

NATIONAL TAXPAYER ADVOCATE

ANNUAL REPORT TO CONGRESS

2016

*Executive Summary: Preface,
Special Focus, and Highlights*



This report is dedicated

to

Tom Beers

TAS research advisor

*from whom I have learned so much,
and without whom this Report
would not be what it is today.*

*I am grateful for his friendship, his
sage advice, and his refreshing honesty.*

We all wish him well in retirement.



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PREFACE: Introductory Remarks by the National Taxpayer Advocate

HONORABLE MEMBERS OF CONGRESS:

I respectfully submit for your consideration the National Taxpayer Advocate's 2016 Annual Report to Congress. Section 7803(c)(2)(B)(ii) of the Internal Revenue Code requires the National Taxpayer Advocate to submit this report each year and in it, among other things, to identify at least 20 of the most serious problems encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems.

During 2016, I and the Taxpayer Advocate Service embarked on an extraordinary endeavor of actively engaging with the taxpayers we serve. As I announced in last year's Annual Report, where we analyzed the IRS's vision for its Future State, I traveled the country and held 12 Public Forums on Taxpayer Needs and Preferences.¹ Together with Members of Congress, I heard directly from taxpayers and their representatives about the challenges they face complying with the tax laws and dealing with the IRS.² TAS also held "Future State" Focus Groups with tax preparers and practitioners at the IRS's Nationwide Tax Forums.³ And we engaged every single TAS office in meetings about the Future State, asking our employees what they thought taxpayers needed now and in the future.⁴ Finally, we conducted a nationwide survey of U.S. taxpayers to learn what they need in the way of taxpayer service.⁵

All of this has been a very humbling and moving experience — to see so many people caring so much about improving tax administration, taking the time to attend the Public Forums, sharing their ideas, and expressing their concerns, including the universal acknowledgement that the IRS needs more funding to do its job. For me, it was a transformative experience. More specifically, it has motivated me to lay out my vision and recommendations for what the IRS needs to be a world-class 21st century tax administration, based on all of the information people have shared with me this year. This vision is set forth in the first section of the Report, titled "Special Focus," and it is arguably the most important piece I have written about the IRS in my 15 years serving as National Taxpayer Advocate.

In addition to the Special Focus section, we have included a third volume of the Report (after our usual Volume Two containing TAS research studies). At the beginning of 2016, I charged my immediate staff with identifying significant research into topics that have relevance for tax administration, including approaches to voluntary compliance, worldwide taxpayer service, alternative dispute resolution, taxpayer rights, fraud detection, online accounts appearance, and geographic focus.⁶ I asked that they not

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- 1 National Taxpayer Advocate Public Forums were held in the following locations: San Antonio, TX (Aug. 30, 2016); Los Angeles, CA (Aug. 22, 2016); Portland, OR (Aug. 18, 2016); Parma, OH (Aug. 16, 2016); Washington, DC (May 17, 2016); Baltimore, MD (May 13, 2016); Red Oak, IA (May 5, 2016); Harrisburg, PA (Apr. 8, 2016); Hendersonville, NC (Apr. 4, 2016); Bronx, NY (Mar. 18, 2016); Chicago, IL (Mar. 9, 2016); and Washington, DC (Feb. 23, 2016).
 - 2 For information about and full transcripts from the National Taxpayer Advocate Public Forums, see <https://taxpayeradvocate.irs.gov/public-forums> (last visited Dec. 31, 2016).
 - 3 TAS Communications and Liaison, *2016 IRS Nationwide Tax Forums TAS Focus Group Report: Preparers' Thoughts About IRS's Proposed Future State* (Oct. 2016).
 - 4 For the results of the discussions with TAS employees, see <https://taxpayeradvocate.irs.gov/public-forums> (last visited Dec. 31, 2016).
 - 5 See Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.
 - 6 See Literature Reviews: *Taxpayer Service in Other Countries*; *Incorporating Taxpayer Rights into Tax Administration*; *Behavioral Science Lessons for Taxpayer Compliance*; *Geographic Considerations for Tax Administration*; *Customer Considerations for Online Accounts*; *Options for Alternative Dispute Resolution (ADR)*; and *Reducing "False Positive" Determinations in Fraud Detection*, vol. 3, *infra*.

limit their review to tax literature, but to look at psychology, organizational theory, network theory, marketing, and other disciplines. As a result, Volume 3 contains comprehensive Literature Reviews on several tax administration topics. We used this research as groundwork for many of the Most Serious Problems herein; we wanted to look at the IRS in a broader context, and the Literature Reviews have enabled us to bring insights from other disciplines and other countries and apply them to IRS problems and challenges.

In light of the arrival in January 2017 of a new Administration and a new Congress, our first two Legislative Recommendations include recommendations pertaining to tax reform — the first identifying the burdens the current tax code places on taxpayers and the IRS alike, and suggesting that Congress undertake comprehensive tax simplification; the second proposing a comprehensive revamp of the tax code’s “family status” provisions to reduce taxpayer burden and combat improper payments. Simply put, the IRS cannot achieve a transition to a 21st century tax administration if it is encumbered by a 20th century tax code. Thus, we hope this Report, and the analysis and recommendations it contains, will prove helpful to the Administration and to Members of Congress this year and your consideration of tax and IRS reform. As always, I stand ready to assist in any way that I can.

Respectfully submitted,



Nina E. Olson
National Taxpayer Advocate
31 December 2016

SPECIAL FOCUS

IRS FUTURE STATE: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration

INTRODUCTION

In the 2015 Annual Report to Congress (ARC), the National Taxpayer Advocate identified the IRS's plans for its "Future State" as the number one most serious problem facing taxpayers.¹ Among other things, she cited concerns about the IRS's lack of transparency with taxpayers and Congress about the plans; the move away from person-to-person assistance and compliance contacts in favor of impersonal electronic "self-service;" and the reliance on private third parties to provide for-fee assistance for core tax administration services previously provided by the IRS for free, thereby increasing taxpayer costs for the "privilege" of paying their taxes.

The IRS has partially addressed the National Taxpayer Advocate's concerns. For example, almost immediately after the issuance of the Annual Report to Congress, the IRS created a webpage on irs.gov dedicated to the "Future State" and uploaded numerous documents.² The IRS Commissioner also made clear in congressional testimony and elsewhere that the IRS did not intend to eliminate phone or in-person assistance.³ Moreover, during the Nationwide Tax Forums this summer, the IRS held a presentation on the "Future State," attended by over 2,200 practitioners and preparers, and also sponsored a suggestion booth.⁴

These steps, however commendable, have not fully addressed the core of the National Taxpayer Advocate's concerns, namely, that the IRS has failed to adequately study and incorporate into its "Future State" plans the needs and preferences of United States taxpayers — an incredibly diverse and complex population. In a budget environment in which the IRS has seen its annual appropriation decreased by about 19 percent on an inflation-adjusted basis, it is tempting and even understandable for the IRS to try to move taxpayers

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- 1 National Taxpayer Advocate 2015 Annual Report to Congress 3-13 (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*).
 - 2 IRS, <https://www.irs.gov/uac/newsroom/irs-future-state> (last visited Dec. 20, 2016).
 - 3 "As we improve the online experience, we understand the responsibility we have to serve the needs of all taxpayers, whatever their age, income, or location. We recognize there will always be taxpayers who do not have access to the internet, or who simply prefer not to conduct their transactions with the IRS online. The IRS remains committed to providing the services these taxpayers need. We do not intend to curtail the ability of taxpayers to deal with us by phone or in person." *Tax Return Filing Season: Hearing Before the H. Subcomm. on Oversight, Comm. on Ways and Means, 114th Cong.* (Apr. 19, 2016) (written statement of John Koskinen, Commissioner, Internal Revenue Service). See also *Can the IRS Protect Taxpayers' Personal Information? Hearing Before the H. Subcomm. on Research and Technology, Comm. on Science, Space and Technology, 114th Cong.* (Apr. 14, 2016) (statement of John Koskinen, Commissioner, Internal Revenue Service), <https://www.irs.gov/uac/written-testimony-of-commissioner-koskinen-before-the-house-science-space-and-technology-committee-on-cybersecurity-and-protecting-taxpayer-information>, and John A. Koskinen, Commissioner of Internal Revenue, Address Before the National Press Club (Mar. 24, 2016), <https://www.irs.gov/uac/March-24-2016-Commissioner-Koskinen-Speech-to-National-Press-Club>.
 - 4 10,723 practitioners and preparers attended the IRS Nationwide Tax Forums. Of those, 2,263 attended the presentation "IRS Future State Initiative" at five Tax Forums in 2016. Email from IRS Office of Online Services to TAS (Dec. 13, 2016).

to less costly methods of communication, or channels, including digital self-service options.⁵ But as tax administrators throughout the world have learned, and as the National Taxpayer Advocate discusses in this annual report, many of these shifts are only superficially less costly.⁶ This is so because even the best-designed digital environment cannot accommodate the sheer complexity of the tax code and the limitless variety of taxpayers' lives and circumstances. This constrained communication, coupled with automated impersonal and often harmful IRS actions, can alienate the taxpayer population and over time may undermine compliance. Even if there is no negative compliance impact (which the National Taxpayer Advocate does not believe), it is not a recipe for good government if a large portion of U.S. taxpayers are alienated from and distrustful of the one government agency they interact with at least annually throughout their adult lives.

... even the best-designed digital environment cannot accommodate the sheer complexity of the tax code and the limitless variety of taxpayers' lives and circumstances.

For these reasons, and given her statutory role as “an independent voice for the taxpayer within the IRS,”⁷ in this Special Focus, the National Taxpayer Advocate has attempted to identify and make recommendations to address the challenges the IRS faces to become a 21st century, taxpayer-centric tax administrator. The first and most obvious is the compelling need for tax reform. In our first legislative recommendation, *Simplify the Internal Revenue Code Now*, we describe in detail the burdens the current, hideously complex Code imposes on taxpayers and the IRS alike. But suffice it to say here that a Code consisting of four million words⁸ and requiring six billion hours of taxpayer time when meeting their filing requirements⁹ is simply too complex to administer well. Add to that the fact that the federal government “spends” more money through the tax code each year than it spends to fund the entire federal

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- 5 In FY 2010, the agency's appropriated budget stood at \$12.1 billion. For FY 2016, its budget was \$11.2 billion, a reduction of nearly eight 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, <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.
 - 6 See Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations* and Literature Review: *Taxpayer Service in Other Countries*, vol. 3, *infra*.
 - 7 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 48 (June 25, 1997).
 - 8 To determine the number of words in the Internal Revenue Code (IRC), TAS downloaded Title 26 of the U.S. Code (*i.e.*, the IRC) from the website of the U.S. House of Representatives, <http://uscode.house.gov>. We copied the file into Microsoft Word, and used the “word count” feature to compute the number of words. The online version of Title 26 we used was current through December 12, 2016. In Word, the document ran 10,928 single-spaced pages. The printed code contains certain information that does not have the effect of law, such as a description of amendments that have been adopted, effective dates, cross references, and captions. The word count feature also counts page numbers, the table of contents, and the like. Therefore, our count somewhat overstates the number of words that are officially considered a part of the tax code, although as a practical matter, a person seeking to determine the law will likely have to read and consider many of these additional words, including effective dates, cross references, and captions. Other attempts to determine the length of the Code may have excluded some or all of these components, but there is no clearly correct methodology to use, and we found no easy way to selectively delete information from a document of this length.
 - 9 The TAS Research function arrived at this estimate by multiplying the number of copies of each form filed for calendar year 2015 by the average amount of time the IRS estimated it took to complete the form. While the IRS's estimates are the most authoritative available, the amount of time the average taxpayer spends completing a form is difficult to measure with precision. This TAS estimate may be low because it does not take into account all forms and, as noted in the text, it does not include the amount of time taxpayers spend responding to post-filing notices, examinations, or collection actions. Conversely, the TAS estimate may be high because IRS time estimates have not necessarily kept pace fully with technology improvements that allow a wider range of processing activities to be completed via automation.

government through the appropriations process.¹⁰ Clearly, the Internal Revenue Code (IRC) is due for an overhaul.

In Public Forums, Tax Forum Focus Groups, and TAS Workgroups, two other broad themes emerged. First, ours is a voluntary compliance system that rests on the cooperation of taxpayers, large and small. It requires engagement with taxpayers. For taxpayers to be engaged, the IRS needs to *talk to the taxpayer!* Here is how one TAS employee stated it: “Sometimes nothing can replace the sound and the tone of a human voice, especially in a crisis situation. IRS must present a human side to the agency to foster and keep voluntary compliance.”¹¹

The last broad theme is the need for establishing minimum standards of and testing for competency of federal tax return preparers. The National Taxpayer Advocate has long recommended a pragmatic oversight regime designed to protect U.S. taxpayers from unscrupulous and incompetent return preparers.¹² She reiterates that recommendation here, and notes that without such standards and oversight, the entire tax system is at risk.

In addition to these three foundational themes, there are several other areas of tax administration requiring attention before the IRS can become a world-class 21st century tax administration. These challenges include:

- **IRS Budget and Oversight:** To fairly, effectively, and efficiently administer the tax system, the IRS must receive increased funding, but such funding should be tied to additional congressional oversight of IRS strategic and operational plans;

¹⁰ In FY 2016, the Treasury Department estimated “tax expenditures” amounted to more than \$1.4 trillion. At the same time, discretionary appropriations amounted to less than \$1.2 trillion. The federal budget consists of discretionary spending for government operations that Congress sets through annual appropriations acts and mandatory spending that is established through eligibility and benefit formulas, such as Social Security and Medicare benefits, as well as interest on the federal debt. For FY 2016, appropriated funds totaled about \$1.17 trillion. See Congressional Budget Office, *An Update to the Budget and Economic Outlook: 2016 to 2026*, Table 1-3 (Aug. 2016), <https://www.cbo.gov/sites/default/files/51118-2016-08-BudgetProjections.xlsx>. For a list and description of tax expenditures, see Office of Tax Analysis, U.S. Department of the Treasury, *Tax Expenditures* (Sept. 2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/Tax-Expenditures-FY2018.pdf>. The Joint Committee on Taxation also publishes estimates of tax expenditures. There are some differences in methodology between the Treasury Department’s methodology and the Joint Committee’s methodology, and the Joint Committee’s most recent estimate of tax expenditures for FY 2016 was more than \$1.3 trillion — also greater than federal appropriations but somewhat less than the Treasury Department’s estimate. See J. COMM. ON TAX’N, JCX-141R-15, *Estimates of Federal Tax Expenditures for Fiscal Years 2015-2019* (Dec. 2015), <https://www.jct.gov/publications.html?func=startdown&id=4857>.

¹¹ TAS, *Executive Briefing, Future State Discussion Analysis* 41 (Sept. 2016). Here is more wisdom from TAS employees: The Future State completely changes the expectations that the taxpaying public can have of the IRS. These taxpayers have always known they could come to an IRS walk-in office or call the IRS toll-free line in order to have their questions answered. However, this is a change in the basic “contract” between the IRS and the taxpaying public. This means that some taxpayers will be comfortable and confident in their ability to understand the tax law and meet their obligations, while other taxpayers will likely feel “left behind” in the Future State. *Id.* at 18.

And:

You can’t replace verbal communication and excel in voluntary compliance, nor customer service. *Id.* at 23.

¹² 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 2006 Annual Report to Congress 197-221 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); 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*).

