances and receive specific guidance on how the law applies to those circumstances. While these answers would be nonbinding on the IRS, the assistors on the helpline would focus on getting taxpayers to the right answer. The helpline would help taxpayers check the accuracy of advice

18 See Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS Is Not Adequately Using the EITC Examination Process as an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance*, *infra*.

19 IRS, Use the EITC Assistant, *available at* http://www.irs.gov/Credits-&-Deductions/Individuals/Earned-Income-Tax-Credit/Use-the-EITC-Assistant (last visited Sept. 18, 2015).

20 IRS, *Earned Income Tax Credit (EITC)*, *available at* http://www.irs.gov/Credits-&-Deductions/Individuals/Earned-Income-Tax-Credit (last visited Sept. 18, 2015).

21 IRS, *EITC Awareness Day*, *available at* http://www.eitc.irs.gov/Partner-Toolkit/awarenessday (last visited Sept. 18, 2015).

22 See National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 1-82 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 94-117 (*IRS Earned Income Credit Audits – A Challenge to Taxpayers*).

23 See National Taxpayer Advocate 2009 Annual Report to Congress 119-20; National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 86-7.

provided them by untrained or unscrupulous return preparers.[24] Not only would individual taxpayers benefit from this helpline, but the IRS would learn from the taxpayers themselves what the sources of confusion are with respect to the EITC. In this way, through a dialogue with taxpayers, the IRS can update and refine its general information for *all* EITC taxpayers.[25]

TAS Research Studies Show that Low Income Taxpayers Need Person-to-Person Contacts In Order to Understand Their Tax Obligations

The first TAS study to support this recommendation occurred in 2004, when TAS explored the effectiveness of EITC audits.[26] In the 2004 study, TAS looked at a representative sample of taxpayers whose EITC was disallowed, in whole or part, in IRS audits and who later requested an audit reconsideration of that disallowance. The results showed that 45 percent of the taxpayers who went to TAS for assistance received additional EITC as a result of the audit reconsideration, as compared to 40 percent who asked Examination for reconsideration. Forty-two percent of the sample responded late or not at all to the original audit inquiry. However, about 43 percent of this group had favorable outcomes from the audit reconsideration process, retaining about 96 percent of the total amount of EITC originally claimed on their returns.

The percentage of taxpayers who received EITC in the audit reconsideration increased in direct proportion to the number of telephone contacts TAS initiated. Overall, only 38 percent of taxpayers who went through the audit reconsideration process but received no phone calls were awarded EITC. This percentage increased to 67 percent for taxpayers who received three or more calls. The 2004 study demonstrated the importance of making personal contact with low income taxpayers under audit. If personal contact could be available earlier in the process, significant noncompliance and future audits potentially could be avoided.

In a 2007 study, TAS identified the types of barriers taxpayers face in the EITC audit process as well as the effect of representation in EITC audits. This study discovered that on a very basic level, 26.5 percent of the surveyed taxpayers did not know from reading the EITC audit letter that they were being audited.[27] Nearly 40 percent did not understand what the IRS was questioning in the audit.[28] Nearly 70 percent of the taxpayers preferred to communicate with the IRS directly instead of the correspondence audit process, 46 percent preferred to communicate by telephone, and 23 percent preferred to communicate in-person.[29] This shows that IRS written communication (both in style and format) does not line up with what low income taxpayers need to be able to engage effectively with the IRS and learn.

The IRS has studied discrete components of low income taxpayers' lives. For instance, as part of the Qualifying Child Residency Certification Study in 2005, the IRS looked to the importance of mobility

24 For an analysis of the role of return preparers in EITC noncompliance and the IRS efforts to address this issue, see Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance, infra*.

25 See Most Serious Problem: *Taxpayer Service: The IRS Has Developed a Comprehensive "Future State" Plan That Aims to Transform the Way It Interacts with Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*, *supra*, for a discussion of the importance of a "positive feedback loop" between IRS and taxpayers.

26 See National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 1-82 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

27 See National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 104. EITC returns are selected for audit differently now than returns were selected for audit in 2007. We do not know if this study would create the same results today.

28 *Id*.

29 *Id.* at 106-7.

of low income taxpayers and taxpayers' opinions of the EITC certification process.[30] The IRS learned that between six and 11 percent of the letters sent by the IRS as part of the study were undeliverable, and almost one-half of the taxpayers selected for a follow-up telephone survey could not be reached by mail or phone in TY 2003.[31]

A dedicated helpline would address low income taxpayers' needs by accommodating their mobility (taxpayers could call it regardless of mobility) *before* filing their tax returns. The helpline would help avoid future noncompliance and instill a sense of procedural justice for all taxpayers — that is, the IRS listened to their concerns and explained what taxpayers needed to do to be compliant.

The IRS Can Learn From the United Kingdom's Approach to Providing Assistance to Taxpayers Claiming Family- and Income-Based Credits

The National Taxpayer Advocate has consistently argued that low income taxpayers need customer service approaches fine-tuned for their specific needs and preferences.[32] In the United Kingdom, Her Majesty's Revenue and Customs (HMRC) has gradually shifted its focus from that of a compliance-driven agency to one that views taxpayers as customers. HMRC is committed to improving the "customer experience" for taxpayers claiming family and other tax credits and as a result it strives to "understand both customers' current communication behaviors, as well as how they would prefer to communicate with HMRC in the future."[33] For instance, HMRC has determined that taxpayers claiming tax credits largely prefer contacting the agency by telephone.[34] HMRC also studied when taxpayers are most likely to need assistance during the process of claiming a tax credit.[35] Last, HMRC studies taxpayers' experiences, perceptions, and attitudes.[36] This approach instills a sense of procedural justice into the process.[37]

Unlike the United States, HMRC provides a dedicated helpline for tax credit inquiries. This helpline provides advice on tax credits, allows taxpayers to report changes in their circumstances, and provides a

30 IRS, *IRS Earned Income Tax Credit (EITC) Initiative, Final Report to Congress* 23, 43 (Oct. 2005).

31 IRS, *IRS Earned Income Tax Credit (EITC) Initiatives, Report on Qualifying Child Residency Certification, Filing Status, and Automated Underreporter Tests* 19 (2008). One-third of the taxpayers selected for a follow-up telephone survey could not be reached by mail or phone in TY 2004. *Id*.

32 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 103-15; National Taxpayer Advocate 2011 Annual Report to Congress 296-312 (Most Serious Problem: *The IRS Should Reevaluate Earned Income Tax Credit Compliance Measures and Take Steps to Improve Both Service and Compliance*); National Taxpayer Advocate 2008 Annual Report to Congress 227-42 (Most Serious Problem: *Suitability of the Examination Process*); National Taxpayer Advocate 2007 Annual Report to Congress 222-41 (Most Serious Problem: *EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2005 Annual Report to Congress 94-122 (Most Serious Problem: *Earned Income Tax Credit Exam Issues*); National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 8-45 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

33 Her Majesty's Revenue and Customs, *Channels of Communication: Usage and Preferences Among Tax Credits Customers* 1 (Aug. 2013). *See also* Colin Payne, Julia Griggs, Mari Toomse-Smith and Hannah Silvester, NatCen Social Research, *Panel Study of Tax Credits Customers: Telephone Survey 2012: Reducing Error and Fraud, and the Transition to Universal Credit* (May 2013).

34 Her Majesty's Revenue and Customs, *Channels of Communication: Usage and Preferences Among Tax Credits Customers* 11 (Aug. 2013).

35 *Id*. at 12.

36 *See, e.g.*, Malen Davies, Rowan Foster, Pippa Lane and Lauren Small, Centre for Economic and Social Inclusion, *High Risk Renewals: Tax Credits Customers' Experiences of and Responses to the High Risk Renewals Intervention* (2013). The High Risk Renewal (HRR) intervention is used by HMRC "to target those tax credits customers identified as having a risk of error or fraud in their claim." *Id*. at 1. The interventions consist of an HRR letter in addition to a "tax credits renewal pack." *Id*. at 2. *See also* Chris Lord, Matt Barnes and Mari Toomse, NatCen Social Research, *Exploring the Dynamics of Tax Credits Renewal Behavior: Longitudinal Analysis of the Panel Survey of Tax Credits and Child Benefit Customers* (July 2012).

37 *Supra* note 15.

The law related to Earned Income Tax Credit (EITC) eligibility is complex. At the same time, the EITC is directed toward a population of taxpayers who are least able to navigate its complexity. Additionally, the population of eligible taxpayers is in constant flux because of changing personal circumstances. With these three elements in mind, education targeted toward taxpayers claiming the EITC is an important component for improving EITC compliance.

venue for taxpayers to make complaints.[38] A majority of taxpayers in the United Kingdom preferred using this dedicated helpline for their source of information over all other services provided by HMRC and the customer satisfaction was reported as highest with the helpline.[39] While 56 percent of the taxpayers used the helpline, the next largest group relied on the HRMC website (19 percent).[40] Some other options included local tax offices (two percent), professional advisors (one percent), and community-based volunteer organizations such as the Citizens Advice Bureau (two percent).[41]

Taking a similar approach could help the IRS pinpoint where mistakes and inadvertent errors are likely to occur in EITC claims, increase efficient use of resources, and encourage taxpayers' participation in EITC compliance. It will enable the IRS to tailor its outreach and education better, based on issues and confusion identified on the helpline. It will also allow taxpayers to check whether the information they receive from their tax return preparers about their eligibility is correct. We know in the United States, low income taxpayers are more likely to use an IRS walk-in office compared to taxpayers with higher incomes.[42] In a 2014 study, TAS determined that over 75 percent of low income respondents preferred in-person meetings and meetings at a community service center compared to 28 percent who preferred telephone contact and 13 percent who preferred contact by writing.[43] This means that the current processes for low income taxpayers should be based on something other than correspondence.

A helpline would be less expensive than face-to-face assistance but still meet the needs of the low income population. By studying the best way to communicate with low income taxpayers, the IRS could determine why low income taxpayers prefer face-to-face assistance over telephone contact. If we can isolate the particular aspects of face-to-face assistance that taxpayers find helpful, it may very well be that the enhanced EITC helpline would also meet those aspects

38 Her Majesty's Revenue and Customs, *Tax Credits: General Enquiries*, *available at* https://www.gov.uk/government/organisations/hm-revenue-customs/contact/tax-credits-enquiries (last visited May 21, 2015).

39 Her Majesty's Revenue and Customs, *Channels of Communication: Usage and Preferences Among Tax Credits Customers* 25 (Aug. 2013).

40 *Id*. at 14.

41 *Id*. The Citizens Advice Bureau described its work as offering "information and advice through face-to-face, phone and email services, and online via Adviceguide.org.uk." Citizens Advice Bureau, *Introduction to the Citizens Advice service*, *available at* https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/who-we-are-and-what-we-do/introduction-to-the-citizens-advice-service/ (last accessed Oct. 9, 2015).

42 Eighty-two percent of low income taxpayers (with incomes under $15,000) reported being "very or somewhat likely" to use an IRS walk-in office compared to 63 percent of taxpayers with income of $75,000 or more. IRS Oversight Board, 2014 *Taxpayer Attitude Survey* 13 (Dec. 2014). The margin of error for the Oversight Board survey is 4 percent at the 95 percent confidence level.

43 National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 9. This study entailed a telephone survey of taxpayers eligible to use a Low Income Taxpayer Clinic for help with a federal tax problem. Participants had to be the person in the household responsible for handling federal income tax matters, they must have filed a federal tax return in the last three years, and their total annual household income could not exceed 250 percent of the federal poverty level. Respondents could check all applicable responses so results total more than 100 percent.

(one-on-one communication, no talk time limits, personal interaction).[44] Based on that assessment, the IRS should reevaluate how it currently serves low income taxpayers and build a system that meets the needs of taxpayers.

CONCLUSION

The law related to EITC eligibility is complex. At the same time, the EITC is directed toward a population of taxpayers who are least able to navigate its complexity. Additionally, the population of eligible taxpayers is in constant flux because of changing personal circumstances. With these three elements in mind, education targeted toward taxpayers claiming the EITC is an important component for improving EITC compliance. In particular, if taxpayers had access to a dedicated helpline, they would be able to confirm their understanding before filing a tax return or receive help if they have a question after entering into the audit process. This could reduce the number of mistakes and inadvertent errors.

The IRS should reevaluate how it serves the particular needs of low income taxpayers. There is a lot of research to indicate that low income taxpayers would benefit from service methods other than correspondence examinations. And yet, most work done with low income taxpayers is through the mail. The IRS should take this opportunity to study how low income taxpayers prefer to work with the IRS. Based on the results of that study, the current procedures should be revamped to optimize taxpayer participation. In doing this, the IRS will promote a sense of procedural justice in tax administration for low income taxpayers and positively impact EITC compliance. Doing this will also undermine unscrupulous and predatory preparers, which will further improve the improper payment rate.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Conduct a study along the lines of the UK experiment to determine how best to serve low income taxpayers. This study should include interviews with taxpayers, nonprofit organizations, and IRS employees, to learn about taxpayer needs and communication preferences.
2. Based on the findings from the proposed study above, create a helpline dedicated to taxpayers who claim the EITC where taxpayers can call in and ask questions about their particular area of concern. This phone line should be staffed by employees with excellent listening and communication skills who have completed training in social work and who can answer specific questions related to EITC eligibility. The IRS should provide, in conjunction with TAS, special training on listening and communication.

44 The Senate Committee on Appropriations recently directed the IRS to conduct an analysis of the specific characteristics of the population of taxpayers that use the walk-in Taxpayer Assistance Centers. In particular, the committee directed the IRS to conduct this analysis along the same lines as an analysis conducted by HMRC. Financial Services and General Government Appropriations Bill of 2016, S.R. 000, 114th Cong. 30-31 (2015).

MSP #23 EARNED INCOME TAX CREDIT (EITC): The IRS Is Not Adequately Using the EITC Examination Process As an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS and Be Heard*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The Earned Income Tax Credit (EITC) is a refundable credit, enacted as a work incentive in the Tax Reduction Act of 1975.[2] It has become one of the primary forms of public assistance for low income working taxpayers. Taxpayers eligible for the EITC often rely on the credit in order to make basic ends meet, such as to cover housing and transportation costs. The EITC is also associated with a high improper payment rate.[3] The IRS currently estimates that the EITC improper payment rate is 27 percent (which accounts for an estimated $17.7 billion in improper payments).[4] Despite much attention to this issue, the current improper payment rate has increased slightly from 2004, when it was 25 percent.[5] Thus, the IRS must balance the obligation of making sure every taxpayer eligible for the EITC receives it, with the obligation to minimize mistakes and fraud.[6]

The EITC is a complex law that involves eligibility rules based on a taxpayer's income, marital status, and parental arrangements, which can often change on a year-to-year basis. The population claiming the

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

2 Pub. L. No. 94-12, § 204, 89 Stat. 26 (1975). For a detailed history of the EITC, see Dennis J. Ventry, Jr., *The Collision of Tax and Welfare Politics: The Political History of the Earned Income Tax Credit, 1969-99*, 53 Nat'l. Tax J. 983-1026 (Dec. 2000).