- **IRS Culture:** To create an environment that encourages taxpayer trust and confidence, the IRS must change its culture from one that is enforcement-oriented to one that is service-oriented;
- **IRS Mission Statement:** To ensure the IRS recruits, hires, and trains employees with the appropriate skill sets, the IRS must revise its mission statement to explicitly acknowledge the IRS's dual mission of collecting revenue and disbursing benefits, as well as the foundational role of the Taxpayer Bill of Rights;
- **Understanding Taxpayer Needs and Preferences:** To ensure that the IRS designs its Current and Future State initiatives based on actual taxpayer needs and preferences, the IRS must actively and directly engage with the taxpayer populations it serves as well as undertake a robust research agenda that furthers an understanding of taxpayer compliance behavior;
- **Taxpayer Rights and the Future State:** To ensure that taxpayer rights, and the Taxpayer Bill of Rights specifically, are the foundation for tax administration the IRS should undertake a comprehensive review of key taxpayer rights provisions in the IRC and issue proposed guidance for public comment, updating these provisions to protect taxpayer rights in the digital environment envisioned by the IRS Future State;
- **Grossly Outdated Technology and Infrastructure:** To enable the IRS to meet the major technology improvements required for a 21st century tax administration, even as it fulfills current operational technology demands, the IRS must articulate a clear strategy that will reassure Congress and taxpayers the funding will be well-spent; and
- **Office of the Taxpayer Advocate:** To protect taxpayer rights and ensure a fair and just tax system, Congress should take steps to strengthen the Taxpayer Advocate Service.

The National Taxpayer Advocate has listed the need for additional IRS funding and oversight first because without adequate funding, taxpayers are being and will be harmed by the “efficiencies” the IRS imposes to deal with budget reductions. However, she links the IRS need for more funding with the need for more congressional oversight of the agency’s priorities. Congressional oversight is necessary to ensure that the IRS appropriately allocates and applies that funding, and that taxpayer needs — not just the agency’s internal needs — are met.

To achieve the appropriate level and allocation of IRS funding, in the sections that follow, the National Taxpayer Advocate identifies and discusses key elements that must be addressed, including a change in IRS culture from enforcement-focused to service first. We must embed taxpayer rights into every aspect of the agency's mission. We must understand how to improve taxpayer morale, including what factors influence taxpayer compliance behavior and what taxpayers need and prefer in order to meet their tax obligations. Similarly with tax reform — we must understand compliance behavior even as we legislate tax policy. Otherwise, we will pass laws with which taxpayers cannot comply.

In writing this Special Focus, the National Taxpayer Advocate has relied heavily on the wealth of information obtained throughout 2016 from her 12 Public Forums on Taxpayer Needs and Preferences; focus groups with practitioners and preparers about the “Future State” held at five Nationwide Tax Forums; and discussion meetings held with all employees in each office of the Taxpayer Advocate Service (TAS). All of these materials, including full transcripts of the Public Forums, are available to the public at <https://taxpayeradvocate.irs.gov/public-forums>. In addition, we include in Volume 2 of this report the interim findings of a nationwide taxpayer survey about their needs and preferences.¹³ Thus, to an unusual extent for government, the analysis and recommendations presented here reflect the perspectives of taxpayers and their representatives, as well as the combined experience of the National Taxpayer Advocate and her employees, whose job it is to advocate for taxpayers.

13 See Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

IRS BUDGET AND OVERSIGHT: To fairly, effectively, and efficiently administer the tax system, the IRS must receive increased funding, but such funding should be tied to additional congressional oversight of IRS strategic and operational plans.

Simply put, the IRS cannot function well in the 21st century with the budget it has today. More funding is paramount — for taxpayer service, for compliance functions, for the agency’s enforcement function (Criminal Investigation), for technology, and for its “support” operations like security and real estate.

The National Taxpayer Advocate has served in her position for over 15 years, and she has witnessed firsthand how IRS officers and employees struggle to meet the often competing demands placed on them by new legislation, congressional priorities, natural and other emergencies, the identity theft epidemic, and taxpayer needs and preferences. Each year the IRS must deliver a filing season in which it processes some 150 million individual tax returns and issues over 115 million refunds totaling over \$345 billion,¹⁴ while guarding against between \$22 and \$24 billion in identity theft and refund fraud.¹⁵ At the same time, it must incorporate new legislative changes — almost 5,900 since 2001, an average of more than one a day¹⁶ — and major new programs like the Affordable Care Act (ACA) and the Foreign Account Tax Compliance Act (FATCA). Thus, the IRS spreads thin the resources it has, and every decision to apply resources in one place means that another area goes begging. Understandably, it focuses on what it considers its major obligations — the filing season, new legislation, and the area of information technology and cybersecurity. The consequences of this “big item” focus are that smaller, important, taxpayer-facing service is reduced or eliminated, including the community presence of education and outreach, Taxpayer Assistance Centers (TACs), compliance personnel, and Appeals officers. For example:

- Despite the IRS’s increased ability to handle taxpayer calls using automation, the percentage of calls the IRS answered from taxpayers seeking to speak with a telephone assistant dropped from 87 percent to 53 percent between fiscal year (FY) 2004 and FY 2016.¹⁷ Among the callers who got through, the average time spent waiting on hold increased from just over 2.5 minutes in FY 2004 to nearly 18 minutes in FY 2016.¹⁸ Comparing FY 2004 with FY 2016, the number of calls the IRS received from taxpayers on its Accounts Management telephone lines increased from 71 million to 104 million, yet the number of calls answered by telephone assistants declined from 36 million to 26 million.¹⁹
- In 2014, the IRS ceased all tax preparation in the TACs and eliminated post-April 15 tax law phone and TAC assistance.
- The IRS has also reduced the number of TACs (also known as walk-in sites) from 401 to 376 (six percent) since 2011.²⁰ Additionally, 22 TACs have no staff, and 95 have only one employee.²¹

14 IRS Pub. 55B, IRS Data Book 2015 (Mar. 2016), Tables 2, 7 and 8. Figures are for FY 2015.

15 Treasury Inspector General for Tax Administration, Ref. 2015-40-026, *Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft 2* (Apr. 24, 2015).

16 For an in-depth discussion of the need for tax reform and the methodology of this calculation, see Legislative Recommendation: *Simplify the Internal Revenue Code Now*, *infra*.

17 *Compare* IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2016) with IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2004). The Accounts Management telephone lines (previously known as the Customer Account Services telephone lines) receive the significant majority of taxpayer calls. However, taxpayer calls to compliance phone lines and certain other categories of calls are excluded from this total.

18 *Id.*

19 *Id.*

20 In 2011, the IRS operated 401 TACs. IRS response to TAS information request (Dec.23, 2014). Today the IRS operates 376 TACs, a reduction of six percent. IRS response to TAS fact check (Dec. 20, 2016).

21 IRS response to TAS fact check (Dec. 20, 2016).

- Sixteen states have no Appeals or Settlement Officers present within their boundaries, and 14 states have no IRS liaisons to Small Business/Self-Employed taxpayers within their boundaries.²²

Figure S.1 shows the reduction in IRS geographic presence and employees between 2011 and 2016.

FIGURE S.1, Locations With Specified Employees in the Last Pay Period of the Fiscal Year²³

Number of Locations, Employees, or Visitors	2011	2012	2013	2014	2015	2016
IRS Offices (Cities)	541	523	510	499	479	470
Appeals Officers (AOs)	1,129	1,058	958	881	795	739
Revenue Officers (ROs)	4,402	4,035	3,703	3,441	3,191	3,072
Revenue Agents (RAs)	11,959	11,258	10,502	9,776	9,090	8,871
Stakeholder Liaison Outreach Employees	137	123	119	110	105	98
Stakeholder Partnerships, Education and Communication Outreach Employees	522	475	444	405	386	365
Taxpayer Assistance Centers (TACs)	401	401	398	382	378	376
TAC Service Reps	1,639	1,515	1,484	1,520	1,423	1,267

At the same time, taxpayer returns and forms filed increased between tax year (TY) 2011 and TY 2015. Overall, filings grew nearly four percent from 234,567,000 in TY 2011 to 243,249,000 in TY 2015.²⁴

We discuss the effects of this reduction in our Most Serious Problems, herein, on the structure of the IRS and the lack of a geographic presence in communities.²⁵

- 22 Appeals response to TAS information request (June 6, 2016). Puerto Rico lacks an Appeals or Settlement Officer in addition to the 16 states. IRS response to TAS fact check (Dec. 15, 2016). IRS Human Resources Reporting Center, *Report of SB/SE Job Series 0526, Stakeholder Liaison Field Employees* as of the week ending October 1, 2016 (report generated Dec. 1, 2016). The District of Columbia lacks an IRS liaison in addition to the 14 states. See Most Serious Problem: *Geographic Focus: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance, infra.*
- 23 Figures for Appeals Officers, Revenue Officers, Revenue Agents, Stakeholder Liaison Outreach, SPEC Outreach, and Taxpayer Assistance Center (TAC) Service Representatives are from the IRS response to TAS fact check (Dec. 16, 2016). TAC customer service representative figures are from the IRS Human Resources Reporting Center, *Position Report by Employee Listing for the ending pay period for FY 2011 to 2016*, Nov. 2, 2016. The IRS response to TAS Fact Check (Dec. 16, 2016) showed the following counts for TAC customer service representative: Fiscal Year (FY) 2011 – 1,977, FY 2012 – 1,839, FY 2013 – 1,775, FY 2014 – 1,803, FY 2015 – 1,678, and FY 2016 – 1,477. TAS was unable to replicate the IRS TAC employee figures. TAC Office figures for FYs 2011–2014 from IRS response to TAS fact check (Dec. 23, 2014). TAC Office figures for FY 2015 from Wage and Investment (W&I) analyst (Dec. 13, 2106). TAC Office figures for FY 2016 from the IRS response to TAS fact check (Dec. 20, 2016).
- 24 IRS, *Databook Returns Filed Tax Year (TYs) 2011-2015* (Nov. 30, 2016). This total includes individual income tax returns, business-entity income tax returns, employment tax returns, estimated tax forms, and certain other returns and forms.
- 25 See Most Serious Problems: *IRS Structure: The IRS's Functional Structure Is Not Well-suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, and *Geographic Focus: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance, infra.* See also Literature Review: *Geographic Considerations for Tax Administration*, vol. 3, *infra.*

Downstream Costs of IRS Budget Cuts Can Outweigh Savings, Increase Taxpayer and IRS Burden, and Erode Taxpayer Trust

Far too often, in response to budget constraints, the IRS makes penny-wise, pound-foolish decisions. For example, the recently announced revised rules about the limited availability of face-to-face Appeals conferences, and changes to settlement authority of certain Appeals' personnel, has led to criticism from key tax professional groups.²⁶ The National Taxpayer Advocate personally provided several suggestions to the Chief of Appeals and other senior Appeals officials that, if adopted, would address many of Appeals' concerns about wise use of resources while not vitiating the taxpayer's *rights to appeal an IRS decision in an independent forum* and *to a fair and just tax system*.²⁷ Instead, far from reducing overall costs, Appeals' proposed procedures will increase costs for both the IRS and the taxpayer by shifting issue resolution to more expensive litigation venues or downstream to the IRS compliance functions or the Taxpayer Advocate Service, increasing unnecessary rework. Either way, taxpayer confidence in and patience with the IRS is eroded.

Initiatives designed to save IRS resources are too often focused inward on the IRS's own needs — how it can gain cost savings in one area so it can reapply them elsewhere. Again, while this is understandable in the present environment, it is not right. These decisions do not adequately take account of taxpayer needs and preferences, taxpayer burden, or the downstream costs incurred because taxpayers have not received the assistance they need.

For example, over the last two years, the IRS has been moving slowly to an appointment-only system for assistance in the TACs. These locations were formerly known as “walk-in centers,” but for all intents and purposes, in the 2017 filing season, the IRS will not be accepting “walk-ins.” While the National Taxpayer Advocate has long recommended the IRS offer taxpayers the *option* of making appointments, she is opposed to making TACs available *exclusively* by appointment.²⁸ The following testimony from the National Taxpayer Advocate Public Forum in San Antonio illustrates the myopia of this policy:

[S]everal months ago I had a client that I was assisting to help make sure that he did not get a lien filed. And so from that perspective he had filed a 2014 tax return and underpaid by several hundred thousand dollars.

Well, he settled that case and came into the money that he needed to pay to the IRS. So I said, okay, well, cut me the check made out to the IRS, folks, of course. And, and I will go

26 See, e.g., Letter from Joan C. Arnold, American College of Tax Counsel, to Kirsten Wielobob, Chief Appeals (Oct. 10, 2016); Coalition for Effective and Efficient Tax Administration, letter to Kirsten Wielobob, Chief Appeals (Oct. 21, 2016); Memorandum from Kenneth M. Horwitz, Texas Society of Certified Public Accountants to Commissioner of Internal Revenue (May 13, 2016) (Preserving and Improving Access to Face-to-Face Appeals Conferences). See also Statement of Jaime Vasquez, Chamberlain, Hrdlicka, White, Williams & Aughtry, National Taxpayer Advocate Public Forum 52 (Aug. 30, 2016):

So what I've seen is that cases that don't need to go to [T]ax [C]ourt can be resolved with the IRS appeals office. And with the cutback of the number of local IRS appeals officers, what's happening is that people's cases are getting shipped to IRS campus offices where they're not getting a face-to-face person who can help resolve their case. And you know, as we all know, sometimes when you're dealing with someone face to face walking them through the particular records and their life circumstances, cases tend to be resolved. These are why such things as mediations are so successful.

27 For a detailed discussion of our concerns about the Office of Appeals concept of operations, see Most Serious Problem: Appeals: The Office of Appeals' Approach to Case Resolution Is Neither Collaborative Nor Taxpayer Friendly and Its "Future Vision" Should Incorporate Those Values, *infra*.

28 See National Taxpayer Advocate 2014 Annual Report to Congress 122-33 (Most Serious Problem: Access to the IRS: Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues); National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 42-45; National Taxpayer Advocate 2012 Annual Report to Congress 302-18 (Most Serious Problem: The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services).

and walk it into the IRS office. Well, that was just when I found out that that local office had just been closed. So there I was with a [\$240,000] check and, you know, I was like, you know, I made several phone calls. No success.

And after a week of sitting with this \$240,000 check, I was getting really embarrassed, of course. No one wants to sit on that much, you know, money for, for someone else. Finally got in touch with an IRS revenue officer who put me in touch with the collection officer for the day who said that, and who had finally, they could accept the [\$240,000] check. And I thought to myself, you know, this is ridiculous.

You know, here I am trying to, you know, help my client getting in compliance with the IRS and we can't even pay the IRS.²⁹

The Role of Congressional Oversight in Achieving Effective 21st Century Tax Administration

As stated above, the IRS has to make difficult choices every day, and those choices have consequences for taxpayers and tax administration. The National Taxpayer Advocate believes there are many things the IRS can do to apply its resources more effectively, particularly with respect to compliance initiatives (indeed, the National Taxpayer Advocate publishes over 1,000 pages a year, via her Annual Reports to Congress, identifying areas for improvement and making recommendations). But the simple fact remains, even with these improvements, the IRS needs more funding. It cannot become a 21st century tax administration without adequate support from Congress.

Sometimes nothing can replace the sound and the tone of a human voice, especially in a crisis situation. IRS must present a human side to the agency to foster and keep voluntary compliance.

That support is not just financial. The National Taxpayer Advocate believes there is a key role for congressional oversight both as a preliminary to and a consequence of additional funding. This oversight should focus on the effectiveness of IRS service and compliance activities with respect to the 150 million individual taxpayers and ten million business taxpayers, especially small businesses and self-employed individuals. Is the IRS availing itself of the most important insights of behavioral science?³⁰ For example, during the first two weeks of January before the 2016 filing season, the National Taxpayer Advocate sent out about 7,100 letters to taxpayers who had claimed the Earned Income Tax Credit (EITC) on their 2014 returns but whose claims were flagged by the IRS Dependent Database (DDb) as being highly questionable. The IRS did not audit these taxpayers because of insufficient resources. The letters were strictly educational and tailored to the specific rule “broken” by the taxpayer; they were written in a helpful tone and clearly stated the taxpayer was not under audit. These letters had a statistically significant positive impact on the EITC compliance of this group of taxpayers. Thus, projected against the population of EITC filers who violated these particular rules, for the cost of a letter and postage, the IRS could prevent \$47 million in EITC noncompliance.³¹ TAS is repeating this test in the 2017 filing season; in this version, we will be offering some EITC taxpayers

29 Statement of Jaime Vasquez, Chamberlain, Hrdlicka, White, Williams & Aughtry, National Taxpayer Advocate Public Forum, 48-49 (Aug. 30, 2016).

30 For a discussion of the application of behavioral insights to tax administration, see *Most Serious Problem: Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *infra*. See also *Literature Review: Behavioral Science Lessons for Taxpayer Compliance*, vol. 3, *infra*.

31 For a copy of the letters sent, and a detailed discussion of this research study, see *Research Study: Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits Apparently in Error and Were Sent an Education Letter from the National Taxpayer Advocate*, vol. 2, *infra*.

a dedicated “Extra Help” line in which trained TAS employees will answer taxpayer questions *before* the taxpayers file their returns.

Nevertheless, the IRS relies on audits as its primary compliance tool for maintaining reporting compliance — closing nearly 874,000 individual taxpayer audits in FY 2016, with 84 percent of those through correspondence.³² To understand the effectiveness of this application of resources, we need to know what percentage of IRS audits result in no change, by type of audit. Research has shown that when an audit results in no change, the taxpayer is more likely to report less income in the future.³³ Where there is an assessment, what percentage of audits are reopened later as audit reconsiderations, resulting in unnecessary downstream re-work? Of the audits that result in a Tax Court case, what percentage are settled — and why — by IRS Appeals or Chief Counsel employees? How much audit activity results in future voluntary compliance? Since the point of an audit is not just to assess additional tax but to ensure that the same errors or positions do not occur again, what percentage of audited taxpayers understand why the adjustments were made? These are just a few of the questions that overseers should be asking of the IRS to ensure that current and additional funding is spent wisely and effectively.

As part of the reorganization mandated by Congress in the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Congress held joint annual hearings, over five years, to review the IRS strategic plan.³⁴ The hearing participants included three members (two majority and one minority) from each of the congressional committees with jurisdiction over the IRS — Senate Finance Appropriations, and Governmental Affairs; and House Ways and Means Appropriations and Governmental Reform and Oversight. The hearings were to cover the following topics:

- (1) IRS progress in meeting its objectives under its strategic and business plans;
- (2) IRS progress in improving taxpayer service and compliance;
- (3) IRS progress on technology modernization; and
- (4) The annual filing season.³⁵

The National Taxpayer Advocate recommends that Congress reinstitute this commendable practice. By holding recurring joint oversight hearings, the IRS will have the opportunity to articulate, with specificity, its need for additional resources and its plans for applying them. Hearing from both the IRS and outside experts — including tax professional organizations, business representatives, Low Income Taxpayer Clinics, and behavioral scientists — Congress will better understand the challenges that both the IRS and taxpayers face. It can then make informed decisions about the level and general application of resources necessary for the IRS to provide U.S. taxpayers with a 21st century tax administration they can trust and admire.

32 IRS, Compliance Data Warehouse, Automated Information Management System (AIMS) Closed Case Database.

33 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 67-98 (Research Study: *Audit Impact Study*); National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 27-42 (Research Study: *Estimating the Impact of Audits on the Subsequent Reporting Compliance of Small Business Taxpayers: Preliminary Results*).

34 Pub. L. No. 105-206, § 4001, enacting IRC § 8021(f), and § 4002, amending IRC § 8022, 112 Stat. 685, 783-84 (1998).

35 H. REP. No. 105-364, at 84-85 (1997). The Restructuring Commission earlier recommended that Congress create a joint committee on IRS administration, which would conduct joint hearings on similar topics. National Commission on Restructuring the IRS, *A Vision for a New IRS* 2-3 (June 15, 1997).

Recommendations

The National Taxpayer Advocate recommends that Congress:

- Reinstating the joint review of the IRS strategic plans and budget provided for under IRC §§ 8021(f) and 8022.
- Requiring the IRS to submit a comprehensive “Future State” plan that describes, in sufficient detail, its vision for a 21st century IRS, including an explanation of how that vision meets the needs and preferences of different U.S. taxpayer segments, and describes the challenges and obstacles the IRS faces in achieving this “Future State.”
- Providing funding for IRS initiatives that enhance and maintain voluntary compliance, align with the specific needs and preferences of taxpayers as they attempt to comply with the tax laws, and eliminate unnecessary downstream re-work.

IRS CULTURE: To create an environment that encourages taxpayer trust and confidence, the IRS must change its culture from one that is enforcement-oriented to one that is service-oriented.

In its *Snapshot of A Better Way for Tax Reform* blueprint, the House Republicans' Tax Reform Task Force describes "A Service First IRS," noting that "[a] simpler, fairer tax code will require a simpler, fairer IRS with one mission: Put the taxpayers first."³⁶ Congress has addressed this issue before. In the IRS Restructuring and Reform Act of 1998 (RRA 98), it directed the IRS to "restate its mission to place a greater emphasis on serving the public and meeting taxpayers' needs."³⁷

Yet today, the IRS's annual appropriation of \$11.2 billion allocates 43 percent to Enforcement, with only 21 percent attributable to taxpayer service. Of the \$2.3 billion allocation for Taxpayer Service, 73 percent is attributable to operational items like receiving and processing tax returns and payments, and only 27 percent is attributable to functions such as outreach and education.³⁸ In other words, outreach and education activities constitute less than six percent of the IRS budget.

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If a tax agency views its primary mission as "enforcing" the tax laws, it will design its procedures and apply its resources to "hunt down" those taxpayers it views as noncompliant.³⁹ It justifies this approach by rationalizing that law-abiding taxpayers want to know that all taxpayers are paying their fair share. The problem with this approach is that it undermines the willingness of taxpayers to comply by focusing most of its resources on those who are not willing to comply. Taxpayers who are willing to comply are left without adequate support.

In an enforcement-oriented tax agency, if taxpayers don't get the help they need to comply and they make a mistake, they are treated as if they are tax evaders. This treatment in turn breeds resentment and increases the risk that the taxpayer who was willing to comply is no longer willing to do so. In this way, the underlying assumption by the tax agency that taxpayers will evade tax becomes a self-fulfilling proposition. The agency ends up converting a compliant taxpayer into a noncompliant one.⁴⁰

What if the tax agency adopted a different approach toward taxpayers? What if it assumed that taxpayers, by and large, wanted to obey the law and that the primary mission of the tax agency was to facilitate that compliance by providing taxpayers with the assistance, education, and clarity they need to meet their tax obligations? What if we started out accepting that taxpayers will make mistakes and, until proven otherwise, assume those mistakes are not attributable to a tax evasion motive? This matters because tax noncompliance, like most human behavior, is driven by a broad spectrum of factors, from just plain

36 House Republicans' Tax Reform Task Force, *A Better Way for Tax Reform*, http://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-Snapshot.pdf.

37 RRA 98, Pub. L. No. 105-206, Title I, § 1002, 112 Stat. 685 (1998).

38 Consolidated Appropriations Act, 2016, Pub. Law 114-113, enacted Dec. 18, 2015. FY 2016 Operating Plan, Integrated Financial System (IFS).

39 See Written Statement of Pam Olson, PricewaterhouseCoopers, National Taxpayer Advocate Public Forum 20-22 (Feb. 23, 2016):

Those of you who know me know that I've not been fond of use of the word enforcement when it comes to the IRS because I think enforcing the law is an action that compels people to do something and it is not something that has to be visited on the average taxpayer. The average taxpayer wants to voluntarily comply and we just need to make sure they have the tools and the resources to do it. They may need advice or assistance but rarely do they need an enforcement action to compel them to pay their tax or to punish them for failing to do so.

40 For a discussion of the drivers of voluntary compliance, see Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called "Enforcement" Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *infra*.

This is not to say we should ignore those who are actively evading tax. Rather, it is to say we should *design* our tax system around the taxpayers who are trying to comply, instead of those who are actively trying not to.

carelessness to ignorance to confusion to polemics to avarice. By focusing on the source or reasons for a taxpayer’s noncompliance, and not just on the end result of the behavior, we have a better chance of changing the behavior and improving tax compliance going forward.⁴¹

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Bringing About a Cultural Shift: You Get What You Measure

The National Commission on Restructuring the IRS summarized the agency’s culture in this way:

The culture of IRS is overly risk averse, based on a tradition of valuing checks and controls over creative approaches to solving problems. In order to evolve into a more taxpayer focused, responsive organization, a cultural shift must occur at the IRS. The positives of the culture are that employees will execute orders and follow directions. The negatives are that the IRS environment often does not encourage personal or organizational growth, and stifles creativity, innovation, and quick problem resolution.⁴²

Changing an organization’s culture begins with understanding what drives employees’ and officers’ behavior. Basically, you get what you measure. The IRS’s own annual announcement of measures and successes reflects this enforcement-heavy mentality — enforcement dollars assessed (via liens and levies), enforcement dollars collected, liens filed, levies issued.⁴³ It includes five pages of “enforcement” results and only one page — six items — of taxpayer service results. There is no mention of how much in the way of tax or penalties are abated annually because they were incorrectly or inappropriately assessed, or how many TAS cases resulted in full or partial relief, or how many outreach or education events were held in-person so that IRS employees and officers (including those in the audit and collection functions) could hear directly about taxpayer concerns. The IRS does not track how many people were turned away from TACs (formerly known as “walk-in sites” but now appointment-only).⁴⁴

41 See Written Statement of Leslie Book, Professor, Villanova Law School, National Taxpayer Advocate Public Forum 55 (Feb. 23, 2016):

I think, however, getting back to trust and how that relates to taxpayers there is no question that sanctions alone is really not the way, a sanctioned based approach is not the only way to encourage voluntary compliance. There needs to be an emphasis on insuring that interactions with taxpayers enhances trust and trust between the taxpayer and the IRS is a two-way street but if the taxpayers have an absence of trust in what the IRS is doing it leads to kind of spirals and increases non-compliance.

42 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 12-13 (June 25, 1997).

43 IRS, *Fiscal Year 2015 Enforcement and Service Results*, <https://www.irs.gov/uac/newsroom/fiscal-year-2015-enforcement-and-service-results>.

44 Since 2014, the National Taxpayer Advocate has published in the Annual Report to Congress a “report card” on the IRS, listing measures that would give a sense of whether the IRS is treating taxpayers right. This list of measures is organized under each of the ten taxpayer rights stated in the Taxpayer Bill of Rights and could serve as a starting point for a more comprehensive and balanced set of performance measures. See *Taxpayer Rights Assessment: IRS Performance Measures and Data Relating to Taxpayer Rights*, *infra*.

If we want IRS employees to focus on increasing taxpayer confidence and trust in the tax system, if we want taxpayers to feel engaged in the tax system they are all a part of, then we need to find ways to encourage and reward the IRS workforce for engaging with the population and viewing the taxpayer as a partner in trying to achieve or maintain voluntary compliance.

If we want IRS employees to focus on increasing taxpayer confidence and trust in the tax system, if we want taxpayers to feel engaged in the tax system they are all a part of, then we need to find ways to encourage and reward the IRS workforce for engaging with the population and viewing the taxpayer as a partner in trying to achieve or maintain voluntary compliance.⁴⁵

Notwithstanding the ubiquitous use of the term “enforcement” throughout IRS training, guidance (including the Internal Revenue Manual), and testimony, there is only one true “enforcement” function in the IRS, and that is the Criminal Investigation function. Every other taxpayer-facing part of the IRS is in the business of serving the taxpayer by encouraging voluntary compliance. Yes, there are some employees who utilize tools that compel action, like liens and levies. But activities such as audits and appeals should be viewed first and foremost as educational opportunities, not “enforcement” mechanisms. In an audit, the IRS can learn about the challenges taxpayers face in complying with the laws, and taxpayers can learn about what, in the eyes of the IRS, they reported incorrectly on the return. In some instances, taxpayers can learn that they can’t get away with something they thought they could; on the other hand, the IRS might just learn that it was wrong about an issue, or actually change its position on an aspect of tax law.

As we discuss in the Most Serious Problem about IRS structure herein, the greatest economies for a service-oriented organization are achieved by operating as small units that are located in the proximity of their customers.⁴⁶ Through structural design, performance measures, and, most importantly, training that reinforces engagement with the taxpayer and understanding taxpayer needs and preferences, the IRS can promote voluntary compliance and become a respected and appreciated federal agency.

Recommendation

The National Taxpayer Advocate recommends that the IRS publish an annual report card on comprehensive measures that not only show traditional “enforcement” measures but disclose how the IRS performed in providing assistance and service in meeting taxpayer needs and preferences, as well as increasing voluntary compliance over time. These measures, in turn, should form the basis for Executive performance commitments and assessments.

45 See Written Statement of Elizabeth Atkinson, LeClair Ryan, National Taxpayer Advocate Public Forum 29 (May 13, 2016):
Our tax code is very, very complicated and it’s better for the IRS to be in a position of listening to the taxpayer than having an authoritarian type of regime that not only makes the taxpayer feel like he or she is not being listened to, but sometimes leads to incorrect results and downstream compliance problems because the person is so turned off to the tax system by their experience, they don’t feel like complying anymore.

46 See Most Serious Problem: *IRS Structure: The IRS’s Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, *infra*.

IRS MISSION STATEMENT: To ensure the IRS recruits, hires, and trains employees with the appropriate skill sets, the IRS must revise its mission statement to explicitly acknowledge the IRS’s dual mission of collecting revenue and disbursing benefits, as well as the foundational role of the Taxpayer Bill of Rights.

In RRA 98, Congress directed the IRS to restate its mission statement with an emphasis on taxpayer service.⁴⁷ Accordingly, the IRS adopted the following mission statement: “Provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and *by applying the tax law* with integrity and fairness to all.”⁴⁸ (Emphasis added.) In 2009, with no public discussion, the IRS quietly made a profound change to that mission statement, which now reads: “Provide 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.” (Emphasis added.) As noted in the preceding discussion of IRS culture, this shift in tone and emphasis, from “apply” to “enforce,” has significant consequences for taxpayers, and is closely related to the issue of agency culture.

A second problem with the agency’s current mission statement is its failure to acknowledge and articulate that the 21st century IRS has two specific lines of business: both revenue collector and benefits administrator. The IRS collects over \$3 trillion annually and issues over \$403 billion in refunds.⁴⁹ The Earned Income Tax Credit (EITC), a refundable credit for low and moderate income working families and individuals, accounts for almost \$67 billion in credits paid to 27 million taxpayers.⁵⁰ The tax code is increasingly used to promote various social and economic policies through the mechanism of tax credits and other tax expenditures.⁵¹ Taking an enforcement-oriented approach to these inherently complex provisions, instead of one based on problem identification and understanding of the root causes of noncompliance, can deter eligible taxpayers from claiming benefits to which they are entitled under the law and prevent ineligible taxpayers from understanding what they did wrong.

Instead, by explicitly recognizing the IRS’s role as a benefits administrator in its mission statement, the IRS will have to rethink how it conducts major aspects of its work.⁵² To fulfill this aspect of its mission, it will have to hire employees whose skills are better suited for this educational and compliance work. Thus, for the EITC and other tax provisions specifically targeted to the low income population, the IRS will have to hire or train employees with skills that are drawn from the social work profession.⁵³ These

47 RRA 98, Pub. L. No. 105-206, Title I, § 1002, 112 Stat. 685 (1998).

48 IRM 1.1.1.1.1 (Mar. 1, 2006).

49 IRS Pub. 55B, IRS Data Book 2015 (Mar. 2016), Table 1. Figures are for FY 2015.

50 IRS, *About EITC*, <https://www.eitc.irs.gov/EITC-Central/abouteitc> (last visited Dec. 31, 2016). For Tax Year 2015, 27.3 million taxpayers had claimed \$66.9 billion in EITC (after math error processing, but prior to any audit of the tax return). IRS, Compliance Data Warehouse, *Individual Returns Transaction File* (includes Tax Year 2015 returns posted as of cycle 47).

51 For a discussion of the complexity and lack of transparency these provisions create, see Legislative Recommendation: *Simplify the Internal Revenue Code Now*, *infra*. For recommendations about reforming the EITC and other Family Status provisions, see Legislative Recommendation: *Tax Reform: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*, *infra*. The National Taxpayer Advocate has previously discussed design elements that should be considered when running social benefit programs through the tax code. See National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, 75-104 (*Running Social Programs Through the Tax System*).