3 An improper payment is defined as "any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements" and "any payment to an ineligible recipient." Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111-204, § 2(f)(2) (2010).

4 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014* 9 (Apr. 27, 2015).

5 *Id*. The lowest improper payment measurement since 2004 was 25 percent, which occurred in 2012. *Id*.

6 For information on how the IRS is addressing the role that tax return preparers play in EITC noncompliance, see Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*, *infra*.

EITC is constantly in flux, with approximately one-third of the eligible population changing every year.[7] At the same time, the population of taxpayers who rely on the EITC share a common set of characteristics, such as low education and high transiency, which create challenges for taxpayer compliance.[8]

Notwithstanding these challenges the IRS persists in using traditional audits as its primary compliance tool. In fact, EITC audits make up 35 percent of all IRS audits despite the fact that EITC returns account for only 19 percent of all returns filed.[9] Because audits are resource-intensive, the IRS should focus its limited resources on audit methods proven to have the greatest direct and indirect effects on compliance in order to have the biggest impact on potentially erroneous EITC claims. The IRS primarily relies on the automated correspondence examination process to work EITC audits. TAS's review of this approach reveals the following concerns:

- The correspondence audit process creates barriers for low income taxpayers due to their unique attributes;
- The EITC audit program has a no-response rate of over 40 percent, raising questions about the accuracy of some default assessments and of the audit's effectiveness as an educational tool for future compliance;[10] and
- The IRS may not be auditing the group of EITC returns that have the most noncompliance, thereby diminishing the effectiveness of IRS efforts to improve future compliance and creating a burden for taxpayers.

Improving the EITC audit program is an important step to improving the improper payment rate, reducing taxpayer burden, and meeting Congress's expectations that the IRS "engage in the first top to bottom review since 1996 of how federal policies can better support work, strengthen families, and move America forward."[11] An improved audit process will also ensure procedural justice for low income taxpayers.[12]

7 IRS, *EITC Fast Facts*, http://www.eitc.irs.gov/Partner-Toolkit/basicmaterials/ff (last visited Sept. 16, 2015). For more information on the changing population of taxpayers eligible for EITC, see National Taxpayer Advocate 2013 Annual Report to Congress 109-10.

8 See Introduction: *The IRS Can Do More to Improve Its Administration of the Earned Income Tax Credit (EITC) and Increase Future Compliance Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights*, *supra*.

9 IRS, *2014 Data Book*, table 9a, comparing the number of EITC returns filed and the number of EITC audits in footnote 5 of the same table.

10 For FY 2014, the exact no response rate is 45.6 percent. This calculation includes 255,286 default assessments minus 99,067 default assessments that involved some taxpayer contact, bringing the total of default assessments with no taxpayer contact to 156,219. In addition, 42,490 cases involving undeliverable mail were then added, for a total of 198,709 cases with either a default assessment and no contact or undeliverable notices. That number divided by the total of 435,639 equals 45.6 percent and represents the portion of taxpayers who did not respond to the EITC audit. Audit Information Management System Closed Case Database. *See Internal Revenue Service Oversight, Hearing Before the H. Subcomm. on Fin. Serv. and Gen. Gov't Comm. on Appropriations*, 113th Cong. 34 (2014) (statement of Nina E. Olson, National Taxpayer Advocate), *available at* http://www.finance.senate.gov/imo/media/doc/Olson%20-Testimony1.pdf.

11 *Challenges Facing Low-Income Individuals and Families in Today's Economy: Hearing Before the Subcomm. on Human Res. of the H. Comm. on Ways and Means*, 114th Cong. (2015) (statement of Subcommittee Chairman Charles Boustany). Additionally, the President's FY 2016 budget includes "strategic reinvestments in the IRS," which among other things, are intended to "help increase audit and collection coverage." *Examining Federal Improper Payments and Errors in the Death Master File, Hearing before the S. Comm. on Homeland Security and Governmental Affairs*, 114th Cong. (Mar. 16, 2015) (statement of David Mader, United States Controller, Office of Management and Budget). If the IRS does receive additional funding, now is a good opportunity to evaluate its EITC audit effectiveness.

12 "Procedural justice" (or fairness) is a concept that considers how a taxpayer is treated by the IRS. It looks to more than just the outcome of the interaction, it also considers if the interaction was "nonjudgmental, polite, and respectful of the individual's rights." It is an important concept to consider when discussing EITC audits because a taxpayer's perception of procedural fairness will affect his or her perception of the agency's fairness. Nina E. Olson, *Procedural Justice for All: A Taxpayer Rights Analysis of IRS Earned Income Credit Compliance Strategy*, *in* 22 Advances in Taxation 1, 3-4 (John Hasseldine ed., 2015).

ANALYSIS OF THE PROBLEM

The Correspondence Audit Process Creates Barriers for Low Income Taxpayers Due to Their Unique Attributes

As noted in the Introduction, EITC taxpayers face significant challenges in interacting with the IRS, including language, financial and computer literacy, transiency, and the other characteristics of low income and poverty populations.[13] Taxpayers claiming the EITC need to have a tailored examination process for a number of reasons, including language barriers, the inability to communicate clearly in writing, complexity of the tax law, and the volume of records required for verification.[14] The National Taxpayer Advocate has consistently argued that low income taxpayers need approaches fine-tuned for their specific needs and preferences.[15] The Treasury Inspector General for Tax Administration (TIGTA) also recently observed that "[IRS] compliance resources are limited, and additional alternatives to traditional compliance methods have not been developed. Consequently, the IRS does not address the majority of potentially erroneous EITC claims."[16] The Government Accountability Office (GAO) reported that effectiveness of audits may be limited partly because of regular backlogs in the audits, which result in delays in responding to taxpayer responses and inquiries.[17] Moreover, practitioners have expressed concern about the suitability of the correspondence examination for taxpayers claiming the EITC:

> The system itself of requiring the least sophisticated users to endure the most impersonal process creates many of the problems for low income taxpayers. In both the examination and collection phases of their case, low income taxpayers go from start straight through to levy without a person assigned individually to their case.[18]

An EITC Denial May Not Effectively Reflect a Taxpayer's Eligibility for the Credit

When the audit process does not meet taxpayer needs, any EITC denied to the taxpayer may reflect the taxpayer's inability to navigate the audit process rather than an improper payment.[19] When taxpayers

13 See Introduction: *The IRS Can Do More To Improve Its Administration of the Earned Income Tax Credit (EITC) and Increase Future Compliance Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights*, *supra*.

14 National Taxpayer Advocate 2008 Annual Report to Congress 233. When it comes to complying with document requests, migratory living patterns, lack of education, lack of time (*e.g.*, holding multiple jobs), lack of transportation, and limited access to technology (internet, faxes, etc.) add to the difficulty of finding and submitting documents. National Taxpayer Advocate 2011 Annual Report to Congress 304.

15 For example, see National Taxpayer Advocate 2013 Annual Report to Congress 103-15 (Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS Inappropriately Bans Many Taxpayers from Claiming EITC*); National Taxpayer Advocate 2011 Annual Report to Congress 296-312 (Most Serious Problem: *The IRS Should Reevaluate Earned Income Tax Credit Compliance Measures and Take Steps to Improve Both Service and Compliance*); National Taxpayer Advocate 2008 Annual Report to Congress 227-42 (Most Serious Problem: *Suitability of the Examination Process*); National Taxpayer Advocate 2007 Annual Report to Congress 222-41 (Most Serious Problem: *EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2005 Annual Report to Congress 94-122 (Most Serious Problem: *Earned Income Tax Credit Exam Issues*); National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 8-45 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

16 TIGTA, Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014* 9 (Apr. 27, 2015). Recently, a new law was enacted which will require the IRS to modify the timeframe for people claiming the EITC to receive their refunds. The new timeframe would mean that taxpayers claiming the EITC could not receive their refunds before February 15, with the intention of reducing fraud and improper payments. Consolidated Appropriations Act, 2016, Pub. L. No. 114-113 § 201 (2015).

17 GAO, *Fiscal Outlook: Addressing Improper Payments and the Tax Gap Would Improve the Government's Fiscal Position* 15 (Oct. 1, 2015). The GAO concludes that legislative action and "significant changes" in the IRS compliance processes would be necessary to reduce EITC improper payments. *Id*.

18 *Tax Complexity, Compliance, and Administration: The Merits of Simplification in Tax Reform, Hearing Before the S. Comm. on Fin.*, 114th Cong. (Mar. 10, 2015) (statement of Keith Fogg, Professor of Law and Director of Low Income Taxpayer Clinic (LITC) Villanova Law School).

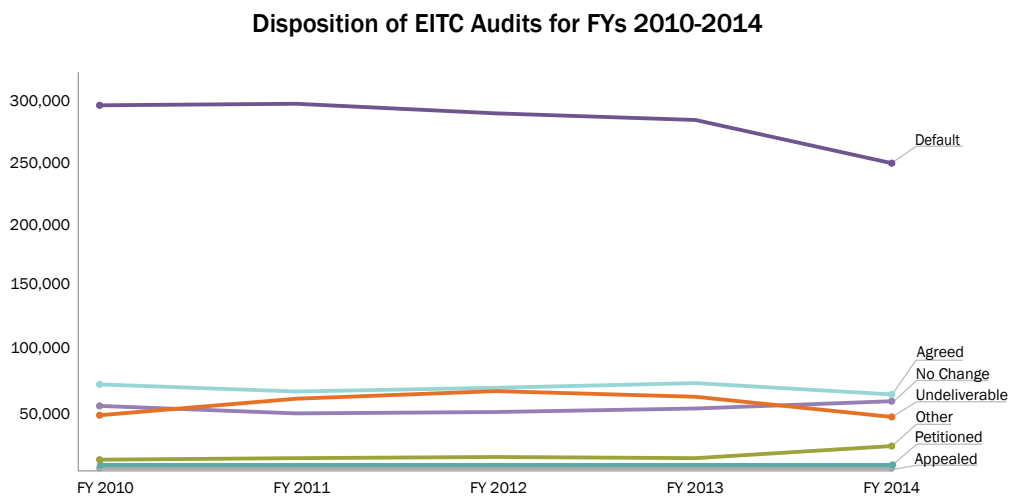
19 National Taxpayer Advocate 2011 Annual Report to Congress 301.

cannot obtain the information they need to substantiate a claim during an audit, they may not pursue the case and may not receive a benefit to which they are entitled. Even if the taxpayer is not eligible for the EITC in the year of audit, if they do not learn why they are ineligible through the audit process, they may just learn that they should not claim the EITC at all, despite being eligible in later years. Or the taxpayer may repeat the mistake in the following year, triggering the two-year ban under Internal Revenue Code (IRC) § 32(k).[20] Such a system does not promote future compliance.

Some taxpayers will appeal their EITC claim denials to the U.S. Tax Court. This increases systemic costs. The taxpayer may retain a *pro bono* attorney through his or her local Low Income Taxpayer Clinic.[21] Litigation will mean increased costs for the IRS in expanding the time of IRS attorneys and Appeals staff, in addition to the court's expenses. Litigation also creates a delay for the taxpayer to receive his or her refund. A TAS review conducted in 2012 examined a random sample of cases in which the taxpayer petitioned the Tax Court for review of IRS disallowance of the EITC and the IRS conceded the EITC issue in full without trial. On average, the taxpayers had to wait 513 days for their refund.[22] Furthermore, the IRS paid $17,400 in interest on delayed refunds in 90 cases.[23]

Figure 1.23.1 shows the disposition of each EITC audit between fiscal years (FY) 2010 and 2014. The overall trends have stayed relatively consistent over the five years.

FIGURE 1.23.1[24]



20 A law has been recently enacted which will allow the IRS to use math error authority in situations where the taxpayer has claimed the EITC during a time that he or she is barred from doing so under IRC § 32(k). Consolidated Appropriations Act, 2016, Pub. L. No. 114-113 § 208 (2015).

21 LITCs represent low income individuals in disputes with the IRS, including audits, appeals, collection matters, and federal tax litigation. *See* IRS Publication 4134, *Low Income Taxpayer Clinic List* (Jan. 2015).

22 National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 86.

23 *Id*.

24 IRS Compliance Data Warehouse (CDW), Audit Information Management System through July 2015. This data represents information provided by the IRS. The amount of Appeals dispositions may not be accurately tracked by the IRS Audit Information Management System.

…An additional percentage of the audits that are closed as undeliverable, meaning the taxpayers never had an opportunity to engage in the audit process because the audit notices could not be delivered to the taxpayer… These numbers indicate that the IRS may not be having sufficient communication with taxpayers to make full use of the audit process, which includes educating taxpayers.

For instance, each year saw over half of all assessments closed with a default assessment (meaning that the credit was denied because the taxpayer did not respond or stopped responding), making default assessments the primary type of audit closure. The number of default assessments was largest in FY 2010, with 63.7 percent of audits closed as a default assessment and smallest in FY 2014, with 58.6 percent closed as a default assessment.[25] Audits closed with a taxpayer in agreement with the outcome also stayed relatively consistent over the five years. The highest number of cases closed with taxpayer agreement occurred in FY 2010 and FY 2013, with 14.7 percent of cases closed in agreement. The lowest measurement for cases closed in agreement occurred in FY 2011, when there were 13.3 percent of the cases closed in agreement.[26] Audits closed with a no change status (meaning that following a review of documentation submitted by the taxpayer, the IRS agreed with the taxpayer's return) peaked in FY 2014 with 12.9 percent and the lowest measurement occurred in FY 2011 with 9.5 percent of the audits closed with no change.[27]

Each fiscal year there is an additional percentage of the audits that are closed as undeliverable, meaning the taxpayers never had an opportunity to engage in the audit process because the audit notices could not be delivered to the taxpayer. For the five fiscal years, an average of 11 percent of the cases were closed as undeliverable.[28] Overall, these numbers indicate that the IRS may not be having sufficient communication with taxpayers to make full use of the audit process, which includes educating taxpayers.

Figure 1.23.2 shows the outcome of closed audits for FY 2013. While a majority (65.2 percent) are full paid, approximately one-quarter remain open with a balance due remaining. Of those listed as currently not collectible (CNC), 23.4 percent were CNC hardship.[29] CNC hardship is a status that is used when the IRS determines that collection of the liability would leave the taxpayer unable to pay their basic living expenses.[30] Taxpayers in this category will still have their refunds offset unless they can request their refund prior to offset. This means that taxpayers whom the IRS has determined are unable to pay their outstanding liabilities may still full pay the liability because of offsets. Liabilities are more likely to be

25 In 2010 there were 474,024 audits and 301,818 resulted in a default assessment. In 2014, there were 435,639 audits and 255,286 resulted in a default assessment. IRS CDW, Audit Information Management System Closed Case Database.