52 See Statement of Pam Olson, PricewaterhouseCoopers LLP, National Taxpayer Advocate Public Forum 47 (Feb. 23, 2016):
I think the most important thing is for the IRS to fully embrace the multifaceted responsibilities that it has with respect to both collecting tax as well as administering benefit system and administering lots of other things and making sure that it is factoring that into how it plans its service.

53 For a detailed discussion of the challenges faced by EITC taxpayers, see Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State’s Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

employees will have the skills not only to employ interviewing techniques that are designed to elicit information without fear, but also to focus on educating the taxpayer going forward.

Finally, the IRS mission should explicitly acknowledge that the Taxpayer Bill of Rights (TBOR) underlies all of its actions. As we discuss later in this report, while the IRS has done a commendable job publicizing the TBOR to taxpayers, it still has considerable work to do integrating the TBOR in the life, training, and ethos of the agency.⁵⁴ Explicit mention in the mission statement would reinforce to IRS employees, and reassure taxpayers, that the TBOR is a guiding principle for all IRS actions.

Recommendation

The National Taxpayer Advocate recommends that the IRS revise its mission statement to re-emphasize a non-coercive approach to tax administration, recognize the IRS's dual roles of revenue collector and benefits administrator, and explicitly affirm the role of the TBOR as the guiding principle for tax administration.

54 See Most Serious Problem: *Taxpayer Bill of Rights (TBOR): The IRS Must Do More to Incorporate the TBOR into Its Operations*, *infra*.

UNDERSTANDING TAXPAYER NEEDS AND PREFERENCES: To ensure that the IRS designs its Current and Future State initiatives based on actual taxpayer needs and preferences, the IRS must actively and directly engage with the taxpayer populations it serves as well as undertake a robust research agenda that furthers an understanding of taxpayer compliance.

In 2005, Congress directed the IRS to conduct a comprehensive review of its current portfolio of services and develop a five-year strategic plan for taxpayer service.⁵⁵ That plan, the Taxpayer Assistance Blueprint (TAB), has since been updated annually, by congressional directive.⁵⁶ Far from being a strategic plan, the TAB has deteriorated into a list of unrelated initiatives. Meanwhile, IRS budget cuts and consequent elimination or radical restructuring of core taxpayer services have increased taxpayer burden and cost.

An understanding of taxpayer needs and preferences is a prerequisite for effective tax administration.⁵⁷ As Figure S.2 shows, the IRS and TAS have separately undertaken different surveys attempting to identify taxpayer needs. The way one asks questions on the surveys, and the very method of conducting the survey, has consequences for the reliability and usefulness of the data collected. For example, a recent Pew Research Center analysis of survey techniques concluded that online-only surveys have a bias against African-Americans and Hispanics.⁵⁸

55 H. REP. No. 109-307, at 209 (2005).

56 See S. REP. No. 113-80, at 27 (2013); see also IRS Pub. 4701, *Annual Report to Congress: The Taxpayer Assistance Blueprint Taxpayer Service Improvements* (Nov. 2015), <http://core.publish.no.irs.gov/pubs/pdf/p4701-2015-11-00.pdf>.

57 See Statement of Leslie Book, Professor, Villanova School of Law, National Taxpayer Advocate Public Forum 27 (Feb. 23, 2016): I think a fundamental starting point in thinking about service is that the IRS needs to know whom it is serving and the characteristics and challenges associated with a particular group of taxpayers or parties it is regulating. It sounds easy enough but knowing the taxpayer actually is a very resource intensive endeavor. An agency fixated on efficiency and delivering services at lowest possible short term costs without knowing the impact and burdens of its actions may find itself pushing more serious problems down the road while at the same time jeopardizing taxpayer rights.

58 Pew Research Center, *Evaluating Online Nonprobability Surveys: Vendor Choice Matters; Widespread Errors Found for Estimates Based on Blacks and Hispanics* (May 2, 2016), <http://www.pewresearch.org/2016/05/02/evaluating-online-nonprobability-surveys/>. “Online nonprobability survey vendors want to provide samples that are representative of the diversity of the U.S. population, but one important question is whether the panelists who are members of racial and ethnic minority groups are representative of these groups more broadly. This study suggests they are not.” *Id.* at 4.

FIGURE S.2, Summary of Taxpayer Surveys

Survey	Description/Purpose	Methodology	Sample Size	Data Collection Frequency	Survey Conducted
Low Income Taxpayer Clinic Survey	<p>The Low Income Taxpayer Clinic (LITC) Program provides tax representation or advice to low income individuals who need help resolving issues with their federal income tax returns.</p> <p>TAS multi-purpose study to learn more about taxpayers who are eligible for help from LITCs. The study gathered information on:</p> <ul style="list-style-type: none"> • eligible taxpayers' awareness and use of LITC services, • the types of issues for which they would consider using clinics, • demographic information, and • other items. 	Telephone Random Digit Dialed (RDD) landline and cellphone	1,143 934 English 204 Spanish	One time	2014
The Taxpayer Advocate Service: Hispanic Survey	<p>Findings are representative of the low income population (household income at or below 250% of the poverty level), including Spanish speakers of this population.</p> <p>TAS Multi-purpose study to evaluate taxpayer knowledge, beliefs, barriers and perception of TAS and the IRS among US Hispanics.</p>	Telephone Random Digit Dialed (RDD) landline and cellphone	1,014 US General Population Hispanics ages 18 and older 432 English 582 Spanish	One time	2014
Service Priorities Survey	<p>TAS Multi-purpose taxpayer survey to explore:</p> <ul style="list-style-type: none"> • Taxpayers' use of IRS services by delivery channels, as well as service users satisfaction and issue resolution with services, and willingness to use and importance of delivery channels; • Taxpayers' understanding of their rights and responsibilities with IRS • Internet use and abilities 	Telephone Random Digit Dialed (RDD) landline and cellphone	4,000 By mid-November, 1,910 completed 1,106 landline, 804 cell phone	Depends on funding	2016
Taxpayer Experience Survey	<p>Multi-purpose taxpayer survey to explore:</p> <ul style="list-style-type: none"> • Taxpayers' awareness and use of IRS services and service channels, as well as service users satisfaction with services; • Taxpayers' behavior patterns and potential areas for improvements based on their pre-filing, filing, and post-filing experiences (includes experience with refunds & notices); and • Knowledge of ACA requirements. 	Online Panel / Phone	3,689 (2,986 online English; 403 online Spanish; 300 Phone English)	Annually	2016

Table continued on next page. ➤

FIGURE S.2, Summary of Taxpayer Surveys (continued)

Survey	Description/Purpose	Methodology	Sample Size	Data Collection Frequency	Survey Conducted
TAC Expectations Survey	Survey of TAC users designed to capture TAC customer demographic profile, measure overall and service delivery satisfaction, and the extent to which TAC customer service and performance expectations were met from the taxpayer perspective. Data from this research endeavor helps Field Assistance assess and modify its business model.	<p>Paper / In-person</p> <p>Used cluster analysis to categorize TACs. 3 visits (pre-filing, filing, post-filing) to each of the 5 different TAC types for a total of 15 visits:</p> <ul style="list-style-type: none"> • High volume, High wait; • Medium Volume, High Overhead; • Medium volume, Low overhead; • Low Volume, Less complex; and • Low Volume, Complex Task. 	1,519 in FY 2013	Every three years	FY 2013 completed, 2016 in analysis
Web - First Strategy Conjoint	<p>Conjoint survey aimed at understanding how taxpayers' preferences shift with changes to service offerings. This conjoint survey offers participants different scenarios for services, with tradeoffs to see which options are the most important to participants. The study objectives are to:</p> <ul style="list-style-type: none"> • Determine the effect of potential service changes on preference for TAC and phone. • Assess baseline preferences for online services and identify potential methods for increasing preference for online services. • Explore how potential service changes, including the addition of new online service options, affect taxpayer preference for higher cost channels, such as TAC and phone. • Suggest how the IRS can facilitate a preference shift to web-first service options. 	Online Panel	1,604	Every year or two depending on funding	2015 - 2016
IRS Oversight Board - Comprehensive Taxpayer Attitude Survey (CTAS) 2015	Telephone survey which captures taxpayers' tax compliance attitudes, service channel preference, and behaviors (can be compared to findings from previous surveys)	Random Digit Dialed Telephone - landline and cell phone	1,000 - 707 landline, 293 cell phone	Annually. Survey may be discontinued given the uncertain status of the IRS Oversight Board.	2015

The IRS has heavily relied upon the Web-First Strategy Conjoint Survey to build its online account. That survey, conducted fully online, is helpful in understanding what taxpayers who are *already online* are willing to do with regard to *online tax administration*. But the survey ignores those taxpayers who are not online or who are unwilling to participate in online surveys.⁵⁹

During the last year, TAS has conducted a survey by telephone (landline and cellphone) of U.S. taxpayers, including those taxpayers who have used IRS service channels in the recent past.⁶⁰ Although our analysis is preliminary, TAS is able to report results on particular segments of the individual taxpayer population, including:

- Not Low Income taxpayers (taxpayers with total positive income (TPI) above 250 percent of the federal poverty level);⁶¹
- Low Income taxpayers (taxpayers TPI at or below 250 percent of the federal poverty level);
- Elderly taxpayers (taxpayers age 65 or older); and
- Disabled taxpayers (taxpayers who self-identified as having a significant disability).

The survey findings for these categories of taxpayers, reported below, are statistically representative of all taxpayers in these categories.⁶² The importance of the responses of the low income taxpayer population is particularly significant, since these taxpayers constitute over 46 percent of the individual taxpayers filing returns in 2016.⁶³ TAS conducted this survey entirely by telephone (landline and mobile phone) in order to ensure it was not biased against taxpayers who were not online or unwilling to answer surveys online.

The study found that Low Income, Senior, and Disabled taxpayers are less likely to have broadband access and more likely to have no internet access than the Not Low Income taxpayers. More than 33 million U.S. taxpayers have no broadband access at home, including 14 million U.S. taxpayers who have no internet access at home. Notably, 28.5 percent, 40 percent, and 31.9 percent of the Low Income, Senior, and Disabled taxpayers, respectively, had no broadband access at home, significantly limiting their online activities.

59 For a more detailed discussion of our concerns about the IRS online account, see Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical as the IRS Develops an Online Taxpayer Account System*, *infra*. See also Literature Review: *Customer Considerations for Online Accounts Introduction*, vol. 3, *infra*.

60 See Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

61 Total Positive Income (TPI) is calculated by summing the positive values from the following income fields from a taxpayer's most recently filed individual tax return: wages; interest; dividends; distribution from partnerships, small business corporations, estates, or trusts; Schedule C net profits; Schedule F net profits; and other income such as Schedule D profits and capital gains distributions. Losses reported for any of these values are treated as zero.

62 For this interim analysis, the confidence interval ranges from +/- 3 percent to 10 percent, depending on the sample size for each question, with most questions falling into the +/- range of 5 percent or better. TAS Research expects confidence levels to improve upon receipt of the complete data set of 4,000 surveys. For a more detailed discussion of the survey design and methodology, see Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

63 Of the 135.8 million individual taxpayers who had filed TY 2015 individual income tax returns through Cycle 43 of 2016, nearly 63 million taxpayers (46.2 percent) had TPI at or below 250 percent of federal poverty level. These numbers exclude filers who are claimed as a dependent on another tax return. Individual Returns Transaction File for Tax Year 2015 (returns processed through October 31, 2016) on the IRS Compliance Data Warehouse.

The IRS has heavily relied upon the Web-First Strategy Conjoint Survey to build its online account. That survey, conducted fully online, is helpful in understanding what taxpayers who are *already online* are willing to do with regard to *online tax administration*. But the survey ignores those taxpayers who are not online or who are unwilling to participate in online surveys.

FIGURE S.3⁶⁴

Taxpayers Without Broadband Access at Home by Demographic Group

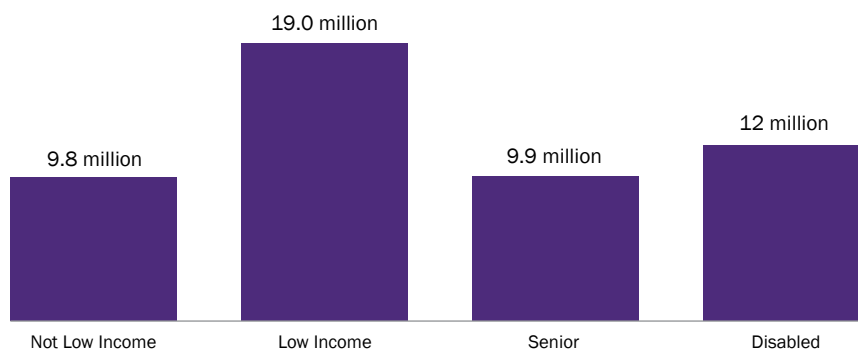
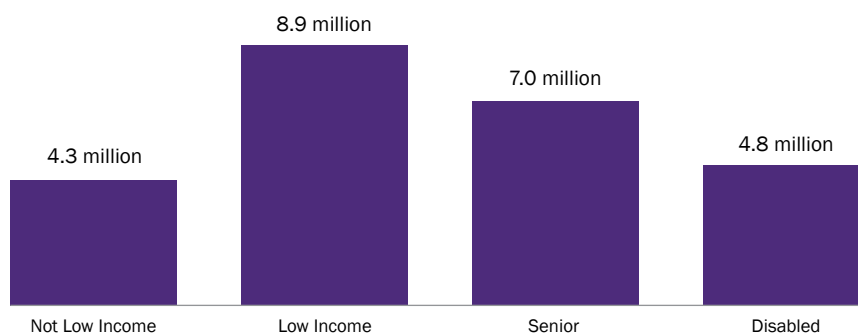


FIGURE S.4⁶⁵

Taxpayers Without Internet Access at Home by Demographic Group



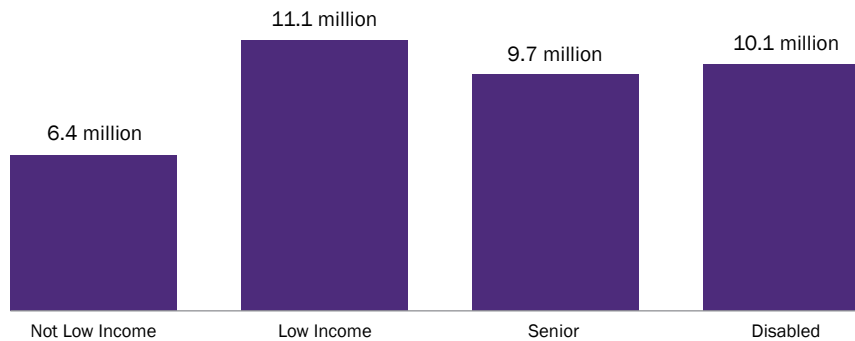
64 See Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

65 *Id.*

The Not Low Income taxpayer group is online more frequently (from home, work, or elsewhere) than the vulnerable groups. Almost 19 percent of the combined Low Income, Senior, and Disabled taxpayer populations said they go online less than once a week or never.

FIGURE S.5⁶⁶

Taxpayers Who Access the Internet Less Than Once a Week, or Not at All, by Demographic Group



Low Income Taxpayers are more likely than Not Low Income taxpayers to access the internet from libraries or through their smartphones.⁶⁷ Access to IRS online accounts via public computers can create serious risks to the privacy of taxpayer data. Moreover, taxpayers whose internet access is through their smartphones report being seriously disadvantaged in performing tasks like uploading resumes and filling out online job applications.⁶⁸ Other complex tasks such as filing a tax return may also pose similar challenges. These findings have significant consequences for a large part of the taxpayer population as the IRS shifts to online accounts, audits, and communication.

The IRS has published several “vignettes” that depict how different types of taxpayers will interact online with the IRS of the future.⁶⁹ Both the Individual (EITC) taxpayer and the Small Business taxpayer vignettes contemplate in-home or in-work broadband access and taxpayers who are comfortable with online tasks. The TAS survey findings show that for large portions of the taxpayer population, taxpayers continue to be uncomfortable with many aspects of online interaction. For example, all of the vulnerable groups (Low Income, Elderly, and Disabled) are less comfortable sending emails on the internet than the Not Low Income. Similarly, all of the vulnerable groups, particularly Seniors, feel they are less

⁶⁶ See Research Study: *Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

⁶⁷ For underlying data, see *Id*.

⁶⁸ Written Statement of Aaron Smith, Pew Research Center, National Taxpayer Advocate Public Forum 1-2 (Feb. 23, 2016):
In a recent survey that we conducted about job seeking online, for example, these “smartphone only” users were far more likely than other Americans to have used their smartphone for highly complex tasks, such as filling out a job application or even creating a resume or cover letter. And in general, a substantial number of non-broadband adopters indicate that performing even relatively basic online job-seeking activities — such as emailing an employer, or filling out an online application — can be challenging without the benefit of a dedicated home connection.”

⁶⁹ See <https://taxpayeradvocate.irs.gov/public-forums> and <https://www.irs.gov/uac/newsroom/future-state-and-irs-activities>. For a detailed discussion of the flawed assumptions relating to the Individual (EITC) vignette, see Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State’s Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

More than 33 million U.S. taxpayers have no broadband access at home, including 14 million U.S. taxpayers who have no internet access at home. Notably, 28.5 percent, 40 percent, and 31.9 percent of the Low Income, Senior, and Disabled taxpayers, respectively, had no broadband access at home, significantly limiting their online activities.

skilled than the Not Low Income at doing research on the internet. And most importantly, more than half of the Low Income, Senior, and Disabled taxpayers stated they did not feel secure sharing personal financial information over the Internet. Indeed, even among the Not Low Income population, over 43 percent of taxpayers said they do not feel secure sharing their personal financial information over the Internet.

Finally, significant percentages of all taxpayer segments did not feel secure sharing personal information with a government agency. Only 38 percent of the Not Low Income population, 33 percent of the Low Income, 17 percent of the Seniors, and 32 percent of Disabled taxpayers were comfortable sharing personal information with the government. These findings have profound implications for taxpayers' willingness to interact with the IRS online in all but the most rudimentary of actions.

These survey findings were mirrored in testimony and comments made at the National Taxpayer Advocate's Public Forums on Taxpayer Needs and Preferences, as well as the Focus Groups at IRS Tax Forums and TAS employee meetings.⁷⁰ From all the data and public suggestions, it is clear that an inadequate emphasis on and provision of in-person assistance will harm U.S. taxpayers in the 21st century.

Recommendations

To ensure that both the present and future states of the IRS serve taxpayers well, the National Taxpayer Advocate recommends that:

- The IRS, in collaboration with the National Taxpayer Advocate, undertake a comprehensive study of taxpayer needs and preferences by taxpayer segment, utilizing telephone, online, and mail surveys, focus groups, town halls, public forums, and research studies. These initiatives should be designed to solicit *taxpayer* needs and preferences, and not be biased by the IRS's own desired direction.
- Congress require the IRS and the National Taxpayer Advocate to jointly report on the results of this comprehensive study through a re-invigorated TAB.

⁷⁰ See, e.g., Oral Statement of Susan Diehl, PenServ Plan Services, Inc., National Taxpayer Advocate Public Forum 18 (Apr. 8, 2016):

What I have observed is that the new individual and business taxpayer experience of the future model seemed to provide little room for personal contact. Granted, this will fit well into the constraints of the budget, but I fear that many will suffer and suffer greatly. Let's consider retirees who have extremely involved questions. Who will help them? Will this model result in more unanswered phone calls with no resolution, or a resolution that comes too late leaving the taxpayer in a penalty situation.

See also Taxpayer Advocate Service, *Executive Briefing: Future State Discussion Analysis 18* (Sept. 2016):

The IRS will be faceless. A taxpayer's only interactions with a human at the IRS will be when there is an enforcement-type action taken with regard to the taxpayer's account. It will leave many taxpayers without basic services needed to comply with the tax system. On one hand, the described scenario might decrease calls and staffing during the initial processing but it could very easily increase calls and staffing after processing because the taxpayer requires clarification of changes and adjustment to his/her account. We have experienced numerous calls when the bar on the "Where's my refund" application changes unexpectedly.

TAXPAYER RIGHTS AND THE FUTURE STATE

Since adopting the National Taxpayer Advocate's proposed Taxpayer Bill of Rights (TBOR), the IRS has made commendable efforts to inform taxpayers about their rights.⁷¹ As we observe later in this report, however, the IRS has a more uneven record in complying with the congressional mandate, codified in Internal Revenue Code (IRC) § 7803(a)(3), to educate IRS employees about the TBOR.⁷²

The National Taxpayer Advocate believes that taxpayer rights, and the TBOR specifically, should be the foundation for tax administration, including any strategic vision for the future. Yet few documents pertaining to the Future State that have been made available to the National Taxpayer Advocate address the TBOR, and those that do only nominally mention it, utilizing a checklist approach at best. None explains how the proposed Future State design and initiatives will specifically advance the general rights stated in the TBOR and the specific protections afforded by the IRC.⁷³

At each of the National Taxpayer Advocate's Public Forums on Taxpayer Needs and Preferences, the panelists and audience members were provided copies of IRS Future State "vignettes" pertaining to individual and small business taxpayers.⁷⁴ These vignettes provide the most detailed representation of the Future State made public to date. As such, they offer insight into how the IRS thinks it will interact with the taxpayers of the future.

At every Public Forum, panelists and audience members expressed serious concerns about the interactions described in the vignettes. A threshold concern was that the system the IRS is designing seems to be stacked in the IRS's favor — *i.e.*, in both vignettes, the taxpayer lost; he or she was wrong. Nowhere did the vignette demonstrate how the taxpayer could prevail in the system of the future. Public Forum panelists and audience members alike commented on this aspect of the Future State:

I find it funny that in both scenarios, there's more taxes. I think that reflects the idea that this model is about the IRS finding new ways to use technology for their benefit, and not for taxpayer purposes.⁷⁵

I'm a CPA, and I've been practicing for 35 years, but my primary reason for coming here, at least — I read your year-end report, and even just seeing these future state diagrams here, and what struck me is there's an arrogance unfortunately of the IRS that they can do this themselves, and they don't need any input from taxpayers. And the examples here — both end up resolving in more tax being owed, is like, we were right, you were wrong, pay us the money.⁷⁶

71 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

72 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)). For a detailed discussion of the IRS's TBOR efforts, see Most Serious Problem: *Taxpayer Bill of Rights (TBOR): The IRS Must Do More to Incorporate the TBOR into Its Operations*, *infra*.

73 The National Taxpayer Advocate has identified specific taxpayer rights concerns relating to "Real Time" tax administration before. See 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 284-295 (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*).

74 <https://taxpayeradvocate.irs.gov/public-forums>. For a reproduction and discussion of the EITC vignette, see Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State's Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

75 Statement of Audience Member, National Taxpayer Advocate Public Forum 39 (Aug. 18, 2016).

76 Statement of Audience Member, National Taxpayer Advocate Public Forum 55-56 (Aug. 18, 2016).

Other panelists noted that the basic assumptions about the taxpayer population illustrated in the vignettes were seriously flawed.⁷⁷ For example, the vignette for individual taxpayers involved an EITC claimant, and as we discuss in a Most Serious Problem later in this report, it assumes that the average EITC recipient has broadband access and a desktop computer in her home, has a high enough education level to hold a middle-school math teacher job, has a sufficient credit history to create an IRS online account, and can navigate and understand the complex provisions of the tax code.⁷⁸ None of these assumptions is accurate with respect to the average EITC recipient. For example, in eight of the 11 cities in which the National Taxpayer Advocate held Public Forums, the starting salary of a middle school math teacher is above the EITC income eligibility for a two-person household. In essence, the entire vignette is based on a nonexistent taxpayer profile. Yet this has not stopped the IRS from building its vision upon this illusion or, at a minimum from using this grossly inaccurate profile to illustrate its vision.

Moreover, the IRS Future State vignettes seem to envision a completely digital interaction with taxpayers about intensely factual and specific matters. Participants in every Public Forum, every Tax Forum focus group, and every TAS group meeting felt this vision was unrealistic and harmful to taxpayers.⁷⁹ Here are just a few of the statements from Public Forum participants.

Because real life situations of real people are so unique that you couldn't make them up, you know, they just — the way that people come to us and with their circumstances, you go, Oh my God how did this happen, but this is the way it is and you have to deal with it. And you're helping them. We couldn't even imagine it.

And again, it's just very arrogant of any computer person who decided to design and think that that's all the options that there are. There's always — you have to be able to think outside the box. That's where a live human being will always be better.⁸⁰

The future vision of the IRS assumes that taxpayers have access to technology and will be able to navigate the IRS's online system to resolve their tax issues. We know from representing vulnerable populations, such as the poor, disabled and elderly, in dealing with our current tax system that they will have no easier time navigating some new online system. There will still be barriers created by poor literacy, mental and physical impairments in the complicated nature of our tax system, as well as new ones, such as access to technology and understanding how to use it. Given this, the IRS's future state vision could make the tax issues of low income and otherwise vulnerable taxpayers worse if they use the online system without fully appreciating what they are agreeing to and what rights they may be foregoing.

77 See Oral Statement of Polly Bone, Texas RioGrande Legal Aid, Inc., National Taxpayer Advocate Public Forum 54-55 (Aug. 30, 2016):

First of all, this vignette, I'm wondering why whoever wrote it may think this is hardly representative of the people who get the earned income tax credit. ... I looked up the starting salaries of teachers here in SAISD and with what, one child her full year, she would not qualify for an earned income tax credit So this isn't representative at all. My client would more than likely be someone who would be a provider or a health home provider, something that goes in and takes care of elderly people during the day or someone who works in housekeeping at one of our many hotels here in San Antonio.

78 See Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State's Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

79 <https://taxpayeradvocate.irs.gov/public-forums>.

80 Statement of Audience Member, National Taxpayer Advocate Public Forum 57-58 (Aug. 18, 2016).

In addition, given the issues the IRS has in replying to mail, I do not have much confidence that electronic communications will be acted upon in a timely manner either.⁸¹

Our first choice of action, typically, if it is fairly straightforward we can compare numbers and see, okay, yeah, there was a mistake, something was missing. We didn't have certain information. Whatever it might be. We could probably handle that by correspondence. Write a check or write a letter. We will get it resolved. A lot of times we need to get on the phone.

So one concern that I have, I think our office has in general with the future state is really looking towards heavy reliance on electronics, technology, to be able to tell us the information that we need. Our experience has been that tells us half the story. It tells us what the IRS thinks is going on or what's in their system that might be causing a problem. But it doesn't actually resolve everything. We have had access to online services in the past, and it gives us some information about what is going on, why the IRS is sending this notice, what might have triggered it, that we can maybe troubleshoot and figure out here is what is missing, or here's what they don't have. But the rest of the story typically takes a phone call.⁸²

And again, because people need back tax help, they need to get copies of their transcripts. In looking at the different ways that the IRS is considering how to get transcripts, I think if you're there on a Tuesday online, the moon is waxing and, you know, there's like a gerbil in the room, you qualify. I think it's like a very narrow set of people that are going to be able to use that.⁸³

Digital Communications and the "Mailbox Rule"

Underlying these general concerns is the potential for erosion of very specific taxpayer rights. For example, under IRC § 7502, if a taxpayer can demonstrate he has mailed a particular document to the IRS on or before the statutory due date, it will be deemed to be timely filed. The Secretary is authorized to promulgate regulations setting forth how "*prima facie* evidence of delivery and the postmark date shall apply to certified mail and electronic filing."⁸⁴ This rule is known as the "timely mailed, timely filed" or "mailbox" rule. To date, the IRS has not explained how this rule will be applied in the Future State.

For example, let's look at Jane, the EITC taxpayer described in the IRS's vignette. Suppose Jane receives a math error notice under IRC § 6213 giving her 60 days to request abatement of the tax and receive deficiency procedures. On day 60, Jane logs on to her IRS account and sends an email requesting an abatement. The IRS receives the email on day 61. In discussions with the Office of Chief Counsel, the National Taxpayer Advocate has been advised that the mailbox rule would not apply to this email, and thus Jane did not respond timely, the assessment stands, and she loses her right to deficiency procedures. This means she also loses the opportunity to petition the United States Tax Court, the only judicial

81 Written Statement of Arthur Bartlett, Legal Services of Southern Piedmont, National Taxpayer Advocate Public Forum 20-21 (Apr. 4, 2016).

82 Oral Statement of Rollin J. Groseclose, Johnson Price Sprinkle, National Taxpayer Advocate Public Forum 25-26 (Apr. 4, 2016).

83 Oral Statement of Robin McKinney, Maryland CASH Campaign, National Taxpayer Advocate Public Forum 44 (May 13, 2016).

84 IRC § 7502(c)(2).

For the Future State to succeed, the IRS and Congress should consider how the mailbox rule will apply to digital communications, weighing the alternatives in the light most favorable to the taxpayer.

forum in which a taxpayer can challenge a deficiency without paying the tax first, undermining her *right to appeal an IRS decision to an independent forum*. When the National Taxpayer Advocate pointed out that the taxpayer could prove when the email was sent (just as a facsimile log can show when a fax transmission occurred), representatives of the Office of Chief Counsel stated that emails and facsimile dates can be altered by the taxpayer, just as postage meter dates can be altered, and therefore the mailbox rule should not apply to digital communications. Under this approach, only the unsophisticated will utilize digital communications where the date of a document is critical.

Here, then, we have the heart of the problem with the Future State. It is designed around a fundamental suspicion that all taxpayers are likely to cheat, rather than giving taxpayers the benefit of the doubt and assuming they will not manipulate dates. If we really care about taxpayer rights, including the right to appeal to an independent forum, we should design a system that is based on the premise that most taxpayers are willing and trying to comply with the tax laws. For the Future State to succeed, the IRS and Congress should consider how the mailbox rule will apply to digital communications, weighing the alternatives in the light most favorable to the taxpayer.

What's an Audit? Taxpayer Rights and Real-Time Adjustments During the Filing Season

An even more troubling issue arises when we consider the impact of the IRS's increasing ability to identify errors and questionable returns while a return is being processed and before a refund is issued. In general, the accelerated due date for Forms W-2 and 1099-Misc (used to report non-employee compensation)⁸⁵ is an extremely important and positive development, one that the National Taxpayer Advocate has proposed since 2009.⁸⁶ But shifting examinations of returns into the filing season has profound implications for taxpayer rights that the IRS has neither acknowledged nor addressed. For example, there is a question about what rights accrue during income-matching and other pre-refund “reviews” of returns.

The National Taxpayer Advocate has previously written about “real” versus “unreal” audits. IRC § 7602(a)(1) grants the IRS the authority to examine any books, papers, records, or other data that may be relevant to ascertain the correctness of any return. The IRS interprets this provision narrowly; thus Automated Underreporter (AUR), Automated Substitute for Return (ASFR), Substitute for Return (SFR), and math and clerical error assessments, along with the entire category of questionable refund and return procedures are not classified as “real” audits.⁸⁷ As Figure S.6 shows, this classification system results in the majority of taxpayer compliance contacts being “unreal” audits — far outstripping what the IRS classifies as “audits” and the National Taxpayer Advocate calls “real” audits.⁸⁸

85 Pub. L. No. 114-113, Division Q, Title II, § 201, 129 Stat. 3040, 3076 (2015).

86 See 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*); see also 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*).

87 An attempt to resolve a discrepancy between a taxpayer's return and third party data does not constitute an examination because the IRS “merely” is asking the taxpayer to explain the discrepancy. Rev. Proc. 2005-32, § 4.03, 2005-1 C.B. (206).