26 In 2010, there were 474,024 audits and 68,185 were closed with taxpayer agreement. In 2011, there were 483,820 audits and 64,275 were closed with the taxpayer in agreement. *Id*.

27 In 2014, there were 435,639 audits and 56,193 were closed with no change. In 2011, there were 483,820 audits and 45,780 closed with no change. IRS CDW, Audit Information Management System Closed Case Database. Appeals closed 212 non-docketed EITC cases in FY 2012. This number totaled 196 in FY 2013, 174 in 2014, and 148 in FY 2015. Appeals did not track this information during FY 2010 or FY 2011. IRS response to TAS information request (Dec. 9, 2015). The IRS noted in its fact check response dated Dec. 16, 2015 that it considers no change cases with adjustment and certain other closures as agreed cases. Accordingly the IRS computation of its agreed cases is some percentage points higher and its computation of its no change rate is correspondingly some percentage points lower. By the IRS classification of disposal codes, FY 2014 has the highest percent of cases agreed at 21.5 percent.

28 FY 2010 had an undeliverable measurement of approximately nine percent, FY 2011 had approximately 12 percent, FY 2012 had a measurement of approximately 13 percent, FY 2013 had a measurement of approximately 12 percent, and FY 2014 had a measurement of approximately ten percent.

29 Individual Master File (IMF) as of cycle 201530, AIMS data, cases closed in FY 2013.

30 Internal Revenue Manual (IRM) 5.16.1.2, *Currently Not Collectible Procedures* (Jan. 1, 2015).

paid by refund offset than by other subsequent payments. In FY 2013, the IRS received approximately $93 million in subsequent payments but approximately $333 million from refund offsets.[31]

FIGURE 1.23.2, Status of EITC Audited Accounts, FY 2013 Audit Closures[32]

Category	Count	Percent
Full Paid	314,720	65.2%
Balance Due Remaining	120,941	25.0%
Installment Agreement	18,543	3.8%
Currently Not Collectible	28,709	5.9%
Total	**482,913**	**100.0%**

Internal Guidance That Encourages Acceptance of Alternative Documentation to Substantiate EITC Claims Will Help Taxpayers Eligible for the Credit

One practice that could benefit low income taxpayers is the acceptance of alternative documentation. The IRS has guidance for analyzing documentation submitted by taxpayers in EITC cases. In particular, IRM 4.19.14.5.4 provides IRS employees with a chart for analyzing EITC cases involving qualifying children.[33] However, the list provided is very narrow and does not reflect the types of documentation and methods of proof that may most likely be available or best-suited for taxpayers claiming the EITC. The current internal guidance also lacks specific instruction for tax examiners to consider alternative documentation.[34] In 2013, the National Taxpayer Advocate issued internal guidance to TAS employees related to EITC issues.[35] This guidance included a list of 50 alternative documents that could be used to substantiate an EITC claim.[36] While not exhaustive, it created a more flexible approach to analyzing documents in EITC cases.[37] The IRS team dedicated to improving the EITC audit process, of which TAS is a member, will address the issue of incorporating alternative documentation into internal guidance in FY 2016.

In 2005, the IRS studied the use of affidavits as part of the EITC Qualifying Child Residency Certification Study.[38] For the study, the IRS mailed documents to taxpayers (the test group) who had claimed the EITC with qualifying children in the previous tax year (TY), but for whom the IRS could not establish qualifying child residency through available data. The documents sent to the taxpayer explained the certification requirements, Form 8836, *Qualifying Child Residency Statement*, an affidavit form, and educational publications.[39] To certify his or her claim, the taxpayers in the study could submit any combination of documents described in Form 8836 (medical and school records, a letter on official letterhead,

31 IMF as of cycle 201526.

32 IMF as of cycle 201530. We could not determine the current status of approximately 175 cases.

33 IRM 4.19.14.5.4, *EITC Qualifying Children* (Jan. 1, 2015). IRS employees who are directed to IRM 4.19.14.5.6 for a list of acceptable documents to prove qualifying child. *See id*.

34 TAS, *Memorandum for Taxpayer Advocate Service Employees, Reissuance of Interim Guidance on Advocating for Taxpayers Claiming Earned Income Tax Credit (EITC) with Respect to a Qualifying Child* (Dec. 23, 2013).

35 *Id*.

36 *Id*.

37 TAS uses the Taxpayer Assistance Order (TAO) process and provides alternative documentation while advocating for taxpayers whose EITC claims were denied by the IRS. In FY 2014, TAS issued 24 EITC TAOs, of which the IRS complied with 21. In FY 2015, 10 EITC TAOs were issued and the IRS complied with nine. Data obtained from the Taxpayer Advocate Management Information System (TAMIS) (Oct. 1, 2014; Oct. 1, 2015).

38 IRS, *IRS Earned Income Tax Credit (EITC) Initiative Final Report to Congress* 7 (Oct. 2005).

39 *Id*.

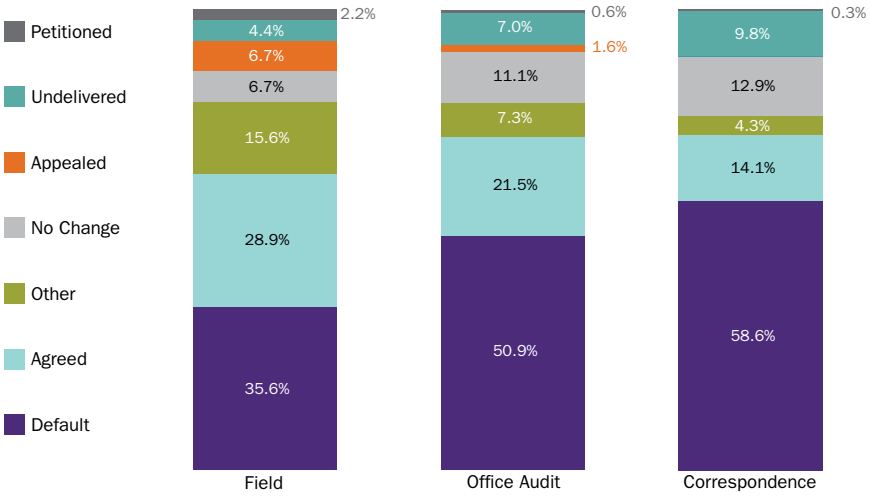
etc.) or the affidavit. The study found that affidavits had the highest rate of acceptance at 82 percent, compared to an overall acceptance rate of 64 percent for all document types.[40] The study concluded that this outcome was reasonable because affidavits had dedicated lines for all of the information, explaining "as long as the affidavit was filled out completely, it would contain all the required information to be accepted."[41]

The EITC Audit Program Has a No-Response Rate of Over 40 Percent, Raising Questions About the Accuracy of Some Default Assessments and of the Audit's Effectiveness As an Educational Tool for Future Compliance

The EITC audit process has a fairly large non-response rate of over 40 percent.[42] Audits are not just about correcting a specific year's tax liability. Every audit provides an opportunity for the IRS to educate the taxpayer about errors on the return, so he or she becomes and remains compliant going forward. If the education is effective, taxpayers not only understand whether they are eligible to claim EITC in the audit year, but they can also remain compliant or avoid future noncompliance as their circumstances change.[43] By meeting the needs of low income taxpayers during the audit process, the IRS may improve the response rate and thus increase future compliance by educating more taxpayers.

FIGURE 1.23.3[44]

FY 2014 EITC Audit Dispositions by Type of IRS Examiner



40 IRS, *IRS Earned Income Tax Credit (EITC) Initiative Final Report to Congress* 33 (Oct. 2005).

41 *Id.*

42 For FY 2014, the exact no response rate is 45.6 percent. This calculation includes 255,286 default assessments minus 99,067 default assessments that involved some taxpayer contact, bringing the total of default assessments with no taxpayer contact to 156,219. In addition, 42,490 cases involving undeliverable mail were then added, for a total of 198,709 cases with either a default assessment and no contact or undeliverable notices. That number divided by the total of 435,639 equals 45.6 percent and represents the portion of taxpayers who did not respond to the EITC audit. Audit Information Management System (AIMS) Closed Case Database.

43 National Taxpayer Advocate 2013 Annual Report to Congress 110.

44 AIMS Closed Case Database. Percentages may not total to 100 percent due to rounding. The examiner type is based on the AIMS employee code. It should be noted that field audits and office audits account for less than 400 of the EITC audits closed in FY 2014. We cannot determine if the selection of EITC cases for audit by different types of employees affects the disposition of the audit.

The audit outcome for a taxpayer appears to improve depending on the audit method and which type of IRS examiner handles the audit. Field audits, in which a revenue agent is assigned to the taxpayer's case, have the lowest default and undeliverable numbers. Field audits had a default closing in 35.6 percent of the cases and the audit was closed as undeliverable in 4.4 percent of the cases.[45] When compared to the average undeliverable rate for all audits above, field audits that result in an undeliverable status are approximately half as frequent. Cases worked in correspondence, which do not have an assigned employee, had a default rate of 58.6 percent and an undeliverable measurement of 9.8 percent.[46] These numbers may indicate that audit outcomes are improved when an assigned employee is working the case and it is not only based on a correspondence examination.[47]

Audits are not just about correcting a specific year's tax liability. Every audit provides an opportunity for the IRS to educate the taxpayer about errors on the return, so he or she becomes and remains compliant going forward.

The correspondence examination process is based on an exchange of documentation and not personal interaction. Under this system, even if the IRS does receive correspondence from the taxpayer, there will be missed educational opportunities. For example, if the taxpayer receives a request for substantiating documentation and does not understand the notice, he or she may send in incomplete or irrelevant documentation. Without an employee to speak with, the taxpayer will not learn what specifically is at issue and what specific documentation is needed. Thus, an otherwise legitimate claim may be denied or reduced in amount simply because the taxpayer needed an explanation of what is at issue and what is required, in terms he or she can understand.

The IRS National Research Program (NRP) recently conducted EITC audits in order to gather information about the nature of errors taxpayers made when claiming the EITC in TYs 2006 through 2008.[48] Focused taxpayer education is one component of the NRP audit that is not present in a correspondence exam.[49] NRP audits are worked by examiners "trained to make every accommodation to meet with taxpayers, to educate them about the necessary documentation for substantiating EITC eligibility, and to give them sufficient opportunity to obtain and supply the necessary information."[50] Nearly 95 percent of the NRP audits require a face-to-face meeting with an IRS examiner.[51] On the other hand, in the correspondence examination process, education of the taxpayer is not a focus.[52] As part of a study on enhanced taxpayer communication in 2013, TAS called taxpayers who had been assessed an

45 AIMS Closed Case Database through August 2015. It should be noted that field audits and office audits account for less than 400 of the EITC audits closed in FY 2014. We cannot determine if the selection of EITC cases for audit by different types of employees affects the disposition of the audit.

46 AIMS Closed Case Database through August 2015.

47 It should be noted that field audits and office audits account for less than 400 of the EITC audits closed in FY 2014. We cannot determine if the selection of EITC cases for audit by different types of employees affects the disposition of the audit.

48 IRS, Research, Analysis & Statistics (RAS), *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* (Aug. 2014). The NRP "seeks to increase public confidence in the fairness of our tax system by helping the IRS identify where compliance problems occur, so that the IRS can efficiently utilize its resources to address those problems." IRM 4.22.1.3(1) (Apr. 25, 2008).

49 For a general discussion of how the lack of an assigned employee in correspondence exam harms taxpayers, see National Taxpayer Advocate 2014 Annual Report to Congress 134-44.

50 IRS, RAS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 8 (Aug. 2014).

51 *Id*. at 5.

52 Since correspondence exam does not assign cases to one employee, the focus in correspondence exam is to have taxpayer contact go to the next available employee instead of the employee working the case. This creates a system where the IRS employee answering the taxpayer's question may not be familiar with the taxpayer's issue or documentation. National Taxpayer Advocate 2014 Annual Report to Congress 139-40.

EITC liability in a correspondence examination and found that less than one-quarter learned that they were ineligible during the audit compared to almost one half after contacting TAS.[53]

If the IRS wants to reach the correct conclusion in *all* of its EITC audits and simultaneously promote future voluntary compliance, it should tailor its correspondence exam process to include interaction with the taxpayer and taxpayer education. Such an approach will increase EITC compliance and instill a sense of procedural justice into the audit process. One way the IRS can accomplish this is by assigning EITC correspondence exam cases to a single employee when the taxpayer responds with some information. That way, the employee can be charged with the same responsibility for educating the taxpayer as NRP auditors are.[54] This approach may reduce the number of EITC audits (which are already a disproportionately high percentage of all individual audits), however, the effectiveness of the audit in terms of ongoing compliance may even increase the indirect effectiveness of the audit.[55] Another approach involves the use of virtual face-to-face audits, whereby the taxpayer can make an appointment and meet with the auditor virtually. This technique captures the cost savings of a centralized audit group and the benefits of face-to-face communication, which enables the auditor to establish trust with the taxpayer and to identify when the taxpayer does not understand directions or is otherwise confused.

The IRS May Not Be Auditing the Group of EITC Returns Having the Most Non-Compliance, Thereby Diminishing the Effectiveness of IRS Efforts to Improve Future Compliance and Creating a Burden for Taxpayers

TAS analysis reveals the following issues with the way in which the IRS selects EITC cases for audit:

- The IRS relies on the Dependent Database (DDb) and does not build a workload selection model based on NRP data;
- Most NRP audits did not trip DDb rules, meaning the existing DDb rules may not be capable of capturing a complete sample of cases to audit; and
- The IRS is currently focusing on cases where the DDb rules for both residency and relationship are broken, and generally focusing only on the relationship component in these audits because it is the easiest basis for denial. Because residency is the eligibility requirement associated with three-quarters of the qualifying child errors, the IRS should consider more cases where the DDb rule for residency is the only rule broken, and also educate the taxpayer about the residency requirements when both rules are broken.

The IRS Relies on the DDb and Does Not Build a Workload Selection Model Based on NRP Data

Data from the NRP show how attributes of the EITC population and the complex eligibility rules impact compliance.[56] The NRP Individual Income Tax study is based on a multi-year random sample of federal individual income tax returns. As noted earlier, the NRP audit approach is better suited than the cor-

53 Unpublished results from *Enhanced Communication Study*, results on file with the National Taxpayer Advocate.

54 See National Taxpayer Advocate 2014 Annual Report to Congress 134-144 (Most Serious Problem: *Correspondence Examination: The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*).