88 See, Nina Olson, *What's an audit, anyway?*, NATIONAL TAXPAYER ADVOCATE BLOG (Jan. 25, 2012), <https://taxpayeradvocate.irs.gov/news/what's-an-audit-anyway>.

FIGURE S.6, Real vs. Unreal Audits: FY 2015 Occurrences Relating to Returns Filed for Tax Year 2014⁸⁹

Adjusted Gross Income Category	FY 2015 Exams	Exam Coverage %	FY 2015 ASFR	FY 2015 AUR	FY 2015 Math Error	FY 2015 Combined	Returns Filled in Calendar Year 2014	Combined Coverage %
No adjusted gross income	20,263	1%	184,776	12,544	31,329	248,448	2,401,182	10%
\$1 under \$25,000	427,452	1%		930,554	708,164	2,052,646	54,757,719	4%
\$25,000 under \$50,000	150,191	0%		1,101,847	479,513	1,717,095	34,032,631	5%
\$50,000 under \$75,000	65,710	0%		557,679	283,301	897,614	19,418,889	5%
\$75,000 under \$100,000	56,460	0%		351,880	178,036	580,175	12,574,091	5%
Subtotal - under \$100,000	720,076	1%	184,776	2,954,504	1,680,343	5,495,978	123,184,512	4%
\$100,000 under \$200,000	98,403	1%		600,769	232,752	921,406	17,349,237	5%
\$200,000 under \$500,000	59,395	1%		210,091	47,287	313,689	5,020,982	6%
\$500,000 under \$1,000,000	18,149	2%		34,040	6,339	58,030	808,547	7%
\$1,000,000 under \$5,000,000	14,657	4%		12,546	2,861	29,769	370,989	8%
\$5,000,000 under \$10,000,000	2,174	8%		658	261	3,060	26,559	12%
\$10,000,000 or more	3,529	21%		335	288	4,055	16,797	25%
Total	916,383	0.6%	184,776	3,812,943	1,970,131	6,825,987	146,777,623	4.7%

⁸⁹ Data from Individual Returns Transaction File, Individual Master File, and Notice Delivery System from the Compliance Data Warehouse. The audits represent taxpayers where the IRS posted a transaction code 420 to at least one individual taxpayer account in FY 2015. In some cases, the return was accepted as filed prior the IRS contact. The statistics for returns secured through Automated Substitute for Return (ASFR) are from the IRS FY 2015 Collection Activity Report No. 5000-139. Since ASFR returns are not filed by the taxpayer, no adjusted gross income (AGI) is associated with the return. The number of taxpayers receiving an Automated Underreporter (AUR) contact are those who received a CP 2000 or CP 2501 notice from the IRS in FY 2015. The combined coverage rate removes duplicates, so that a taxpayer is only counted once even if affected by two or more of these compliance programs in FY 2015. Taxpayers who received FY 2015 compliance actions on tax returns in more than one AGI category are counted in each AGI category. The coverage rate is computed by dividing by the number of individual income tax returns filed in each AGI category for Tax Year 2014.

At every Public Forum, panelists and audience members expressed serious concerns about the interactions described in the vignettes. A threshold concern was that the system the IRS is designing seems to be stacked in the IRS's favor — *i.e.*, in both vignettes, the taxpayer lost; he or she was wrong. Nowhere did the vignette demonstrate how the taxpayer could prevail in the system of the future.

The National Taxpayer Advocate's position is that for purposes of IRC § 7602, an audit includes both pre-refund and post-refund examinations of returns that require the taxpayer to provide some level of documentation. This definition has several consequences relating to the taxpayer's *right to finality* and the *right to appeal an IRS decision in an independent forum*. First, it more accurately states the audit rate, which will be higher than what the IRS currently reports, and it changes the incidence of the audit rate. Second, and more importantly, it protects taxpayers from multiple reviews of the same return — it forces the IRS to identify *all* issues relating to the return that require some sort of documentation and address those issues as early as possible in one proceeding.⁹⁰ Third, and most importantly, it provides the taxpayer with an appeal to the IRS Office of Appeals. Currently, when a taxpayer disagrees with an “unreal” audit's proposed assessment, the taxpayer receives a Statutory Notice of Deficiency, with no opportunity to seek an administrative appeal to the IRS Office of Appeals. The taxpayer's only option is to go to the U.S. Tax Court, the cost of which may be prohibitive for many taxpayers. In “real” audits, on the other hand, taxpayers generally receive 30-day letters offering them a chance to request an administrative appeal before petitioning the Tax Court.

Effect of Erroneous IRS Advice Communicated Digitally

The reliance on online “communications” and “digital notifications” raises the question of whether such communication constitutes erroneous written advice for purposes of interest abatement. IRC § 6404(f)(1) requires the IRS to abate penalties and additions to tax attributable to deficiencies where a taxpayer relied on erroneous written advice from the IRS. The IRS's vision of its Future State, and its current Taxpayer Digital Communication pilot, utilize the online account and secure emails to exchange information, including answers to taxpayer questions. If the IRS provides a “tailored digital communication,” as it does in the vignette about Bennett, the Small Business taxpayer, is that “written advice” under IRC § 6404(f)? Moving people from the phones (oral advice) to emails and other digital communications increases the IRS cost of inaccuracy, because failure to be accurate will cost the public fisc through interest abatements. In the past, the IRS has responded to risks like this by minimizing and dumbing down the specific advice it provides to taxpayers, as it has in the case of declaring entire areas of tax law “out of scope” for purposes of telephone tax law assistance. Thus, by moving to a digital format, the IRS may be reducing the assistance it provides to taxpayers, and this will increase their costs of tax compliance by driving them to tax preparers who charge a fee. Receiving overly broad or unreliable “digital notifications” is not a desirable Future State.

These issues are not new, and they are only the most obvious examples. They were first raised in 2011, both at the public hearing held by the IRS on Real Time Tax Administration,⁹¹ and in the National

90 IRC § 7605(b) protects taxpayers from unnecessary examinations and inspections and generally allows the Secretary to conduct only one inspection of a taxpayer's books of account for each taxable year.

91 Comments of T. Keith Fogg, Director, Villanova Law School Federal Tax Clinic, Real Time Tax System Initiative (Dec. 8, 2011), http://www.irs.gov/pub/irs-utl/t_keith_fogg_aba_tax_section_and_low_income_tax_clinic.pdf (last visited Aug. 2, 2012).

Taxpayer Advocate's 2011 and 2012 Reports to Congress.⁹² In numerous meetings of the IRS senior leadership and Future State teams, the National Taxpayer Advocate has asked the IRS and the Office of Chief Counsel to articulate its position and explain to the public how it will protect taxpayers from repetitive audits in the Future State. To date, neither the IRS nor the Office of Chief Counsel has provided any response. To design a Future State without addressing these and related concerns means that the Future State is not based on taxpayer rights, and taxpayer rights will be layered on as an afterthought rather than serving as a foundation for the future of tax administration.

Recommendation

The National Taxpayer Advocate recommends that the Office of Chief Counsel, in collaboration with the National Taxpayer Advocate, immediately undertake a comprehensive review of key taxpayer rights provisions in the IRC and issue proposed guidance for public comment, updating these provisions to protect taxpayer rights in the digital environment envisioned by the IRS Future State. These provisions include the application of the mailbox rule and the erroneous advice rule to digital communications, and the definition of an "examination" or "audit" in light of the substantial pre-refund review activity envisioned by the Future State.

92 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*).

GROSSLY OUTDATED TECHNOLOGY AND INFRASTRUCTURE: To enable the IRS to meet the major technology improvements required for a 21st century tax administration even as it fulfills current operational technology demands, the IRS must articulate a clear strategy that will reassure Congress and taxpayers the funding will be well-spent.

The current state of the IRS’s technology limits how much and how quickly the IRS can advance to its “Future State.” But the impact of technology on *today’s* tax administration cannot be overstated. As we discuss later in a Most Serious Problem on Enterprise Case Management,⁹³ the IRS has two of the oldest information systems in the federal government.⁹⁴ Think about that — the nation’s revenue accounts are accessed and stored on five-decade old technology.

Today, the IRS has at least 60 major case management systems, and estimates range anywhere from 60 to 200 repositories of case data. This means that when a taxpayer calls the IRS for information about his or her account, the employee on the phone often doesn’t have access to the relevant system, can’t answer the taxpayer’s question, and has to send a referral to another IRS function to handle (one that has access to the relevant system). This all but certainly leads to the taxpayer calling or writing again, creating a vicious cycle of ever more work for the IRS and the taxpayer.

In the National Taxpayer Advocate’s Public Forums, taxpayers and practitioners alike spoke with enthusiasm about how an online account could provide them basic information without having to wait endlessly on the telephone. But the IRS’s ability to provide the full and seamless experience taxpayers and representatives want is far from a reality. For example, taxpayer representatives were particularly eager to see copies of notices that had been sent to their clients, since many clients don’t retain them or misplace them.⁹⁵ Yet most IRS notices are “vapor” — they don’t exist on IRS systems except as a record that such-and-such notice number was sent. Moreover, most letters and correspondence the IRS sends to taxpayers in audits and collection are not retained on IRS systems as digital images. Even if they were, the IRS would have to program between all of its case management systems and the online account in order for the information to be uploaded into the account. This is years away, and in the meantime, taxpayers and their representatives will continue to call and write.

In the Public Forums, the Nationwide Tax Forum focus groups, and the TAS group meetings, all participants expressed concern about the security of an online account.⁹⁶ The IRS shares those concerns and has been consulting with both government and private sector experts on this matter. The IRS cannot

93 See Most Serious Problem: *Enterprise Case Management (ECM): The IRS’s ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Integrated System (TASIS) As a Quick Deliverable and Building Block for the Larger ECM Project*, *infra*.

94 Government Accountability Office (GAO), GAO-16-468, *Information Technology: Federal Agencies Need to Address Aging Legacy Systems* (May 2016) (discussing aging IT systems throughout the government and listing the IRS’s Individual Master File (IMF) and Business Master File (BMF) as the two oldest investments or systems at 56 years old each).

95 See Oral Statement of Robert Hamilton, MidPenn Legal Services Low Income Taxpayer Clinic, National Taxpayer Advocate Public Forum 9-10 (Apr. 8, 2016):

Major sources of delay in helping our clients is attempting to locate their notices, letters or records from the IRS, but the IRS already has, or should have, on file, particularly those documents submitted in connection with an audit.

The Form 2848, *Power of Attorney*, which our clients fill out at the beginning of representation, allows me to have access to their online transcripts, where I can obtain a clearer picture of what has transpired on their IRS account and where the taxpayer stands in the audit process; however, these transcripts only provide me with the dates of a notice or a letter that was issued, a short phrase summarizing that notice and the amount of the adjustment made to the client’s account.

It would be much more useful if, for example, all of these documents could actually be uploaded, opened and viewed directly through the online services function; however, while these online upgrades and online interfaces could surely enhance my representation of taxpayers, I have serious doubts about taxpayers utilizing and relying exclusively on online services as a replacement to direct person-to-person contact with the IRS representatives.

96 See <https://taxpayeradvocate.irs.gov/public-forums>.

The IRS has two of the oldest information systems in the federal government. Think about that — the nation’s revenue accounts are accessed and stored on five-decade old technology.

balance the need for security with the need for access — security must be *paramount*. But the IRS must clearly acknowledge — to Congress, to the taxpaying public, and in its Future State plans — that there are consequences to the high level of security. Such high security means that only a limited segment of taxpayers will be able or willing to use the online account. The most recent data show that only 34 percent of taxpayers who attempted to create an online account were able to do so.⁹⁷ The taxpayers who sought to establish online accounts were the early adopters — the ones most eager and comfortable with online financial transactions. Yet even among that group, only one-third got through. That means two-thirds of the U.S. taxpayer population will still need telephone or face-to-face assistance.

As the IRS conducts its Taxpayer Digital Communication pilot this year, it will be interesting to see if taxpayers will be willing to engage digitally with the IRS in audits and other interactions.⁹⁸ If they agree to communicate via email, do they continue to do so throughout the audit, or do they revert to more personal methods such as phone calls? Will the IRS leverage technology to provide clear and individual explanations, or will taxpayers feel frustrated with the IRS templates for responses to questions and issues? Will IRS employees be able to respond to specific questions, or will they send canned responses? Will the IRS learn from these dialogues and update its responses and guidance? It hasn’t done that in its analog processes, so what is it about the Future State that makes us think it will do so in the digital environment?

The Consequences of Insufficient Information Technology (IT) Funding to Fundamental Tax Administration Operations

The multiple demands on the IT function of the IRS create the same difficulties as the budget constraints on the IRS overall. In recent years, the IRS understandably has decided to focus most of its IT resources and talent on several major projects, including the Return Review Program (RRP), the Enterprise Case Management (ECM) system, International Data Exchange Service (IDES, for information sharing under FATCA and inter-government agreements), and Information Sharing and Reporting (IS&R, for Affordable Care Act implementation). But this approach leaves most of the IT needs of smaller functions, and even important projects for the larger functions, unfunded and unaddressed. Thus, chronic underfunding of the IRS IT function creates taxpayer burden and wasted resources from manual and unnecessary rework.

Even in areas that are currently the subject of major IT activity, the excuse of “no funding” arises. Currently, the IRS is moving to develop the RRP to replace the aging Electronic Fraud Detection System (EFDS).⁹⁹ But, as we discuss in a Most Serious Problem herein, a system is only as good as the intelligence that goes into it.¹⁰⁰ The IRS’s filters and business rules used for detecting fraudulent returns and identity theft had many false positive rates (FPRs) over 50 percent. This means that legitimate

97 The pass rate was 28 percent on Nov. 16, 2016, 29 percent on Nov. 17, 2016, and increased to 34 percent as of Dec. 18, 2016. IRS response to TAS Fact Check (Dec. 20, 2016).

98 For a discussion of TAS’s participation in the Taxpayer Digital Communication (TDC) pilot, see *TAS Case Advocacy*, *infra*.

99 W&I’s Business Modernization Office Return Review Program is a new integrated system that adds to the Service’s capability to detect, resolve and prevent criminal and civil tax non-compliance and fraud.

100 See Most Serious Problem: *Fraud Detection: The IRS’s Failure to Establish Goals to Reduce High False Positive Rates for Its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *infra*. See also Literature Review: “False Positive” Determinations in Fraud Detection, vol. 3, *infra*.

taxpayers are burdened unnecessarily while the IRS goes about its important work of detecting and stopping questionable returns.

In the private sector, financial and other institutions have found that false positives cost the business more through customer base erosion than does actual fraud. Thus, they have a strong incentive to minimize the rate and burden of false positives.

Because taxpayers cannot just leave the IRS and find themselves another tax administrator, it is incumbent on the IRS to respond *in real time* during the filing season to rules that have high false positive rates. Institutions throughout the government and the private sector accept the importance of using incoming data in real time to minimize false positives. When TAS recommended creating a dedicated sub-team of an IT Executive Steering Committee to accomplish programming approvals quickly, the IRS responded it already had an operational structure in place that addresses fraud model modifications in an almost real time atmosphere. Yet the Business Rules and Requirements Management office that must approve all business rule modifications does not meet regularly.¹⁰¹ Thus, the IRS wastes the funds it does have by having to work the phone calls and letters from 1.2 million legitimate taxpayers whose \$9 billion in refunds were delayed.¹⁰²

Recommendation

The National Taxpayer Advocate recommends that Congress require the IRS to provide a detailed plan of its ECM strategy, including the RRP and the IRS strategy for reducing FPR in refund fraud detection, as well as a detailed report about the components and progress on the Taxpayer Advocate Service Integrated System (TASIS).¹⁰³

101 See National Taxpayer Advocate FY 2017 Objectives Report to Congress, vol. 2, 23.

102 Most Serious Problem: *Fraud Detection: The IRS's Failure to Establish Goals to Reduce High False Positive Rates for Its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *infra*.

103 For a discussion of TASIS, see Most Serious Problem: *Enterprise Case Management (ECM): The IRS's ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Information System as a Quick Deliverable and Building Block for the Larger ECM Project*, *infra*.

OFFICE OF THE TAXPAYER ADVOCATE: To protect taxpayer rights and ensure a fair and just tax system, Congress should take steps to strengthen the Taxpayer Advocate Service.

It has been 18 years since the establishment of the Office of the Taxpayer Advocate and the positions of National Taxpayer Advocate and Local Taxpayer Advocates under RRA 98. The Taxpayer Advocate Service (TAS) is now well-established. Since 2001, it has assisted about four million taxpayers in cases involving significant hardship, obtaining in whole or in part the relief taxpayers requested in over 75 percent of those cases. In the area of systemic advocacy, the IRS accepts, on average, more than half of our administrative recommendations, and enacted 32 of our legislative recommendations, including incorporating the Taxpayer Bill of Rights into the Code, and the IRS and Treasury have adopted additional recommendations by regulation.¹⁰⁴ The National Taxpayer Advocate has testified or submitted written testimony at over 60 congressional hearings, and the Annual Report to Congress is recognized as an important source of information about tax administration and taxpayer rights.

Our work in growing and strengthening TAS has not been without its challenges. Maintaining TAS's independence within an agency that is resistant to change and has a predilection for maintaining the status quo demands constant vigilance.¹⁰⁵ But over the years, progress has been made. The IRS senior leadership recognizes the important role TAS plays in reviewing IRS policies and actions, and acknowledges our role as an advocate for the taxpayer in those discussions.

Having sat at the IRS senior leadership table for almost 16 years (to our knowledge, longer than any other IRS official), the National Taxpayer Advocate is well aware of the challenges the IRS faces on a daily basis. But her job, and that of her employees, is to speak up for the taxpayers whose lives are impacted by the decisions the IRS makes daily in response to those challenges. This is very difficult work — trying to alter the course of an organization that is heading full-tilt in a particular direction.

The statutory framework of the Office of Taxpayer Advocate is what underlies the success of TAS. Without the strong language and structure of IRC §§ 7803(c) and 7811, the National Taxpayer Advocate would be a substanceless mouthpiece, and TAS a token gesture. But even a strong foundation can be improved. To enhance the effectiveness of the Office of the Taxpayer Advocate in advocating for taxpayers, the National Taxpayer Advocate offers the following ideas for consideration.

Reinforce the National Taxpayer Advocate's Right of Access to Taxpayer and IRS Information and to Meetings Between the IRS and Taxpayers

By and large, the National Taxpayer Advocate and her employees have significant access to IRS systems and data. Yet over the years, both in the context of specific cases and systemic advocacy, including during the preparation of the Annual Report to Congress, the IRS has:

- Refused to allow the National Taxpayer Advocate and other TAS employees access to the audit files of taxpayers with cases open in TAS;
- Refused to allow the National Taxpayer Advocate and her employees to attend meetings between the IRS and taxpayers with cases open in TAS, even when the taxpayer him or herself requests TAS attendance;

¹⁰⁴ See *National Taxpayer Advocate Legislative Recommendations with Congressional Action*, *infra*.

¹⁰⁵ See *supra* for a discussion of IRS culture; see also *Most Serious Problem: IRS Structure: The IRS's Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, *infra*.

- Refused to provide the National Taxpayer Advocate with data she requires for analyzing a most serious problem of taxpayers in the context of the Annual Report to Congress; and
- Refused to consent to publication of such data on the basis it is “official use only,” even though no exception or exclusion applies under the Freedom of Information Act.

IRC § 6103 sets out the confidentiality protections of tax returns and return information. It categorically states, “Returns and return information shall, without written request, be open to inspection by or disclosure to officers and employees of the Department of the Treasury whose official duties require such inspection or disclosure for tax administration purposes.”¹⁰⁶ Under IRC § 7803(c), the National Taxpayer Advocate’s tax administration duties are extraordinarily broad, encompassing all of tax administration.¹⁰⁷ Therefore, there is no basis for the IRS to decline to make accessible to the National Taxpayer Advocate or her employees a taxpayer’s administrative file (including the audit file) relating to a case open or pending in TAS. Similarly, when a taxpayer requests that TAS participate in conferences or meetings between IRS employees and the taxpayer, there is no basis for the IRS to deny TAS that access.¹⁰⁸ Yet these refusals keep occurring. Therefore, the National Taxpayer Advocate recommends that Congress clarify the extent of TAS’s access to tax returns and tax return information with respect to cases open and pending in TAS, including the ability to participate in meetings between the taxpayer and the IRS, at the taxpayer’s request.

Moreover, where the National Taxpayer Advocate, in the course of exercising her statutory tax administration duties, identifies an issue as a most serious problem of taxpayers, or is investigating the systemic causes of taxpayer problems in general, there is no basis for the IRS to decline to make available to her any data, information, records it has compiled, or is preserving relating to that issue. However, because TAS has encountered numerous instances over the years in which IRS officials have declined to

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¹⁰⁶ IRC § 6103(h)(1).

¹⁰⁷ See IRC § 7803(c)(2)(A)(i)-(iv).

¹⁰⁸ See Oral Statement of Jim Oliver, Jim Oliver & Associates, PC., National Taxpayer Advocate Public Forum 37-38 (Aug. 30, 2016).

This was a very complex problem. The [taxpayer] advocate tracked down the IRS auditor in Ogden who was handling the problem. The IRS auditor in Ogden informed us with the advocate on the phone it was against policy for them to engage in a conference call with the advocate and a taxpayer representative at the same time. I don’t know that policy, but that’s what this person said and refused, refused to engage in a conference call where I needed to talk to how complex this problem was and how it needed to be fixed.

provide her access to certain information, the National Taxpayer Advocate recommends that Congress clarify her right to such information.¹⁰⁹

Include Local Taxpayer Advocate Office Phone Numbers and Addresses in Statutory Notices of Deficiency

IRC § 6212(a) provides that any notice proposing a deficiency of tax “shall include a notice to the taxpayer of the taxpayer’s right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.” IRC § 7803(c)(2)(D)(i)(I) requires the National Taxpayer Advocate to “appoint local taxpayer advocates and make available at least 1 such advocate for each State.” Since the year 2000, when TAS first began its formal operations, the National Taxpayer Advocate has tried to get the IRS to include *on the Statutory Notice of Deficiency (SNOD)* the actual “location and phone number of the appropriate office.” As we discussed in an earlier Annual Report, the IRS has consistently declined to do so.¹¹⁰

In the past, the IRS and Chief Counsel maintained it satisfied this statutory mandate by including in the SNOD a stuffer notice listing all of the TAS local taxpayer advocate offices (Notice 1214), rather than the information pertaining to the *appropriate* office. With the IRS’s declining budget, the IRS in recent years has presented the National Taxpayer Advocate with a Hobson’s Choice — either agree to putting an internet address on the SNOD for taxpayer’s to look up the “appropriate” TAS location and phone number, or agree to TAS paying for the annual cost of printing at least three million Notices 1214 for inclusion in the SNODs.¹¹¹

As we discussed earlier in this report, about one-third of the U.S. individuals do not have home broadband access, concentrated in lower income, elderly, and minority populations.¹¹² For these millions of taxpayers to access the internet to complete a search for a TAS local office, they must seek out wi-fi. And even so, they often have pay-as-you-go cell phone contracts. Thus, the use of a general internet address on the SNOD does not provide the mandated TAS contact information to a large swath of the taxpayer population. The alternative proposal of TAS endlessly paying for stuffer notices reduces funds available for its direct case advocacy on behalf of taxpayers. Instead, for a modest upfront investment, the IRS could develop a technology-based solution.

109 This issue arose recently in the context of this Annual Report to Congress. In an unprecedented move, the IRS declined to respond to the Enterprise Case Management (ECM)-related information requested by TAS as part of our development of a Most Serious Problem. The IRS took the position that ECM is internal to the IRS and “cannot be categorized as a most serious problem ‘encountered by taxpayers.’” IRS response to TAS research request (Nov. 3, 2016). Thus it declined to provide us with data and financial information the National Taxpayer Advocate had deemed necessary to her analysis of the problem. As such, TAS was unable to obtain the bulk of the information it sought to prepare this Most Serious Problem. TAS obtained the information used in this Most Serious Problem from external sources and from IRS information outside of the formal Most Serious Problem process. See Most Serious Problem: *Enterprise Case Management (ECM): The IRS’s ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Information System as a Quick Deliverable and Building Block for the Larger ECM Project*, *infra*.

110 See National Taxpayer Advocate 2014 Annual Report to Congress 237-44 (Most Serious Problem: *Statutory Notices of Deficiency: Statutory Notices of Deficiency Do Not Include Local Taxpayer Office Contact Information on the Face of the Notices*).

111 The estimate of the cost for one year’s worth of Notice 1214 for SNODs issued by the Small Business/Self-Employed Operating Division was \$47,000. This does not include any SNODs issued by W&I with respect to Earned Income Tax Credit audits.

112 See discussion of taxpayer needs and preferences, *supra*; see also Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences is Critical as the IRS Develops an Online Taxpayer Account System* and Research Study: *Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, *infra*.

Since 2013, TAS has proposed that the IRS program its notice-generation system to allow for matching between the taxpayer's last known address (used on the notice) and the "location and phone number of the appropriate [local TAS] office." TAS has submitted Unified Work Requests (UWRs) to the IRS requesting such programming. To date, the IRS has denied all such requests. Therefore, in order to ensure that all taxpayers have the *right to a fair and just tax system*, the National Taxpayer Advocate recommends that Congress establish a date certain by which the IRS shall be required to complete programming for including the specific phone number and address of the appropriate local TAS office, based on the taxpayer's last known address.¹¹³

Provide the National Taxpayer Advocate the Authority to Hire Independent Counsel, Comment on Regulations, and File Amicus Briefs in Litigation Raising Taxpayer Rights Issues

The National Taxpayer Advocate is required by law to assist taxpayers in resolving problems with the IRS, to identify areas in which taxpayers have frequent problems or that are the subject of frequent litigation, and to identify administrative and legislative solutions to reduce controversy and mitigate such problems.¹¹⁴ The mission of the Office of the Taxpayer Advocate would be advanced by additional statutory authority in three areas: *amicus curiae* briefs pertaining to taxpayer rights; the administrative rulemaking process; and the ability to hire independent counsel.

The mission of the Office of the Taxpayer Advocate would be advanced by additional statutory authority in three areas: *amicus curiae* briefs pertaining to taxpayer rights; the administrative rulemaking process; and the ability to hire independent counsel.

The National Taxpayer Advocate is not authorized to participate in litigation.¹¹⁵ While the conduct of relevant trials themselves may be best left to trial lawyers equipped to advocate zealously on behalf of individual clients, precedential issues of interest to numerous taxpayers may come before the judiciary with no one representing the rights of taxpayers in general. In the case of the Small Business Administration (SBA), the Chief Counsel for Advocacy has statutory authority to represent the interests of small businesses by appearing as *amicus curiae*.¹¹⁶

Although the National Taxpayer Advocate is charged with representing the interests of individuals, including low income taxpayers, there is no statutory requirement that the IRS address the National Taxpayer Advocate's comments before publishing final regulations. In the case of the SBA, the Chief Counsel for Advocacy has statutory authority to represent the interests of small businesses by providing comments that the IRS must consider before publishing any final regulation.¹¹⁷ In the case of small businesses, Congress recognized this need by legislatively mandating regulatory review on their behalf by a counsel dedicated to this function. The rights of individual taxpayers, including low income taxpayers, may fall in a gap in regulatory review. While the National Taxpayer Advocate is often included in pre-publication circulation

¹¹³ The right to a fair and just tax system means "[t]axpayers have the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels." IRS Pub. 1, *Your Rights as a Taxpayer* (Dec. 2014).

¹¹⁴ IRC § 7803(c)(2)(A)(i)-(iv).

¹¹⁵ See 28 U.S.C. § 516 ("Except as otherwise authorized by law, the conduct of litigation in which the United States, an agency, or officer thereof is a party, or is interested, and securing evidence therefor, is reserved to officers of the Department of Justice"); 5 U.S.C. § 3106 ("Except as otherwise authorized by law, the head of an Executive department or military department may not employ an attorney or counsel for the conduct of litigation in which the United States, an agency, or employee thereof is a party"); IRC § 7452 (indicating that the Secretary of the Treasury "shall be represented by the Chief Counsel"). See also Program Manager Tech. Assistance 00566, *Authority for the National Taxpayer Advocate to File Amicus Briefs with the Courts of the United States* (Oct. 2, 2002).

¹¹⁶ 5 U.S.C. § 612(b).

¹¹⁷ IRC § 7805(f).

of proposed or temporary regulations, the IRS is not required to address her comments in the published preambles to final regulations. The National Taxpayer Advocate believes that tax administration would be improved if the public knew what her concerns were with respect to regulations and how the IRS addressed (or did not address) those concerns.

When Congress reorganized the IRS in 1998, the Senate passed legislation providing for counsel to the National Taxpayer Advocate to be appointed by and report directly to the National Taxpayer Advocate and to operate within the Office of the Taxpayer Advocate.¹¹⁸ In sponsoring this provision, Senator Charles Grassley (R-Iowa) offered the following rationale:

The purpose of doing this is to give the Taxpayer Advocate ready access to legal opinions and legal judgments. Currently, the Taxpayer Advocate must put requests into the Office of Chief Counsel. In order to make the Taxpayer Advocate more independent, which is what this bill does, it logically follows that the Taxpayer Advocate should have its own legal counsel. This will guarantee it fast, confidential legal advice to help those taxpayers in greatest need. Because it is the taxpayers in greatest need who go to the Taxpayer Advocate.¹¹⁹

This provision was eliminated in the conference agreement. Still, the conference report noted that the “conferees intend that the National Taxpayer Advocate be able to hire and consult counsel as appropriate.”¹²⁰

Accordingly, to assist the National Taxpayer Advocate in fulfilling her statutory duties, TAS employs several attorney-advisors and has done so for more than a decade. The first round of hiring began in 2003 after the National Taxpayer Advocate briefed the Commissioner, and it has continued since that time. TAS requires independent attorney-advisors because the office often takes positions, both in working taxpayer cases and in systemic advocacy, that are directly contrary to the position of the IRS and the Office of Chief Counsel. TAS attorney-advisors do not purport to offer formal legal advice or represent the agency, but they are indispensable in enabling the National Taxpayer Advocate to develop an independent perspective and advocate as the law intends.¹²¹

In 2015, we were informed that TAS’s longstanding ability to hire attorney-advisors within TAS is inconsistent with Treasury Department General Counsel Directive No. 2, which states: “Except for positions in the Inspectors General offices or within the Office of the Comptroller of the Currency, attorney positions shall not be established outside of the Legal Division” unless the General Counsel or Deputy General Counsel(s) provides a waiver. On November 29, 2016, the National Taxpayer Advocate submitted a memorandum to the Acting General Counsel, Department of the Treasury, requesting that Treasury General Counsel Directive No. 2 be modified to include the Office of the Taxpayer Advocate

118 H. REP. NO. 105-599, at 215 (1998) (Conf. Rep.).

119 144 Cong. Rec. § 4460 (May 7, 1998) (statement of Sen. Grassley).

120 H. REP. NO. 105-599, at 216 (1998) (Conf. Rep.).

121 The Office of Chief Counsel has created the position of “Special Counsel to the National Taxpayer Advocate” to manage and coordinate Office of Chief Counsel support for the National Taxpayer Advocate and her headquarters employees. The Special Counsel and her staff are responsible for providing legal advice for programs and services related to the mission of TAS. The Special Counsel’s work is very helpful to the functioning of TAS in working many taxpayer cases, reviewing proposed regulations, coordinating with other divisions within the Office of Chief Counsel, reviewing training materials, and the like. However, the Special Counsel to the National Taxpayer Advocate reports to the IRS Chief Counsel and receives her performance reviews from the Chief Counsel. When the National Taxpayer Advocate wishes to articulate a position in her independent role that is contrary to the Office of Chief Counsel’s position, the Special Counsel is obligated to follow the position of the Chief Counsel.

along with the Inspectors General offices and the Office of the Comptroller of the Currency as Treasury offices excepted from the policy against hiring and employing attorney-advisors.¹²²

Set TAS's Annual Appropriations Level Through a Separate Account Rather Than as Part of the IRS's Taxpayer Services Account

The IRS is currently funded through four appropriations accounts — Taxpayer Services, Enforcement, Operations Support, and Business Systems Modernization. Funding for TAS is provided through the Taxpayer Services account, and except to the extent specified in an appropriations act, the IRS may decide how much funding to provide to TAS. This “power of the purse” may compromise TAS’s independence because the IRS can — explicitly or implicitly — penalize TAS if the National Taxpayer Advocate or other TAS employees criticize IRS policies and programs that they believe fail to respect taxpayer rights.