55 IRS FY 2014 Data Book Table 9a. The audit coverage rate for all individual returns is about 0.9 percent, while the coverage rate is about 1.6 percent for EITC returns. *See also supra* note 9 regarding the number of EITC audits.

56 IRS, RAS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* (Aug. 2014). Unlike the IRS's typical EITC audits, NRP EITC audits have a response rate of about 85 percent when a qualifying child is involved. The response rate for operational EITC audits is under 60 percent. For more information on this topic, see National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 123-28.

respondence audit to accurately determine the audit results of the low income population by generally providing for in-person (instead of correspondence) audits. NRP data should be driving how the IRS selects EITC cases for audit, since it provides information about the sources of EITC noncompliance. Currently, however, Examination receives most of its EITC cases from the DDb.[57] In this program, returns are scored by comparing the return information against various business rules established by the IRS, with the highest-scoring returns selected for audits.

Most NRP Audits Do Not Trip DDb Rules

TAS analyzed NRP audits that broke DDb rules and found that in TY 2008, approximately 86 percent of the NRP cases with adjustments *did not* trip a DDb rule.[58] As mentioned above, the quality of the NRP data is quite high. The IRS should use this information to reevaluate its method of selecting cases for audit and improve on its ability to identify areas of noncompliance. The following figure shows the results from 2006 through 2008 NRP audits.

FIGURE 1.23.4[59]

NRP Audits Disallowing Some EITC That Broke DDb Rules

57 IRM 4.19.14.1(2) (Jan. 1, 2015).

58 The DDb data comes from a Business Object interface with the DDb. The NRP and closed audit information comes from the database of NRP data stored on the IRS CDW and from the AIMS also on the IRS CDW. The NRP data is a weighted sample. TAS used a weighting scheme which did not generally assign a weight to no response cases and cases selected for audit based on the DDb score. If the weights are recomputed to include these cases, about 80 percent of the returns where EITC was disallowed did not trip DDb rules. This percentage has also dropped in subsequent years, but is still about 70 percent. IRS fact check response (Dec. 16, 2015).

59 *Id*.

In other words, the IRS is concentrating its Earned Income Tax Credit (EITC) audit resources on taxpayers with a noncompliance issue that is relatively minor, compared to an issue associated with 75 percent of all EITC qualifying child errors. If the point of an audit is not just to score audit adjustments and create good statistics, but rather to educate taxpayers so they understand the rules and voluntarily comply in the future, then IRS EITC audit strategy is ineffective.

The IRS Should Consider More Cases Where the DDb Rule for Residency Is the Only Rule Broken

NRP data shows that approximately 75 percent of children claimed in error failed the residency test and only about 20 percent failed the relationship test.[60] TAS further analyzed DDb audits for TY 2012, and preliminary data show that approximately 70 percent of the returns selected for audit failed both the residency and relationship DDb audit rules. However, EITC returns with qualifying children that DDb indicates as not meeting the residency and relationship rules only comprise 23 percent of all returns that broke an EITC DDb rule.[61] TAS also found that only 11 percent of the audited returns broke the DDb rules for residency but not relationship for all children claimed, even though these returns represent about 31 percent of the returns that failed or partially failed a DDb test.[62] The data suggest that the IRS should focus some of its audit efforts on returns that have qualifying children with only residency issues, instead of primarily focusing on returns with qualifying children having both relationship and residency issues. In other words, the IRS is concentrating its EITC audit resources on taxpayers with a noncompliance issue that is relatively minor, compared to an issue associated with 75 percent of all EITC qualifying child errors. If the point of an audit is not just to score audit adjustments and create good statistics, but rather to educate taxpayers so they understand the rules and voluntarily comply in the future, then the IRS EITC audit strategy is ineffective.

Analysis of DDb Data Shows It Is Not Detecting Most Noncompliant Taxpayers

TAS also compared NRP data to DDb data. Preliminary results suggest that based on residency and relationship, most noncompliant taxpayers were not detected by the DDb. The NRP EITC study indicates that qualifying child errors are the most expensive, and account for at least 42 percent of the overclaims.[63] The NRP study involved a random sample of returns weighted to reflect the taxpayer population.[64] On the other hand, the IRS EITC audit population includes EITC returns that tripped the DDb rules. Of all returns in the NRP EITC study (which includes data from TYs 2006 through 2008) with at least one child failing EITC eligibility for residency, only approximately 25 percent also failed a DDb residency rule (for at least one child). Likewise, of all the returns in the NRP EITC study with at least one child failing EITC eligibility for relationship, only 28 percent also failed a DDb relationship rule.

60 IRS, RAS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 22-23 (Aug. 2014).

61 The DDb data comes from a Business Object interface with the DDb. The NRP and closed audit information comes from the database of NRP data stored on the IRS CDW and from the AIMS also on the IRS CDW. In order for a taxpayer to claim a child with the EITC, that child must be a "qualifying child" as defined by IRC § 152(c). Two aspects of qualifying child include relationship and residency. To be related, the child must be the child of the taxpayer or a descendent of such a child or a brother, sister, stepbrother, stepsister of the taxpayer or a descendent of any such relative. IRC § 152(c)(2). This includes relationships by marriage and by law, such as adoptions. The residency test generally requires that the child live with the taxpayer for more than half of the tax year. IRC § 152(c)(1)(B). The DDb also selects returns for audit because the taxpayer is required to recertify EITC eligibility because of prior non-compliance with EITC eligibility rules.

62 The DDb data comes from a Business Object interface with the DDb. The NRP and closed audit information comes from the database of NRP data stored on the IRS CDW and from the AIMS also on the IRS CDW.

63 IRS, RAS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* iv (Aug. 2014).

64 *Id*. at 5.

According to this NRP analysis, most returns failing EITC residency and relationship requirements are not being detected by the DDb rules. As noted above, the NRP study indicates that qualifying child errors are the most expensive EITC errors. NRP data also show that nearly three-quarters of the qualifying child errors stem from failing the residency requirements, while less than 25 percent result from relationship requirements.[65] However, the IRS does not have significant audit coverage of those who only fail EITC residency rules. By not selecting the most appropriate cases for audit, the IRS is missing many opportunities that could truly impact compliance, overlooks educational opportunities, and continues to allow erroneous claims to be filed.

CONCLUSION

A poorly designed EITC audit program results in lost opportunities to educate taxpayers and thus improve voluntary compliance, thereby reducing the improper payment rate. Under the present correspondence exam program, taxpayers whose EITC is correctly disallowed in one year do not learn about EITC eligibility rules and, as a result, may not claim the EITC in a future year in which they are eligible. Given that many low income taxpayers are not equipped to deal with the complexity of the EITC, the IRS should redesign its audit strategy to take into consideration how best to reach these taxpayers, how they respond to various types of outreach and education, how they prefer to receive service from the IRS, and how well they can comply with the EITC requirements and instructions.[66] The approach should foster engagement, valuing education and future compliance over assessed dollars.

The IRS should also consider how it selects EITC cases for audit so that the cases with the largest impact are being reviewed. Examination receives most of its EITC cases from the DDb. However, TAS research indicates that this approach alone may not identify the most appropriate cases for audit, which impacts EITC noncompliance.

65 IRS, RAS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* v (Aug. 2014); *supra* note 60.

66 See National Taxpayer Advocate 2009 Annual Report to Congress 117.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Conduct an EITC pilot with three different treatments: a regular correspondence examination, an office audit, and a correspondence examination with one auditor assigned. The pilot should measure the following: direct time on case, no response/drop-out rate, agreed to rate, audit reconsideration rate, and future compliance rate.
2. When an EITC taxpayer calls the IRS with information in response to an audit, one employee should be assigned to the taxpayer's case until it is resolved. If the taxpayer calls back, he or she could have the option to speak to the next available employee or wait for the assigned employee to call back. The IRS should hire employees with a social work background or train existing auditors to conduct the audits.
3. Use NRP data to design a formula for workload selection in addition to (or incorporated into) the DDb that will reach the audits with the most impact for taxpayer education and improvement to future compliance. This would include qualifying child errors that involve the residency test.
4. Revise the IRM with the list of additional documentation listed in the TAS IGM, as well as IRM updates about accepting alternative EITC substantiating documentation.
5. Publish and accept Form 8836, *Third Party Affidavit*, for purposes of substantiating the residency requirement for a qualifying child.
6. Collaborate with TAS to draft IRM guidance requiring correspondence examiners to adjust accounts for the childless worker credit when the taxpayer is ineligible for the EITC with children. This should be done automatically without requiring the taxpayer to request the credit.

MSP #24 EARNED INCOME TAX CREDIT (EITC): The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance

RESPONSIBLE OFFICIALS

Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED[1]

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

DEFINITION OF PROBLEM

The Earned Income Tax Credit (EITC) is one of the primary forms of public assistance for low income working taxpayers. To receive the benefits, the taxpayer must have earned income and file a tax return.[2] The determination of EITC eligibility is very complex and is difficult to navigate by taxpayers who are more likely to have lower literacy rates, to speak English as a second language, and to have a nontraditional family structure (where the child is not the biological child of the taxpayer claiming the credit). Fifty-five percent of returns claiming EITC were prepared by paid return preparers in tax year (TY) 2013.[3] Equally important, one IRS study showed unenrolled return preparers had the highest frequency and percentage of EITC overclaims, with 49 percent of those EITC returns containing an overclaim, and overclaims amounting to 33 percent of the total EITC claimed on those returns.[4]

Despite the involvement of so many paid preparers, the EITC suffers from a high noncompliance rate.[5] The problem of noncompliant return preparers contributing to the EITC error rate is well documented.

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

2 The design of the EITC contains a phase-in, plateau, and phase-out state. Generally as the amount of income increases, the amount of EITC increases. At a certain point the EITC amount plateaus in relation to the amount of income (the taxpayer's income can increase while he or she receives the maximum amount of EITC) and then phases out as the EITC decreases with a decrease in income. In tax year (TY) 2014, taxpayers filing a joint return with three or more kids were ineligible for the EITC with earnings of $53,269. Rev. Proc. 2014-61, 2014-47 I.R.B. 860.

3 *The National Taxpayer Advocate's 2014 Annual Report to Congress: Hearing Before the Subcomm. on Government Operations of the H. Comm. on Oversight and Reform*, 114th Cong. 28, *Figure 4: Taxpayers Claiming Refundable Credits, Claim Amounts, and Preparer Usage, Tax Years 2010-2013* (2015) (written statement of Nina E. Olson, National Taxpayer Advocate).

4 IRS, Research, Analysis & Statistics, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 26 (Aug. 2014). These numbers represent the lower bound estimates. This measure is likely to be low because it does not account for preparers who do not sign the returns they prepare. *The National Taxpayer Advocate's 2014 Annual Report to Congress: Hearing Before the Subcomm. on Government Operations of the H. Comm. on Oversight and Reform*, 114th Cong. 28 (2015) (written statement of Nina E. Olson, National Taxpayer Advocate).

5 The current improper payment rate of 27 percent has increased slightly from the improper payment rate in 2004, which measured 25 percent. Treasury Inspector General of Tax Administration (TIGTA), Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014* 9 (Apr. 27, 2015).

In 2014, the Government Accountability Office (GAO) conducted 19 undercover visits to randomly selected tax preparer offices. Only two of the 19 tax returns showed the correct refund amount.[6]

Since 2002, the National Taxpayer Advocate has highlighted the need to protect taxpayers from non-compliant return preparers.[7] Based on a review of the IRS's existing EITC Return Preparer Strategy, the National Taxpayer Advocate has identified several concerns:

- Preparers who do not sign the returns and preparers who are the subject of complaints to the IRS Return Preparer Office (RPO) are not incorporated into the EITC Return Preparer Strategy;
- The public does not have access to the IRS's measures for evaluating the effectiveness of the strategy; and
- The EITC Return Preparer Strategy does not sufficiently focus on the unenrolled preparer population which, combined with a comprehensive public education campaign, is critical to improving EITC noncompliance.

Moreover, the EITC Return Preparer Strategy group does not partner with TAS, despite our extensive research into the role of return preparers in facilitating compliance, and our role as overseer of Low Income Taxpayer Clinics (LITC), which have keen insights and evidence of return preparer conduct with respect to EITC.

ANALYSIS OF PROBLEM

Background

The EITC and Refundable Credits Policy and Coordination (ERCPC) unit is charged with "developing and coordinating delivery of the EITC Return Preparer Strategy" within the Wage and Investment (W&I) Division.[8] ERCPC lists many key IRS partners and stakeholders, including W&I Chief Counsel, Criminal Investigation Refund Crimes, W&I Campus Compliance, W&I Research & Analysis (WIRA), the RPO, and TAS.[9] However, the IRS has not involved TAS in the development or implementation of the EITC Return Preparer Strategy.

6 GAO, *Paid Tax Preparers: In a Limited Study, Preparers Made Significant Errors* 9 (Apr. 8, 2014). The National Consumer Law Center also conducted similar "mystery shopper" testing in 2010 and found "incompetence and fraud" in about 30 percent of the tests. *Protecting Taxpayers From Incompetent and Unethical Return Preparers, Hearing Before the S. Comm. on Fin.*, 113th Cong. 39 (2014) (statement of Chi Chi Wu, staff attorney, National Consumer Law Center).

7 National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 71-78; National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remains Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing Its Efforts to Effectively Regulate Unenrolled Preparers*); National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2008 Annual Report to Congress 504-12 (Most Litigated Issue: *Accuracy-Related Penalty Under Internal Revenue Code Sections 6662(b)(1) and (2)*); National Taxpayer Advocate 2006 Annual Report to Congress 197-221 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2005 Annual Report to Congress 223-37 (Most Serious Problem: *Regulation of Electronic Return Originators*); National Taxpayer Advocate 2004 Annual Report to Congress 67-88 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216-30 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers); Protecting Taxpayers From Incompetent and Unethical Return Preparers, Hearing Before the S. Comm. on Fin.*, 113th Cong. 7 (2014) (statement of Nina E. Olson, National Taxpayer Advocate); *Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 109th Cong. (2005) (statement of Nina E. Olson, National Taxpayer Advocate).

8 Internal Revenue Manual (IRM) 1.1.13.6.4.2(3) (Oct. 7, 2013).

9 IRS response to TAS information request (June 24, 2015). Though TAS is listed on the response as a stakeholder, it has not been included in any meetings since inception of the EITC Return Preparer Strategy.

Prior to fiscal year (FY) 2012, the EITC Return Preparer Strategy primarily focused on treating preparers through methods described below after the filing season. Beginning in 2011, the IRS implemented a "real time" preparer intervention program. Instead of waiting until the end of the filing season to identify and treat preparers, preparers are also scored on a daily basis and treatments are administered in real time.[10] Once prior year compliance activities conclude and the analysis is complete, the Refundable Credits Administration (RCA) office, WIRA, and Office of Compliance Analytics (OCA) meet to score and select preparers for the next fiscal year's pre-filing season treatments.[11] Once the filing season starts, filing season treatments begin and preparers whose scores meet the threshold and who have a given volume of EITC returns prepared are selected daily for the filing season treatments.[12] The scoring is based on four criteria that relate to breaking a Dependent Database (DDb) rule related to the amount of the EITC relative to the number of qualifying children or a DDb rule related to disabled qualifying children.[13]

The EITC Return Preparer Strategy Office says that it is "always striving for improvement in all areas of the program" by implementing prior year lessons and testing new ideas.[14] The EITC Return Preparer Strategy uses a "test and learn" approach that involves experimenting with different combinations of new and traditional compliance tools that are reviewed on an annual basis.[15] For instance, in its FY 2015 annual report, the Strategy described an iterative "pre-filing season treatment delivery process" that increased the contact rate from approximately 70 percent to nearly 95 percent.[16]

The EITC Return Preparer Strategy uses various tools at its disposal for preparers of questionable EITC claims, referred to as "treatments."[17] Preparers are identified in the pre-filing season and, if there are no signs of improvement, then more intensive treatment continues into the filing season.[18] Treatments include:

- *Reaching out to preparers via letter and phone contact* – letters are sent both during the pre-filing season and filing season as a warning and to educate preparers;
- *"Knock and talk" visits* – educational visits conducted by an SB/SE agent and a special agent from Criminal Investigation (CI);
- *Visits and audits for preparer due diligence* – audits of high risk preparers conducted by SB/SE employees to ascertain compliance with due diligence requirements under Internal Revenue Code (IRC) § 6695(g);[19] and

10 IRS response to TAS information request (June 24, 2015).

11 IRS response to TAS information request (Oct. 21, 2015). These meetings occur in mid-summer and the pre-filing season activities generally start on October 1. *Id*.

12 *Id*.

13 IRS response to TAS information request (June 24, 2015). The DDb addresses non-compliance relevant to the EITC and other tax benefits related to the dependency and residency of children. The IRS claims the DDb consistently applies the tax laws to a return claiming EITC as well as other tax issues, such as dependent exemptions, filing status, Child and Dependent Care Credit, Child Tax Credit, and education benefits, are addressed concurrently. IRM 4.19.27.2.3, *Dependent Database (DDb)* (Mar. 19, 2015). However, it is possible that a return could break a DDb rule but the taxpayer could still be eligible for the EITC. *See The Public Does Not Have Access to the IRS's Measures for Evaluating the Effectiveness of the EITC Return Preparer Strategy*, *infra*.

14 IRS response to TAS information request (June 24, 2015).

15 *Id*.

16 WIRA, *Fiscal Year 2015 EITC Return Preparer Analysis Summary* 2 (June 15, 2015).

17 IRS, Refundable Credits Administration Return Integrity and Compliance Services, *Overview of EITC Return Preparer Program* 3 (May 7, 2015).

18 *Id*.

19 IRS response to TAS information request (June 24, 2015).

- *Injunctions against paid preparers* – the Department of Justice (DOJ) may seek an injunction against a preparer, which prevents that individual from "engaging in specified misconduct or from preparing tax returns for others."[20]

For the purpose of the EITC Return Preparer Strategy, an EITC preparer is a return preparer who files 25 or more EITC returns.[21] All preparers who meet this definition are scored. Based on this score, the preparer may receive a compliance treatment.[22] Allocation of resources and geographical limitations are also considered when determining treatments.[23]

Reaching Out to Paid Tax Preparers by Letter

Figure 1.24.1 shows the types and number of letters sent to preparers for FYs 2013 through 2015.

FIGURE 1.24.1, Pre-Filing and Filing Season Education and Compliance Letters for FYs 2013–2015[24]

Letter Number	Type	FY 2013	FY 2014	FY 2015
Pre-Filing				
4833	Compliance	10,673	10,892	7,261
4833-A	Educational	n/a	n/a	8,473
5138	Compliance	n/a	n/a	1,734
5025-C	Educational	985	2,856	479
5025-D	Educational	n/a	1,351	572
5025 (no alpha)	Educational	966	994	644
5025-Q	Educational	953	522	2,182
Filing				
4858	Compliance	1,866	2,272	3,796
5138	Compliance	736	867	1,015
5364/Alert	Missing Form 8867 Letter & e-File Alert	6,667	6,526	15,935
Total Number Sent		**22,846**	**26,280**	**42,091**

Pre-filing season letters are sent to preparers who prepared questionable EITC returns during the previous year. Filing season letters are sent to preparers whose due diligence compliance does not improve while the filing season is underway.[25] Preparers who do not receive their pre-filing season letter because it was

20 See Dep't of Justice, *Program to Shut Down Schemes and Scams*, *available at* http://www.justice.gov/tax/injunctions.htm. The DOJ can also pursue criminal prosecution. Since this is not an area worked by the EITC Preparer Strategy, it will not be covered in this discussion.

21 This amount is through cycle 26 of the current tax year. An EITC return is defined as a tax return "with at least one dollar claimed and/or received in EITC based on at least one qualifying child for a tax year." IRS response to TAS information request (June 24, 2015).

22 IRS response to TAS information request (June 24, 2015).

23 *Id*. By limiting compliance treatments only to preparers who prepare 25 or more returns, the pool of preparers who do not sign returns will not receive a compliance treatment, an issue discussed in more detail below.

24 IRS response to TAS information requests (June 24, 2015 and Oct. 26, 2015).

25 IRS response to TAS information request (June 24, 2015).

undeliverable, will receive a follow up phone call.[26] Undelivered letters do pose a problem for an effective treatment. In FY 2012, the non-delivery rate for Letter 4833 was 24 percent and the rate rose to 36 percent in FY 2014.[27] The Strategy has attempted to resolve this by recommending such things as the use of an internal database to reduce outdated addresses and sending uncertified letters.[28]

When developing educational and compliance letters, the IRS should look to the concept of "responsive regulation," which is explained by Australian researcher Valerie Braithwaite to mean that regulators, such as the IRS, should be "responsive to the conduct of those they seek to regulate in deciding whether a more or less interventionist response is required."

Currently, the EITC Return Preparer Strategy intends to use educational letters to inform less egregious preparers of due diligence requirements and possible consequences of filing inaccurate EITC returns.[29] Compliance letters are intended to emphasize the penalty and consequences that may result from returns with EITC errors.[30] There are opportunities to make these letters more effective, as described in more detail below.

When developing educational and compliance letters, the IRS should look to the concept of "responsive regulation," which is explained by Australian researcher Valerie Braithwaite to mean that regulators, such as the IRS, should be "responsive to the conduct of those they seek to regulate in deciding whether a more or less interventionist response is required."[31] Braithwaite uses a "regulatory pyramid" that includes the least intrusive actions at the bottom and most intrusive at the top.[32] The idea is that taxpayers generally will comply at the least intrusive step but if not, more intrusive actions can be taken. Applying this theory to the Strategy's current letters demonstrates some deficiencies.

For instance, Letter 4858, *Return Preparer Filing Season - 2015*, a compliance letter, informs preparers that a review of current year returns filed by the preparer "indicates you may have prepared inaccurate returns for your clients," but does not provide information on the exact nature of the errors being made by the preparer, thus limiting its effectiveness in getting preparers to avoid these errors in the future.[33] There is no reason why "compliance" letters should not be educational. In fact, to get preparers to modify their behavior, the letter should inform the preparer of the errors they are making.

The 5025 series of letters informs the preparer of the reason for noncompliance in a very general manner. If the primary issue identified is questionable income and expenses on Schedule C, *Profit or Loss from Business*, the preparer may receive Letter 5025-C, *You May Have Prepared Inaccurate EITC Returns with Self-Employment Income*. When the primary issue identified involves claiming children who are permanently or totally disabled, the preparer may receive Letter 5025-D, *You May Have Violated Tax Law By Preparing Inaccurate EITC Returns*. If the primary issue is claiming qualifying children, the preparer may receive Letter 5025-Q, *You May Have Prepared Inaccurate EITC Returns Based on Questionable Qualifying*

26 IRS, Refundable Credits Administration Return Integrity and Compliance Services, *Overview of EITC Return Preparer Program* 3 (May 7, 2015).

27 WIRA, *Fiscal Year 2014 EITC Return Preparer Analysis Summary* 29 (June 20, 2014). The primary reasons for being undeliverable include the letter being unclaimed and the address being outdated. *Id.*

28 *Id.* at 30.

29 IRS response to TAS information request (Nov. 5, 2015).

30 *Id.*

31 Valerie Braithwaite, *Responsive Regulation and Taxation: Introduction*, 29 Law & Pol'y 3, 4 (Jan. 2007).

32 *Id.*

33 IRS, Letter 4858, *Return Preparer Filing Season – 2015* (Nov. 2015).

The lack of distinction between educational and compliance letters indicates the IRS does not have a comprehensive strategy with respect to letters. In most instances the IRS has not designed the letters to make clear what behavior the preparer should change going forward. It also has not designed the letters so that successive letters make clear to the preparer that the stakes for noncompliance are being raised.

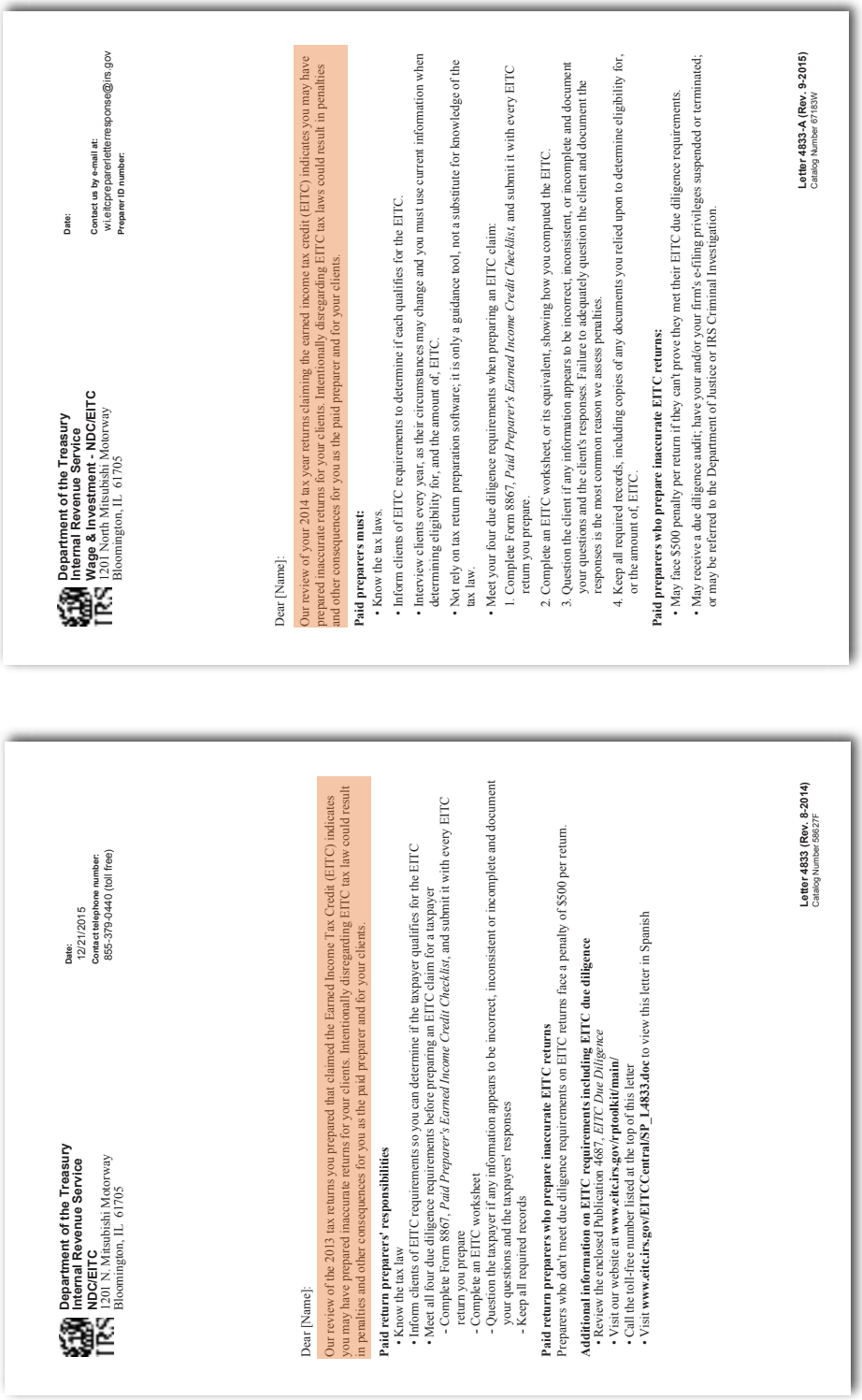
Children. However, the preparer will not learn what particular error he or she is making.

There also appears to be little difference between compliance and educational letters. Without a clear distinction between education and compliance, preparers may not realize they are receiving a communication meant to ramp up their regulation (and consequences). For instance, Letter 4833 was the "compliance" letter most frequently mailed during the pre-filing season in FY 2015. The language in Letter 4833 is similar in many aspects to Letter 4833-A, which was the primary "educational" letter sent during the filing season in FY 2015. The opening section of both letters informs the preparer that the IRS has reviewed returns they prepared and the review "indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax laws could result in penalties and other consequences for you as the paid preparer and for your clients." Letter 4833-A, the educational letter, contains additional information to explain to the preparer that if inaccurate returns continue to be prepared, the preparer may face a penalty or an audit and his or her clients could face repercussions.

Figures 1.24.2 and 1.24.3 compare the language in Letters 4833 and 4833-A.

FIGURE 1.24.2[34]

IRS Letter 4833, *EITC Return Preparer Pre-Filing Season Alert*, page 1 and Letter 4833-A, *EITC Tax Return Preparer Alert*, page 1



Department of the Treasury
Internal Revenue Service
NDC/EITC
1201 N. Mitsubishi Motorway
Bloomington, IL 61705

Date: 12/21/2015
Contact telephone number: 855-379-0440 (toll free)

Dear [Name]:

Our review of the 2013 tax returns you prepared that claimed the Earned Income Tax Credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you as the paid preparer and for your clients.

Paid return preparers' responsibilities
- Know the tax law
- Inform clients of EITC requirements so you can determine if the taxpayer qualifies for the EITC
- Meet all four due diligence requirements before preparing an EITC claim for a taxpayer
  - Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist*, and submit it with every EITC return you prepare
  - Complete an EITC worksheet
  - Question the taxpayer if any information appears to be incorrect, inconsistent or incomplete and document your questions and the taxpayers' responses
  - Keep all required records

Paid return preparers who prepare inaccurate EITC returns
Preparers who don't meet due diligence requirements on EITC returns face a penalty of $500 per return.

Additional information on EITC requirements including EITC due diligence
- Review the enclosed Publication 4687, *EITC Due Diligence*
- Visit our website at **www.eitc.irs.gov/rptoolkit/main/**
- Call the toll-free number listed at the top of this letter
- Visit **www.eitc.irs.gov/EITCCentral/SP_1.4833.doc** to view this letter in Spanish

Letter 4833 (Rev. 8-2014)
Catalog Number 58627F

Department of the Treasury
Internal Revenue Service
Wage & Investment - NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:

Contact us by e-mail at:
w.i.eitcpreparerletterresponse@irs.gov
Preparer ID number:

Dear [Name]:

Our review of your 2014 tax year returns claiming the earned income tax credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax laws could result in penalties and other consequences for you as the paid preparer and for your clients.

Paid preparers must:
- Know the tax laws.
- Inform clients of EITC requirements to determine if each qualifies for the EITC.
- Interview clients every year, as their circumstances may change and you must use current information when determining eligibility for, and the amount of, EITC.
- Not rely on tax return preparation software; it is only a guidance tool, not a substitute for knowledge of the tax law.
- Meet your four due diligence requirements when preparing an EITC claim:
  1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist*, and submit it with every EITC return you prepare.
  2. Complete an EITC worksheet, or its equivalent, showing how you computed the EITC.
  3. Question the client if any information appears to be incorrect, inconsistent, or incomplete and document your questions and the client's responses. Failure to adequately question the client and document the responses is the most common reason we assess penalties.
  4. Keep all required records, including copies of any documents you relied upon to determine eligibility for, or the amount of, EITC.

Paid preparers who prepare inaccurate EITC returns:
- May face $500 penalty per return if they can't prove they met their EITC due diligence requirements.
- May receive a due diligence audit; have your and/or your firm's e-filing privileges suspended or terminated; or may be referred to the Department of Justice or IRS Criminal Investigation.

Letter 4833-A (Rev. 9-2015)
Catalog Number 67183W

34 IRS, Letter 4833, *EITC Return Preparer Pre-Filing Season Alert* (Aug. 2014); IRS, Letter 4833-A, *EITC Tax Return Preparer Alert* (Sept. 2015).

FIGURE 1.24.3[35]

IRS Letter 4833, *EITC Return Preparer Pre-Filing Season Alert*, page 2 and Letter 4833-A, *EITC Tax Return Preparer Alert*, page 2

We will continue to monitor the EITC returns you prepare. If the accuracy of these EITC returns does not improve, you may be subject to special follow-up procedures, including the possibility of an on-site audit.

Thank you for your cooperation.

Sincerely,

Michael C. Beebe
Deputy Director
Return Integrity & Compliance Services

Enclosures:
Publication 4687

Letter 4833 (Rev. 8-2014)
Catalog Number 58627F

Your clients:

- May be audited after we issue their refunds. If we determine your clients don't qualify for the EITC, they must repay the overpayments, plus interest.
- May be unable to claim the EITC for 2 years if the claim was due to reckless or intentional disregard of the EITC rules, or 10 years if the claim was due to fraud.

For additional information:

- Review Publication 4687, *EITC Due Diligence Brochure*, at www.irs.gov/formspubs.
- Visit our website at www.eitc.irs.gov and click on "Tax Preparer Toolkit."
- Visite www.eitc.irs.gov e ingrese las palabras claves "Letter 4833-A(SP)" para leer esta carta en español.

We will continue to monitor future EITC returns you prepare to ensure you're meeting your EITC due diligence requirements.

This letter is for your information only. You don't need to respond.

If you have questions, you can contact us via e-mail at the address listed above. For security purposes, don't include any client information if you contact us by e-mail. Include your telephone number and the hours we can reach.

Please note that we're unable to provide you with the specific returns that appear to be questionable.

Sincerely,

Steven C. Klingel
Director, Refundable Credits
Policy & Program Management

Letter 4833-A (Rev. 9-2015)
Catalog Number 69183W

35 IRS, Letter 4833, *EITC Return Preparer Pre-Filing Season Alert* (Aug. 2014); IRS, Letter 4833-A, *EITC Tax Return Preparer Alert* (Sept. 2015).

In order for this correspondence stage of the EITC Return Preparer Strategy to be effective, there should be a distinct difference when the preparer receives a compliance letter after receiving an educational letter. Letter 5138, a compliance letter, comes closest to accomplishing this goal. It informs the preparer that some of their clients are being audited for their EITC claims and reminds the preparer that "failure to comply with the due diligence requirements when preparing client returns for EITC claims can adversely affect you and your clients."[36]

Letter 5364 is not categorized as either educational or compliance. This letter informs the preparer that he or she failed to attach Form 8867, *Paid Preparer's Earned Income Credit Checklist*, and may be subject to penalties and other actions.[37] Most importantly, it provides the preparer with a list of incomplete returns. Thus, the letter warns the taxpayer of *specific* consequences for failing to comply with his or her *specific* obligations under the law, and alerts the preparer to *specific* returns the IRS considers incomplete. This gives the preparer clear information with which to modify behavior; moreover, failure to modify behavior in the face of such information and warning is a good indicator that the preparer is negligent. This would set up the next stage of the compliance strategy, namely Due Diligence penalties. However, it will only be effective if the IRS follows up with those preparers who ignore the letter.

The lack of distinction between educational and compliance letters indicates the IRS does not have a comprehensive strategy with respect to letters. In most instances the IRS has not designed the letters to make clear what behavior the preparer should change going forward. It also has not designed the letters so that successive letters make clear to the preparer that the stakes for noncompliance are being raised.

As described above, the IRS will send a pre-filing season letter to a preparer based on the previous year's returns.[38] Additional letters are sent if the preparer does not improve.[39] It was not possible for TAS to determine precisely how the IRS determined which letters would be sent each year. TAS assumes a process is in place since the approach taken between FYs 2013 and 2015 has changed. A TAS review of unpublished EITC Return Preparer Strategy reports shows that the Strategy does conduct reviews that cover distinct issues related to various letters. However, TAS has not been able to locate a year-to-year review of the effectiveness of all letters, or any analysis of whether single letters or a sequence of letters are more or less effective in improving EITC compliance. Without such an analysis, it is impossible to determine the effectiveness of the IRS's EITC letter strategy.

Due Diligence Requirements

Congress has recognized the role that paid preparers play in EITC compliance by imposing a penalty on preparers if they fail to comply with due diligence requirements.[40] IRC § 6695(g) provides that any tax return preparer who files a return or claim of refund involving the EITC and who fails to comply with due diligence requirements, will be liable for a penalty of $500 for each failure.[41] To meet the due diligence requirements, the preparer must complete Form 8867, *Paid Preparer's Earned Income Credit*

36 IRS, Letter 5138, *Return Preparer EITC Client Audit Notification* (Sept. 2015).

37 IRS, Letter 5364, *Warning to EITC Return Preparers - Missing Forms 8867* (Dec. 2015).

38 IRS response to TAS information request (June 24, 2015).

39 *Id*.

40 IRC § 6695(g). This duty also extends to determining the correct amount of credit allowed. *Id*. Recently, a law was enacted which would require the IRS to conduct a study of the effectiveness of the return preparer due diligence requirements on EITC claims (in addition to Child Tax Credit and American Opportunity tax credit claims). Consolidated Appropriations Act, 2016, Pub. L. No. 114-113 § 207 (2015).

41 The United States-Korea Free Trade Agreement Implementation Act, Pub. L. No. 112–41, § 501, 125 Stat. 428, amended IRC § 6695(g) by increasing the amount of the penalty from $100 to $500 for returns filed after December 31, 2011.

Checklist, and include it with the return.[42] The form is to be completed based on information provided by the taxpayer or "otherwise reasonably obtained" by the preparer.[43] TAS first recommended requiring a signed Form 8867 be attached to each tax return back in 2003.[44] The IRS finally adopted this recommendation for tax returns filed after December 31, 2011.[45]

To meet the knowledge requirement on Form 8867, the preparer must attest that he or she did not know or have reason to know that any information he or she relied on to determine eligibility for the EITC (and the amount of credit) is incorrect. The preparer is instructed to not ignore implications of any information provided and to ask questions if any of the information provided seems to be "incorrect, inconsistent, or incomplete."[46]

"Knock and Talk" Visits

A more advanced treatment for noncompliance attributable to a return preparer is the "knock and talk" visit. This treatment consists of an educational visit by a team made up of a revenue agent and a criminal investigator.[47] During these visits the IRS employees discuss EITC laws and due diligence requirements.[48] As shown in figure 1.24.4, the number of Knock and Talk visits has decreased from 109 in FY 2013 to 94 in FY 2015.

FIGURE 1.24.4, EITC Preparer Compliance Treatments, FY 2013–2015[49]

	FY 2013	FY 2014	FY 2015
Preparer Penalty Cases			
Due Diligence Audits	734	601	815
Missing Form 8867	771	224	130
Number of Returns Resulting in Proposed Preparer Penalties			
Due Diligence Audits	35,886	51,034	62,914
Missing Form 8867	26,655	5,688	4,191
KTV and DDV Conducted			
Due Diligence Audits	867	736	956
Knock and Talk Visits	109	96	94

Audits of Preparer Due Diligence

As mentioned above, IRC § 6695(g) provides that any tax return preparer who files a return or claim of refund involving the EITC and who fails to comply with due diligence requirements, will be liable for a

42 Treas. Reg. § 1.6695-2.

43 *Id.*

44 National Taxpayer Advocate 2003 Annual Report to Congress 272. *See also* National Taxpayer Advocate 2009 Annual Report to Congress 56.

45 Treas. Reg. §§ 1.6695-2(b)(1) and 1.6695-2(e).

46 IRS Form 8867, *Paid Preparer's Earned Income Credit Checklist* 3 (2013).

47 IRS, Refundable Credits Administration Return Integrity and Compliance Services, *Overview of EITC Return Preparer Program* 3 (May 7, 2015).

48 *Id.*

49 IRS response to TAS information requests (June 24, 2015 and Oct. 26, 2015).

penalty of $500 for each failure. Beginning in FY 2013, the IRS also began proposing penalties for EITC returns submitted without Form 8867, *Paid Preparer's Earned Income Credit Checklist*.[50]

The EITC Return Preparer Strategy includes audits on preparers' adherence to due diligence requirements. When the examiner determines that the preparer did not comply with the due diligence requirements, the due diligence penalty is assessed.[51] Figure 1.24.4 shows that the number of returns resulting in a proposed penalty has increased from 35,886 in FY 2013 to 62,914 in FY 2015.

The Treasury Inspector General for Tax Administration (TIGTA) conducted a review of due diligence audits in 2010. Its findings highlighted several areas for improvement, including inadequate case documentation and potentially ineffective reviews by group managers.[52] The IRS reports that case reviews are conducted annually to identify areas of improvement and training materials are revised to address problem areas.[53] One example is training material for SB/SE examiners covering EITC due diligence visits, which emphasized the need for adequate workpapers to support the conclusions in the case.[54]

When compared to Knock and Talk visits, a due diligence audit is more burdensome for both the IRS and the preparer. According to the idea of "responsive regulation," the Strategy generally should apply the less burdensome approach first. However, the Strategy has reduced the amount of Knock and Talk visits while increasing due diligence audits. An internal review of the Strategy's annual reports shows that the IRS annually tracks the "effectiveness" of each treatment. However, as discussed in more detail below, the IRS's measures of "effectiveness" may not be the best ones for tracking preparer compliance. Before the Strategy decides to forego a less intensive form of treatment, it should fully study long term preparer compliance associated with each treatment to ensure it is efficiently achieving a change in preparer behavior.

Tracking EITC Return Preparer Improvement After Treatment

The EITC Return Preparer Strategy maintains a database of every preparer who has received a treatment (or attempted treatment) since FY 2012.[55] The progress of individual preparers does not appear to be the emphasis when measuring the change in tax return preparer behavior. In order to quantify the benefit of treatments, WIRA applies the same four criteria used in the scoring process.[56] WIRA compares the change in performance of a control group with that of the treated preparers from one filing season to the next.[57] The difference in the year-to-year change in performance between the two groups is attributed to the treatments.[58] This analysis is conducted on each treatment type to determine its effectiveness.[59]

One concern with this approach is that once in the treatment system, not all preparers continue to be tracked. While the EITC Return Preparer Strategy maintains that it monitors all preparers who receive treatment, this monitoring only applies if the preparer continues to show up as a preparer. An

50 IRS response to TAS information request (June 24, 2015).

51 Preparers have the right to appeal a proposed penalty assessment. IRM 20.1.6.19.1, *Pre-Assessment Appeal Rights—IRC 6694, IRC 6695, IRC 6707A, and IRC 6713* (May 16, 2012). Between TYs 2008 and 2013, Appeals abated approximately $1.7 million in penalty assessments. IRS response to TAS information request (Dec. 2, 2015).

52 TIGTA, Ref. No. 2010-40-116, *Actions Can Be Taken to Improve the Identification of Tax Return Preparers Who Submit Improper Earned Income Tax Credit Claims* 10 (Sept. 14, 2010).

53 IRS response to TAS information request (June 24, 2015).

54 IRS response to TAS information request (Oct. 21, 2015).

55 *Id.*

56 *Id.*

57 The control group is randomly assigned amongst the preparers in each treatment stream. *Id.*

58 *Id.*

59 *Id.*

unscrupulous preparer may "go underground" once they receive a high level of treatment. Such a preparer would no longer be tracked by the EITC Return Preparer Strategy. While it may be resource intensive, the EITC Return Preparer Strategy should continue to track all preparers who have received treatment while introducing new preparers each year. As discussed in more detail below, the EITC Return Preparer Strategy should not just focus its measure of success on return on investment and dollars saved, but actual long term improvement in preparer compliance.

Given the Stagnant EITC Improper Payment Rate, Several Areas of the EITC Return Preparer Strategy Can Be Revised to Improve Its Effectiveness

As mentioned above, the percentage of EITC improper payments remains practically unchanged over the last decade.[60] The current improper payment rate of 27 percent has increased slightly from the improper rate in 2004, which measured 25 percent.[61] Based on a review of the existing EITC Return Preparer Strategy, the National Taxpayer Advocate has identified several concerns discussed in detail below.

Preparers Who Do Not Sign the Returns and Preparers Who Are the Subject of Complaints to the IRS Return Preparer Office Are Not Incorporated into the EITC Return Preparer Strategy

The EITC Return Preparer Strategy currently only reaches the pool of paid tax return preparers who prepare more than 25 EITC returns that contain errors.[62] Not all errors are committed by a known preparer. As Senate Finance Committee Chairman Wyden points out: "[i]n some egregious cases, preparers calculate a taxpayer's refund in person and skip the line that shows who did the work. Then, after the taxpayer leaves, the preparer falsifies the math to boost the refund, files the return, and pockets the difference."[63] In this situation, since the preparer did not sign the return, the preparer would not receive treatment through the EITC Return Preparer Strategy but might be discovered through a complaint by a taxpayer or other party (including IRS employees) to the IRS.

In FY 2014, the EITC Return Preparer Strategy identified 1,152 preparers misusing preparer identification.[64] [redacted]

60 For information on how the EITC audit process is not effectively reducing the improper payment rate, see Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS Is Not Adequately Using the EITC Examination Process as an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance*, *supra*.

61 TIGTA, Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014* 9 (Apr. 27, 2015). The lowest improper payment measurement was 23 percent, which occurred in 2012. *Id*.

62 IRS response to TAS information request (June 24, 2015).

63 *Protecting Taxpayers From Incompetent and Unethical Return Preparers, Hearing Before the S. Comm. on Fin.*, 113th Cong. 2 (2014) (statement of Ron Wyden, Chairman, Committee on Finance).

64 WIRA, *Fiscal Year 2014 EITC Return Preparer Analysis Summary* 2 (June 20, 2014).

65 [redacted] The IRS has identified the information discussed is this paragraph as "official use only" and therefore we are not at liberty to disclose it.

66 [redacted] The IRS has identified the information discussed in this paragraph as "official use only" and therefore we are not at liberty to disclose it.

In 2012, the RPO began sharing referrals with the ERCPC.[67] The ERCPC independently identified and treated only 37 percent of the referred preparers, finding that most did not meet the program's selection criteria.[68] Given limited resources, using referrals as a criterion for compliance treatment could be effective in identifying noncompliant preparers, particularly those who are operating invisibly and highly likely to be harming taxpayers. If someone, either a taxpayer, a preparer, or an internal IRS employee, refers a preparer, that should be a selection criterion heavily weighted for at least an education, if not compliance, treatment.

The Strategy currently is not equipped to address preparers who do not sign returns. [redacted] However, the Strategy is aware of the impact these preparers have on EITC noncompliance. In its 2014 annual report, the Strategy reported developing a systemic methodology to identify "ghost preparers" as part of its long term strategic plan.[70] The report stated that the effort required would be high but the potential impact would also be high.[71]

Given limited resources, using referrals as a criterion for compliance treatment could be effective in identifying noncompliant preparers, particularly those who are operating invisibly and highly likely to be harming taxpayers. If someone, either a taxpayer, a preparer, or an internal IRS employee, refers a preparer, that should be a selection criterion heavily weighted for at least an education, if not compliance, treatment.

A possible method for identifying ghost preparers is to track preparers after they fall off the radar and are no longer tracked. The EITC Return Preparer Strategy could obtain a preparer inventory listing, which shows every return prepared by a preparer, for the year before the preparer falls off the radar.[72] The EITC Return Preparer Strategy could review that list and compare it to some or all of the current year returns. If there is a pattern of similar mistakes on the current year returns, or if a large portion of the current taxpayers now appear to prepare their own returns, the EITC Return Preparer Strategy may want to interview the taxpayers to see who prepared their returns. If there is a trend with the new returns, it is possible that the preparer has gone underground.

The EITC Return Preparer Strategy could partner with SB/SE and its Return Preparer Program (RPP) to identify the preparers who fall off the radar.[73] Under the RPP, the IRS can create program action cases (PAC), which are "preparer investigations where clients of questionable preparers are examined to determine whether preparer penalties and/or injunctive actions against the preparers are warranted."[74] PACs are limited to "situations where information indicates a return preparer has engaged in a widespread practice of making material errors that demonstrates intentional misconduct or clear incompetence in preparing tax returns."[75] This type of situation would capture the

67 IRS response to TAS information request (June 24, 2015).

68 *Id*.

69 [redacted] The IRS has identified the information discussed in this paragraph as "official use only" and therefore we are not at liberty to disclose it.

70 WIRA, *Fiscal Year 2014 EITC Return Preparer Analysis Summary* 10 (June 20, 2014).

71 *Id*.

72 Return preparer coordinators have access to listings of returns prepared by preparers using an internal IRS database. Perhaps the EITC Return Preparer Strategy would have to partner with such coordinators to obtain this listing if they cannot obtain it on their own. IRM 20.1.6.6, *Program Action Cases Overview* (Sept. 10, 2013).

73 For information on the RPP, see IRM 4.1.10.1, *Overview of Return Preparer Program* (Jan. 14, 2011).

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

75 IRM 4.1.10.3(2) (Jan. 14, 2011).

actions of an unscrupulous EITC return preparer. In fact, the EITC Due Diligence program is already a priority for the RPP.[76]

The Public Does Not Have Access to the IRS's Measures for Evaluating the Effectiveness of the EITC Return Preparer Strategy

The ERCPC issues an annual report that evaluates the success of the EITC Return Preparer Strategy but these reports are not available for public inspection.[77] In fact, since the population of preparers receiving treatment constantly changes, the IRS looks at the return on investment of the program to measure success.[78] Return on investment (and therefore success of the program) is measured by the amount of EITC bad returns and dollars saved divided by the cost of treatment.[79] The cost of each treatment is easy to ascertain. However, as discussed below, the measurement for "bad" EITC returns and dollars saved may not be accurate. Since FY 2012, the EITC Return Preparer Strategy estimates it has protected $2.4 billion in EITC claims.[80] However, because there is no public report that discloses or describes the return on investment for the EITC Return Preparer Strategy, the public has no way of ascertaining the accuracy of IRS claims of success or the overall effectiveness of the IRS EITC Return Preparer Strategy. As discussed below, the IRS's methodology likely overstates the program's revenue protection amount.

…because there is no public report that discloses or describes the return on investment for the Earned Income Tax Credit (EITC) Return Preparer Strategy, the public has no way of ascertaining the accuracy of IRS claims of success or the overall effectiveness of the IRS EITC Return Preparer Strategy.

An erroneous EITC return is defined as a return that contains the same errors used in the scoring process.[81] If the return breaks one of the filters in the scoring process, it is deemed a "bad" return and any credit dollars attributed to it is considered revenue protected.[82] Thus, if a return is categorized as potentially erroneous, both the entire amount of EITC claimed as well as the entire amount of Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC) claimed are identified as potentially erroneous.[83] However, these returns do not undergo an audit by the IRS prior to this designation. As a result, there may be instances where a return deemed erroneous is actually accurate or at least partially accurate. For instance, there could be a return where the taxpayer claimed a child who is not a qualifying child, but the taxpayer is still eligible for the childless EITC. Alternatively, the child could be a "qualifying relative" of the taxpayer, which could be determined by reviewing documentation in an audit.[84] There could also be an issue with identify theft that affected a taxpayer's initial eligibility.

76 IRM 4.1.10.1.2, *Return Preparer Program Priorities* (Jan. 14, 2011).

77 IRS response to TAS information request (June 24, 2015).

78 Minutes for meeting via telephone between TAS employees and IRS employees responsible for implementation of the EITC Return Preparer Strategy (Nov. 20, 2015) (on file with the National Taxpayer Advocate).

79 *Id*.

80 This amount does not include the additional revenue generated from audits and due diligence visits but does include money protected for Child Tax Credit and Additional Child Tax Credit claims. IRS response to TAS information request (June 2, 2015). Since FY 2012, the EITC Preparer Strategy has a total program value of $1.7 billion. IRS response to TAS information request (Oct. 20, 2015); IRS, *FY 2015 EITC Return Preparer Strategy Analysis Summary, Executive Summary* (June 2015).

81 IRS response to TAS information request (Oct. 21, 2015).

82 Minutes for meeting via telephone between TAS employees and IRS employees responsible for implementation of the EITC Return Preparer Strategy (Nov. 20, 2015) (on file with the National Taxpayer Advocate).

83 IRS response to TAS information request (Oct. 21, 2015).

84 For information on what constitutes a qualifying relative, *see* IRC § 152(d). In many aspects, the documentation needed to prove eligibility for qualifying relative status is similar to proving a qualifying child. IRM 4.19.14.5.6, *Personal Exemptions and Dependents* (Jan. 01, 2015).

To calculate dollars protected, the EITC Return Preparer Strategy compares the change in potentially erroneous dollars of the control group to the treated group from one year to the next.[85] The change between the two groups is considered a benefit of the treatments.[86] The EITC Return Preparer Strategy measures the impact for each treatment type separately.[87] A TAS review of internal EITC Return Preparer Strategy reports indicates that each treatment type is tracked annually to show its return on investment and the bad dollars saved attributed to it.

One way in which the EITC Return Preparer Strategy could improve its analysis is to adopt a consistent approach to each year's work. For instance, since FY 2012, the EITC Return Preparer Strategy has introduced new key questions to be answered and objectives each year.[88] Such an approach does not allow for a year-to-year comparison. It also does not require the EITC Return Preparer Strategy to focus on one consistent goal. Instead, the EITC Return Preparer Strategy should adopt a core set of questions and objectives that guide the process and introduce new topics as they are identified.

As described above, not all individual preparers are tracked each year. Some may not prepare 25 returns after receiving a treatment and as a result, they will not return to the test sample.[89] We believe the EITC Return Preparer Strategy should create a core set of preparers who are tracked over time and introduce new preparers as they are identified.

Last, the current measurements for success, which include dollars protected and the return on investment, may not be the best measure to capture an increase in preparer compliance. In particular, the basis for the calculation may not be accurate as not all returns deemed "potentially erroneous" are actually erroneous, or are only partially in error. Once this calculation is improved, it will make the return on investment measurement more accurate. An improved return on investment measurement in addition to long-term tracking of a core group of preparers will show a more accurate picture of preparer compliance and the impact of IRS "touches" on that compliance.

Thus far, the IRS has shared only basic information about the EITC Return Preparer Strategy with the public. Given the importance of the EITC and the large number of preparers contributing to EITC noncompliance, transparency is extremely important. The ERCPC unit should release the annual analysis for the EITC Return Preparer Strategy to the public, including the measures used to evaluate the effectiveness of the strategy.

The EITC Return Preparer Strategy Does Not Sufficiently Focus on the Unenrolled Preparer Populations, Which Combined With a Comprehensive Public Education Campaign, Is Critical to Improving EITC Noncompliance

The low income population is particularly vulnerable to unskilled and unethical preparers and as numerous studies have shown, these preparers operate in the areas and communities where low income persons

85 IRS response to TAS information request (Oct. 21, 2015).

86 *Id*. As an example, the Strategy calculated that the average preparer receiving a treatment improved $15,000 after treatment, whereas the average preparer in the control group improved by $5,000. So the impact of treatments is estimated to be $10,000 on average. The total impact of treatments is then calculated by multiplying the average savings by the number of preparers in the test group. *Id.*

87 *Id*.

88 WIRA, *Fiscal Year 2015 EITC Return Preparer Analysis Summary* 3 (June 15, 2015).

89 Derived from IRS response to TAS information request (June 24, 2015). The IRS reports that it will continue to monitor every preparer after they are initially identified. However, TAS is unable to ascertain what this monitoring entails.

reside.[90] The ERCPC data show that compared to attorneys and Certified Public Accountants (CPA), unenrolled preparers receive the vast majority of compliance treatments. Between FYs 2012 and 2015, an average of 94 percent of all due diligence audits were performed on unenrolled preparers while four percent of the due diligence audits were conducted on enrolled agents, 1.6 percent on CPAs, and less than one percent were performed on attorneys, as shown on Figure 1.24.5.[91] The IRS should determine if due diligence audits are the most effective way to address unenrolled preparers. Based on current analysis, the Strategy measures its effectiveness of each treatment on return on investment and dollars saved. As mentioned above, these measurements may be flawed. Given the unique characteristics of the unenrolled population, the Strategy should ensure that the due diligence audit is more effective than the less costly knock and talk visit.

FIGURE 1.24.5, Due Diligence Audits by Preparer Enrollment, FYs 2012–2015[92]

Fiscal Year	CPA	Attorney	Enrolled Agent	Unenrolled
2012	1.3%	0.0%	2.4%	96.3%
2013	2.2%	0.1%	5.7%	92.0%
2014	1.3%	0.0%	2.7%	96.0%
2015	1.8%	0.1%	4.8%	93.3%
Average	**1.7%**	**0.05%**	**3.9%**	**94.4%**

The EITC Return Preparer Strategy does not have a way to identify if a preparer is unenrolled and instead relies on the preparer to self-identify during EITC due diligence audits.[93] Since the EITC Return Preparer Strategy already coordinates with the RPO and RPO attends the Strategy meetings, RPO could share preparer types and geographical location with the Strategy, if the preparer is in the RPO database.[94] If the preparer is not in the RPO database, then by definition that preparer is an unenrolled preparer or not in compliance with the requirement to obtain a preparer tax identification number (PTIN).[95] Currently the Strategy receives complaints about preparers from RPO but only treats 37 percent of these referrals because "most of the referral complaints are for preparers who file less than 25 EITC returns, are for issues that cannot be addressed with our current compliance tools, or are sole complaints from a single taxpayer concerning his/her preparer."[96] If the Strategy is not going to incorporate all of these referrals into its treatment cycle, it could at least glean information about the unenrolled population from the referrals.

Since the EITC Return Preparer Strategy cannot identify unenrolled preparers on its own, it offers information on due diligence requirements in the form of presentations and webinars and on social media to enrolled and unenrolled agents alike.[97] Sharing educational information is a good start, however,

90 For a chilling inventory of studies showing the predatory practices and abuses in this area, see Brief of Amici Curiae, National Consumer Law Center and National Community Tax Coalition in Support of Defendants-Appellants, *Loving v. Internal Revenue Service*, No. 13-5061 (D.C. Cir. 2014.)

91 IRS response to TAS information request (June 24, 2015).

92 IRS response to TAS information requests (June 24, 2015 and Oct. 26, 2015).

93 IRS response to TAS information request (Oct. 21, 2015).

94 IRS response to TAS information request (June 24, 2015).

95 Unenrolled preparers may wish to "voluntarily increase their knowledge and improve their filing season competency." They can do this by taking 18 hours of continuing education, obtaining a PTIN, and agreeing to certain terms of Circular 230, *Regulations Governing Practice before the Internal Revenue Service*. IRS, *General Requirements*, *available at* https://www.irs.gov/Tax-Professionals/General-Requirements-for-the-Annual-Filing-Season-Program-Record-of-Completion.

96 IRS response to TAS information request (June 24, 2015).

97 *Id.*

a tailored approach that directly focuses on unscrupulous unenrolled preparers in the neighborhoods where they operate and where the potential victims reside, is essential to improving EITC compliance. For instance, when the RPO office shares individual complaints received from a single taxpayer with the EITC Return Preparer Strategy, these referrals do not become part of the treatment stream. However, the referrals could be investigated to learn more about where the unenrolled preparers concentrate their work. More compliance-driven educational material could be provided in these areas specifically to target unenrolled preparers. This material would focus on the consequences of disregarding due diligence requirements and filing bad returns, up to and including prosecution. This could be done by using preparer information provided in the referrals from RPO. The EITC Return Preparer Strategy could also partner with the LITC program and consumer rights groups to gain a better understanding of how these preparers operate.

In 2015, the IRS announced an online public directory of tax return preparers, which taxpayers can search to find a preparer with specific credentials or qualifications, including attorneys, CPAs, enrolled agents, and those who have taken the voluntary annual IRS filing season training.[98] Unenrolled preparers are not included in this database, but use of this directory should be advertised in the neighborhoods where unenrolled preparers practice to empower taxpayers to make educated decisions. Since 2002, TAS has recommended that taxpayer outreach be part of the EITC compliance strategy.[99] Presumably, many improper payments could have been saved if the IRS had followed through with this recommendation in 2002 to educate taxpayers. In 2002, TAS also proposed a legislative recommendation to allow Congressional authority and funding for "an extensive public awareness campaign" targeted at taxpayers.[100] The marketing campaign would include a simple message to inform taxpayers about the preparer registration process so that taxpayers could make educated decisions.

The marketing campaign could use internal information that the Strategy has based on referrals to target the message to certain geographic areas. The campaign should also utilize partners, such as LITCs, Volunteer Income Tax Assistance (VITA) programs, and local organizations providing services to the affected taxpayer populations.[101] The partners would help to develop the outreach as well as to deliver the information to a target audience. The information should include information on the due diligence requirements, so that taxpayers know what to expect when they visit a preparer. It should also include information on how to figure out if the preparer is reputable.

A public education component to the EITC Preparer Strategy would empower taxpayers to avoid some of the problematic preparers upfront. For instance, TAS created a poster and pamphlet in 2013 to educate taxpayers who rely on preparers.[102] By helping the taxpayer be an educated consumer, the public information campaign could reduce the amount of EITC noncompliance, while also decreasing costs associated with compliance treatments and resolving erroneous refunds.

98 IRS, IR-2015-22, *IRS Launches Directory of Federal Tax Return Preparers; Online Tool Offers New Option to Help Taxpayers*, *available at* http://www.irs.gov/uac/Newsroom/IRS-Launches-Directory-of-Federal-Tax-Return-Preparers (last visited Sept. 30, 2015).

99 National Taxpayer Advocate 2002 Annual Report to Congress 73.

100 *Id.* at 229.

101 For example, CA$H is a collaboration of ten state coalitions, made up of more than 50 non- and for-profit partners with the goal of helping low-to moderate income people "make the most of their money." For more information, see CA$H Maine, *About CA$H*, http://www.cashmaine.org/about (last visited Sept. 15, 2015).

102 TAS, Publication 5074, *Protect Your Tax Refund* (2013); TAS, Publication 5074-A, *Protect Your Tax Refund* (Mar. 2015). For more information on this educational material, see National Taxpayer Advocate 2013 Annual Report to Congress 70-71.

The EITC Preparer Strategy Does Not Collaborate With TAS

The Strategy benefits from many IRS partners and stakeholders. For instance, ERCPC is the owner and primary driver of the EITC Return Preparer Strategy, but collaborates with communication functions, research, and counsel.[103] TAS is listed as a stakeholder, however, the only time TAS was invited to participate in the EITC Return Preparer Strategy was a phone call in December 2013.

The IRS does not currently include TAS in planning for its EITC Return Preparer Strategy. However, the National Taxpayer Advocate has dedicated many resources to studying problems associated with the EITC and proposing solutions.[104] The National Taxpayer Advocate has also testified before Congress numerous times to highlight issues related to the EITC.[105] EITC cases consistently rank in the top ten of all TAS case receipts.[106] Last, the National Taxpayer Advocate also administers the LITC program, which provides legal representation in numerous EITC cases.[107] The LITCs see firsthand the problems taxpayers experience with preparers, often before the issues surface with the IRS. Given TAS's extensive knowledge, research, and affiliations, TAS should be involved in the IRS's EITC Return Preparer Strategy from the start, as well as to fine tune its focus and to develop quantifiable measures of strategy effectiveness.

CONCLUSION

The National Taxpayer Advocate commends ERCPC for its efforts to address the role that preparers play in EITC errors. However, the IRS is not effectively using the resources at its disposal, such as collaborating with TAS, other internal and external stakeholders and partners, and using referrals made about problematic preparers. Additionally, a creative and targeted outreach to unenrolled preparers and a comprehensive education campaign for taxpayers, including both localized campaigns targeted at areas where ghost or otherwise noncompliant preparers are operating, and nationwide public service advertisements, could augment the online public directory of tax return preparers. Success of the campaign would be measured not just by a reduction in bad returns and consideration of return on investment, but it would consider what types of errors are occurring by certain geographic areas. The strategy could focus efforts to study this over the longterm since sustained change in behavior for both preparers and taxpayers takes time.

103 IRS response to TAS information request (June 24, 2015).

104 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 71-104 (*Study of Tax Court Cases In Which the IRS Conceded the Taxpayer was Entitled to Earned Income Tax Credit (EITC)*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 75-104 (*Running Social Programs Through the Tax System*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 94-117 (*IRS Earned Income Credit Audits—A Challenge to Taxpayers*); National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 1-80 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

105 See, *e.g.*, *Protecting Taxpayers From Incompetent and Unethical Return Preparers, Hearing Before the S. Comm. on Fin.*, 113th Cong. 7 (2014) (statement of Nina E. Olson, National Taxpayer Advocate); *The National Taxpayer Advocate's 2014 Annual Report To Congress, Hearing Before the Subcomm. on Government Operations of the H. Comm. on Oversight and Reform*, 114th Cong. 28 (2015) (statement of Nina E. Olson, National Taxpayer Advocate).

106 A review of TAS case receipts since FY 2010 shows that EITC cases ranked ninth in 2010 (11,198 cases), tenth in FY 2011 (8,729 cases), seventh in FY 2012 (7,441 cases), fourth in FY 2013 (11,980 cases), third in FY 2014 (13,450 cases), and fourth in FY 2015 (10,880 cases). Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015).

107 LITCs represent individuals with limited income or low income. *Low Income Taxpayer Clinics Program Report* (Dec. 2014). In 2014, EITC cases were 12 percent of the LITC caseload. LITC Program 2014 Year End Report.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Release the annual analysis for the EITC Return Preparer Strategy to the public, including the measures used to evaluate the effectiveness of the strategy.
2. Include TAS as a member of the EITC Return Preparer Strategy team.
3. In collaboration with TAS and other IRS functions, and based on this annual analysis, determine where to focus resources and how to measure success with a multiyear analysis.
4. Incorporate preparer referrals, both from internal and external sources, and preparers who misuse PTINs, as a selection criterion for compliance treatment in the EITC Return Preparer Strategy.
5. Use measures for evaluating the effectiveness of the strategy on an annual basis that are not limited to measuring protected dollars or return on investment, but also include a year-to-year analysis of the preparer's behavior following treatment.
6. Tailor outreach specifically to the unenrolled preparer population that addresses due diligence requirements and is presented where these preparers operate. This outreach should incorporate TV and radio as well as social media.
7. Conduct a creative, geographic-based public education campaign in conjunction with other internal and external stakeholders including public service advertisements, videos, and tweets in order to educate taxpayers on how to select a competent preparer, what the rules of due diligence require, and the consequences of using an unskilled or unscrupulous preparer, including identity theft. Different marketing approaches should be tested and studied to track EITC compliance over the years.

APPENDIX A, Letter 5025 Series

LETTER 5025, *You May Have Prepared Inaccurate EITC Returns With Questionable Qualifying Children and Self-Employment Income*

Department of the Treasury
Internal Revenue Service
Wage & Investment
NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:
10/28/2015
Contact us by e-mail at:
wi.eitcpreparerletterresponse@irs.gov
Preparer ID number:

You May Have Prepared Inaccurate EITC Returns with Questionable Qualifying Children and Self-Employment Income

Dear [Name]:

Our review of your 2014 tax year returns claiming the earned income tax credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you as the paid preparer and your clients. The primary issues we identified on the tax year 2014 returns you prepared are:

- Qualifying children for the EITC who don't appear to meet the relationship, residency, age, and joint return requirements.
  - A permanently and totally disabled child is considered to meet the age requirement. A child is considered permanently and totally disabled for EITC if the child can't engage in any substantial gainful activity because of a physical or mental condition, and a doctor determined the condition has lasted or can be expected to last continuously for at least one year or can be expected to lead to death.
- Questionable income and expenses on Schedule C, *Profit or Loss from Business.*

EITC due diligence requirements for paid preparers:
As a paid preparer, you must take extra steps to ensure your EITC returns are complete and correct.

Paid preparers must:
- Know the tax laws.
- Inform clients of EITC eligibility requirements to determine if each client qualifies for the EITC.
- Interview clients every year as their circumstances may change and you must use current information when determining eligibility for, and the amount of, the EITC.
- Not rely on tax return preparation software; it is only a guidance tool, not a substitute for knowledge of the tax laws.
- Meet all four due diligence requirements when preparing an EITC claim:
  1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist,* and submit it with every EITC return you prepare.
  2. Complete an EITC worksheet, or its equivalent, showing how you computed the EITC.

Letter 5025 (Rev. 9-2015)
Catalog Number 59926H

LETTER 5025C, *You May Have Prepared Inaccurate EITC Returns With Self-Employment Income*

Department of the Treasury
Internal Revenue Service
Wage & Investment - NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:

Contact us by e-mail at:
wi.eitcpreparerletterresponse@irs.gov
Preparer ID number:

You May Have Prepared Inaccurate EITC Returns with Self-Employment Income

Dear [Name]:

Our review of your 2014 tax year returns claiming the earned income tax credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you as the paid preparer, and your clients. The primary issues we identified on the tax year 2014 returns you prepared are questionable income and expenses on Schedule C, *Profit or Loss from Business*.

EITC due diligence requirements for paid preparers:

As a paid preparer, you must take extra steps to ensure your EITC returns are complete and correct.

Paid preparers must:

- Know the tax laws.
- Inform clients of EITC requirements to determine if each qualifies for the EITC.
- Interview clients every year, as their circumstances may change and you must use current information when determining eligibility for, and the amount of, EITC.
- Not rely on tax return preparation software; it is only a guidance tool, not a substitute for knowledge of the tax law.
- Meet your four due diligence requirements when preparing an EITC claim:
  1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist,* and submit it with every EITC return you prepare.
  2. Complete an EITC worksheet, or its equivalent, showing how you computed the EITC.
  3. Question the client if any information appears to be incorrect, inconsistent, or incomplete and document your questions and the client's responses. Failure to adequately question the client and document the responses is the most common reason we assess penalties.
  4. Keep all required records, including copies of any documents you relied upon to determine eligibility for, or the amount of, EITC.

Letter 5025-C (Rev. 9-2015)
Catalog Number 59927S

LETTER 5025D, *You May Have Violated Tax Law by Preparing Inaccurate EITC Returns*

Department of the Treasury
Internal Revenue Service
NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:
10/28/2015
To contact us toll free:
1-855-379-0440

You May Have Violated Tax Law
By Preparing Inaccurate EITC Returns

Dear [xxxxx]:

Our review of the Tax Year 2013 Earned Income Tax Credit (EITC) returns you prepared indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you as the paid preparer and your clients**.** The primary issues we identified on your TY 2013 returns is a high percentage of EITC returns that claim qualifying children who may not be permanently or totally disabled.

A child is considered permanently and totally disabled if both of the following apply:

- The child can't engage in any substantial gainful activity because of a physical or mental condition
- A doctor determines the condition has lasted or can be expected to last continuously for at least a year or can lead to death

If You Prepare Inaccurate EITC Returns

Your client may face:

- An audit during which we will hold his or her refund until we can determine EITC eligibility. We can also conduct an audit after we issue the refund. If we determine that your client doesn't qualify for EITC, he or she must repay any overpayment, plus interest.
- A ban for 2 or 10 years from claiming the EITC, if we determine your client's EITC claim was due to reckless or intentional disregard of the EITC rules or fraud

You may face:

- **A $500 penalty** for each failure to comply with EITC due diligence requirements (Section 6695(g) of the Internal Revenue Code)

Letter 5025-D (Rev. 8-2014)
Catalog Number 64087J

LETTER 5025Q, *You May Have Prepared Inaccurate EITC Returns Based on Questionable Qualifying Children*

Department of the Treasury
Internal Revenue Service
Wage & Investment - NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:

Contact us by e-mail at:
wi.eitcpreparerletterresponse@irs.gov
Preparer ID number:

You May Have Prepared Inaccurate EITC Returns Based on Questionable Qualifying Children

Dear [Name]:

Our review of your 2014 tax year returns claiming the earned income tax credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you, as the paid preparer, and your clients.

The primary issues we identified are questionable qualifying children who may not meet the residency or relationship tests, and/or questionable qualifying children who may not be permanently and totally disabled.

- A child is a qualifying child if he or she meets the relationship, age, residency, and joint return tests.
- A permanently and totally disabled child is considered to meet the age requirement. A child is considered permanently and totally disabled for EITC if the child can't engage in any substantial gainful activity because of a physical or mental condition, and a doctor determined the condition has lasted or can be expected to last continuously for at least one year or can be expected to lead to death.

EITC due diligence requirements for paid preparers:

As a paid preparer, you must take extra steps to ensure your EITC returns are complete and correct.

Paid preparers must:

- Know the tax laws.
- Inform clients of EITC requirements to determine if each qualifies for the EITC.
- Interview clients every year, as their circumstances may change and you must use current information when determining eligibility for, and the amount of, EITC.
- Not rely on tax return preparation software; it is only a guidance tool, not a substitute for knowledge of the tax law.
- Meet your four due diligence requirements when preparing an EITC claim:
  1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist,* and submit it with every EITC return you prepare.
  2. Complete an EITC worksheet, or its equivalent, showing how you computed the EITC.

Letter 5025-Q (Rev. 9-2015)
Catalog Number 59928D