The “power of the purse” may compromise TAS’s independence because the IRS can — explicitly or implicitly — penalize TAS if the National Taxpayer Advocate or other TAS employees criticize IRS policies and programs that they believe fail to respect taxpayer rights.

In most years since FY 2006, the Appropriations Committees have addressed this concern by including language in appropriations acts that provides a minimum funding level for TAS. But the decision to provide a minimum TAS funding level is not institutionalized. It is made on an *ad hoc* basis from year to year. In most years, in fact, the Administration’s budget request asks that Congress *not* provide TAS with a minimum funding level,¹²³ and in some years, one house of Congress has specified a minimum funding level for TAS while the other has not.¹²⁴

By creating a separate appropriation for TAS within the IRS budget — much like the Inspectors General have a separate appropriation with the Treasury Department’s budget — this independence issue can be resolved on a permanent basis.

Codify the Authority to Issue a Taxpayer Advocate Directive (TAD) and Clarify the Appeal Process Applicable to Taxpayer Assistance Orders (TAOs) and TADs

IRC § 7811 authorizes the National Taxpayer Advocate to issue a TAO if she “determines the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered by the Secretary.”¹²⁵ Only the National Taxpayer Advocate, the Commissioner of Internal Revenue, or the Deputy Commissioner of Internal Revenue may modify or

122 It is worth noting that as of Oct. 20, 2016, there were 278 attorney-advisors in the IRS whose positions were outside the Office of Chief Counsel. In addition to the attorneys in TAS, there were 238 attorney-advisors in the Small Business/Self-Employed Division’s estate and gift tax area (pursuant to an express waiver from General Counsel Directive No. 2), 14 attorneys in the Office of Professional Responsibility, six attorneys in the Large Business & International Division, four attorneys in the Human Capital Office, two attorneys in the Return Preparer Office, and one attorney each in the Commissioner’s Office, the Chief Financial Officer’s Office, and the Tax Exempt & Government Entities Division. IRS Human Resources Reporting Center (Oct. 10, 2016).

123 See, e.g., IRS, *Congressional Justification for FY 2015 Budget at IRS 95* (“The IRS supports adequate funding for the Taxpayer Advocate Service. Specifying the TAS funding level in law prevents the IRS from proposing an operating plan that allocates resources in the best interest of taxpayers”), <https://www.treasury.gov/about/budget-performance/CJ15/10.%20-%202015.%20IRS%20CJ.pdf>.

124 For FY 2016, for example, the Senate bill provided a minimum funding level for TAS, but the House bill did not. Compare S. 1910, 114th Cong. (2015) with H.R. 2995, 114th Cong. (2015). For FY 2017, both houses provided a minimum funding level for TAS. See S. 3067, 114th Cong. (2016); H.R. 5485, 114th Cong. (2016).

125 IRC § 7811(a)(1)(A). IRC § 7811(b) establishes the terms of the Taxpayer Assistance Order (TAO).

rescind the TAO, and “only if a written explanation of the reasons for the modification or rescission is provided to the National Taxpayer Advocate.”¹²⁶

Similarly, in the course of assisting taxpayers in resolving problems or identifying areas in which taxpayers have problems in dealing with the IRS, the National Taxpayer Advocate from time to time confronts procedural obstacles. In such cases, the Commissioner of Internal Revenue has delegated to the National Taxpayer Advocate the authority to issue TADs that direct IRS units to change procedures “to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers.”¹²⁷ However, the IRS may not comply with or even respond to a TAD because it comes not under a statute but merely a delegated power that the Commissioner could revoke. In practice, the Commissioner or Deputy Commissioner, along with the National Taxpayer Advocate, may rescind or modify a TAD.¹²⁸

Recommendations

To enhance the independence of the Office of the Taxpayer Advocate and ensure that the rights of taxpayers, including the most vulnerable and unrepresented, are considered and protected in tax administration, regulations, and litigation, the National Taxpayer Advocate recommends that Congress:

1. Amend IRC § 7803(c) to clarify, pursuant to IRC § 6103(h)(1), that the National Taxpayer Advocate shall have access to tax returns and return information with respect to cases open and pending in TAS, and shall have the right to participate in meetings between taxpayers and the IRS when asked to do so by the taxpayer.
2. Amend IRC § 7803(c) to clarify that, in furtherance of her tax administration duties, the National Taxpayer Advocate shall have access to all data, statistical information, and documents necessary to perform a “full and substantive analysis” of the issues.¹²⁹
3. Amend IRC § 6212(a) to require the IRS to include on and within the SNOD itself the specific phone number and address of the appropriate local TAS office, based on the taxpayer’s last known address.
4. Authorize the National Taxpayer Advocate to submit *amicus curiae* briefs in federal appellate litigation on matters relating to the protection of taxpayer rights.
5. Require the IRS to submit proposed or temporary regulations to the National Taxpayer Advocate on a pre-publication basis for comment within a reasonable time, and address those comments in the preamble to final regulations.
6. Authorize the National Taxpayer Advocate to appoint independent counsel who report directly to the National Taxpayer Advocate, provide independent legal advice, help prepare *amicus curiae* briefs and comments on proposed or temporary regulations, and assist the National Taxpayer Advocate in preparing the Annual Report to Congress and in advocating for taxpayers individually and systemically.
7. Create a separate appropriation for TAS within the IRS budget to ensure that TAS funding is controlled by Congress and not by IRS.

¹²⁶ IRC § 7811(c).

¹²⁷ Delegation Order 13-31 (formerly DO-250, Rev. 1), *reprinted* as IRM 1.2.50.4 (Jan. 17, 2001); see also IRM 13.2.1.6 (July 16, 2009).

¹²⁸ *Id.*

¹²⁹ IRC § 7803(c)(2)(B)(i).

8. Grant to the National Taxpayer Advocate non-delegable authority to issue a TAD with respect to any IRS program, proposed program, action, or failure to act that may create a significant hardship for a segment of the taxpayer population or for taxpayers at large, and require that, to object to a directive, the IRS would have to respond timely in writing.
9. Amend IRC § 7811 to clarify the process by which the IRS shall appeal a TAO, and require the Commissioner of Internal Revenue or the Deputy Commissioner of Internal Revenue to raise his or her objections to a TAO (*i.e.*, appeal the Order) issued by the National Taxpayer Advocate by responding in writing within a reasonable time, as established by the National Taxpayer Advocate in the TAO. If the order is modified or rescinded, a detailed explanation of the reasons for such modification or rescission should be provided.¹³⁰

¹³⁰ See Taxpayer Rights Act of 2015, S. 2333, 114th Cong. §§ 401 & 402 (2015); Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. §§ 401 & 402 (2015) (addressing aspects of Taxpayer Assistance Orders and Taxpayer Advocate Directives).

TAXPAYER RIGHTS ASSESSMENT: IRS Performance Measures and Data Relating to Taxpayer Rights

In the 2013 Annual Report to Congress, the National Taxpayer Advocate proposed a “report card” of measures that “... provide a good indication whether the IRS is treating U.S. taxpayers well and furthering voluntary compliance.”¹

On June 10, 2014, the IRS adopted a Taxpayer Bill of Rights (TBOR), a list of ten rights that the National Taxpayer Advocate recommended to help taxpayers and IRS employees alike gain a better understanding of the dozens of discrete taxpayer rights scattered throughout the multi-million word Internal Revenue Code.² While this was a significant achievement for increasing taxpayers’ awareness of their rights, and an important first step toward integrating taxpayer rights into all aspects of tax administration, more can be done. The *Taxpayer Rights Assessment* contains selected performance measures and data organized by the ten taxpayer rights and is one step toward integrating taxpayer rights into tax administration.

This *Taxpayer Rights Assessment* is a work in progress. The following data provide insights into IRS performance; however, they are by no means comprehensive. In some instances, data is not readily available. In other instances we may not yet have sufficient measures in place to address specific taxpayer rights. And, despite what the numbers may show, we must be concerned for those taxpayers who still lack access to services and quality service even when performance metrics are increasing. This *Taxpayer Rights Assessment* will grow and evolve over time as data becomes available and new concerns emerge.

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

Measure/Indicator	Fiscal Year (FY) 2015	FY 2016
Individual Correspondence Volume (adjustments) ^a	4,358,447	4,817,708
Average cycle time to work Individual Master File (IMF) Correspondence ^b	80 days	84 days
Inventory overage ^c	68.3%	49.1%
Business Correspondence Volume (adjustments) ^d	2,952,329	2,940,925
Average cycle time to work Business Master File (BMF) Correspondence ^e	46 days	47 days
Inventory overage ^f	18.8%	8.6%
Total Correspondence (all types)	TBD	TBD
Quality of IRS Forms & Publications	TBD	TBD
IRS.gov Web Page Ease of Use	TBD	TBD
IRS Outreach	TBD	TBD

a IRS, Joint Operations Center (JOC), *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2016). The FY 2015 figure has been updated from what we reported in the 2015 Annual Report to Congress. These data on correspondence are also repeated under Right 4 – *The Right to Challenge the IRS’s Position and Be Heard*.

b IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2016).

c IRS, *Weekly Enterprise Adjustments Inventory Report*, FY 2016 (week ending Oct. 1, 2016).

d IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2016).

e IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2016).

f IRS, *Weekly Enterprise Adjustments Inventory Report*, FY 2016 (week ending Oct. 1, 2016).

1 See National Taxpayer Advocate 2013 Annual Report to Congress xvii-xviii (Preface: *Taxpayer Service Is Not an Isolated Function but Must Be Incorporated Throughout All IRS Activities, Including Enforcement*).

2 IRS, IR-2014-72, *IRS Adopts “Taxpayer Bill of Rights;” 10 Provisions to Be Highlighted on IRS.gov, in Publication 1* (June 10, 2014).

- 2. THE RIGHT TO QUALITY SERVICE** – Taxpayers have the right to receive prompt, courteous, and professional assistance in their dealings with the IRS, to be spoken to in a way they can easily understand, to receive clear and easily understandable communications from the IRS, and to speak to a supervisor about inadequate service.

Measure/Indicator	FY 2015	FY 2016
Number of Returns Filed (projected, all types) ^a	245,821,318	248,898,800
Total Individual Income Tax Returns ^b	148,840,642	151,027,600
E-file Receipts, calendar year (Received by 12/04/15, 12/02/16) ^c	128,784,000	131,851,000
E-file: Tax Professional (calendar year) ^d	61%	60%
E-file: Self Prepared (calendar year) ^e	39%	40%
Returns Prepared by:		
VITA/TCE/AARP (tax year) ^f	3,519,006	3,580,640
Free File Consortium (tax year) ^g	2,588,934	2,356,167
Fillable Forms (tax year) ^h	355,080	346,098
Number of Taxpayer Assistance (“Walk-In”) Centers ⁱ	378	376
Number of TAC Contacts ^j	5.6 million	4.5 million
Total Calls to IRS ^k	116,679,405	117,479,981
Number of Attempted Calls to IRS Customer Service Lines ^l	101,507,150	104,275,387
Toll-Free: Percentage of calls answered (LOS) ^m	38.1%	53.4%
Toll-Free: Average Speed of Answer ⁿ	30.5 minutes	17.8 minutes
NTA Toll-Free: Percentage of calls answered (LOS) ^o	43.7%	58.1%
NTA Toll-Free: Average Speed of Answer ^p	16.2 minutes	8.9 minutes
Practitioner Priority: Percentage of calls answered (LOS) ^q	47.6%	71.0%
Practitioner Priority: Average Speed of Answer ^r	46.6 minutes	10.5 minutes
Tax Exempt/Government Entities: Percentage of calls answered (LOS) ^s	60.2%	56.8%
Tax Exempt/Government Entities: Average Speed of Answer ^t	23.4 minutes	15.9 minutes
Toll-Free Customer Satisfaction ^u	87.0%	88.0%
Awareness of Service (or utilization)	TBD	TBD
IRS Issue Resolution – Percentage of taxpayers who had their issue resolved as a result of the service they received	TBD	TBD
Taxpayer Issue Resolution – Percentage of taxpayers who reported their issue was resolved after receiving service	TBD	TBD

a IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2016-2023* (Aug. 2016), at 4. The FY 2015 figure has been updated from what we reported in the 2015 Annual Report to Congress to report actual return counts. The FY 2016 figures are projected numbers. The number of returns and related metrics are proxies for IRS workload and provide context for the environment in which taxpayers seek Quality Service and other rights.

b IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2016-2023* (Aug. 2016), at 4. The FY 2015 figure has been updated from what we reported in the 2015 Annual Report to Congress to report actual return counts.

c IRS, Filing Season Statistics, available at <https://www.irs.gov/uac/newsroom/filing-season-statistics-for-week-ending-december-second-2016> (last visited Dec. 12, 2016).

d *Id.*

e *Id.*

f Free, in-person return preparation is offered to low income and older taxpayers by non-IRS organizations through the Volunteer Income Tax Assistance (VITA), Tax Counseling for the Elderly, and AARP Tax-Aide programs. IRS, Compliance Data Warehouse (CDW), Individual Returns Transaction File. The FY 2015 figure represents tax year 2014 returns. The FY 2016 figures represent tax year 2015.

g IRS, CDW, Electronic Tax Administration Marketing Database.

h *Id.*

i FY 2015 figures from W&I analyst (Dec. 13, 2016). FY 2016 figure from W&I response to TAS fact check (Dec. 20, 2016). In the 2015 Annual Report to Congress we reported a different figure for 2015 (380) which reflected the number of TACs open during the filing season.

j W&I, Business Performance Review (BPR), 4th Quarter, FY 2016 (Nov. 9, 2016) at 7.

k IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2016; report generated Nov. 5, 2016).

l *Id.* Number of calls to Accounts Management (formerly Customer Services) is the sum of 29 lines (0217, 1040, 4933, 1954, 0115, 8374, 0922, 0582, 5227, 9887, 9982, 4184, 7388, 0452, 0352, 7451, 9946, 5215, 3536, 2050, 4017, 2060, 4778, 4259, 8482, 8775, 5500, 4490, and 5640).

m IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2016; report generated Nov. 5, 2016). Accounts Management calls answered include reaching live assistant or selecting options to hear automated information messages.

n *Id.*

Footnotes continued on next page. ►

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- o IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2016; report generated Nov. 5, 2016).
 p *Id.*
 q *Id.*
 r *Id.*
 s *Id.*
 t *Id.*
 u W&I, BPR, 4th Quarter, FY 2016 (Nov. 9, 2016), at 12.

3. THE RIGHT TO PAY NO MORE THAN THE CORRECT AMOUNT OF TAX – Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties, and to have the IRS apply all tax payments properly.

Measure/Indicator	FY 2015	FY 2016
Toll-Free Tax Law Accuracy ^a	95.0%	96.4%
Toll-Free Accounts Accuracy ^b	95.5%	96.1%
Scope of Tax Law Questions Answered	TBD	TBD
Correspondence Examinations (Form 1040 Series)		
No change rate ^c	17.3%	16.2%
Agreed rate ^d	16.3%	20.6%
Non-response rate ^e	48.3%	42.1%
Percentage of cases appealed	TBD	TBD
Field Examinations (Form 1040 Series)		
No change rate ^f	15.3%	14.6%
Agreed rate ^g	45.7%	45.4%
Non-response rate ^h	0.3%	0.3%
Percentage of cases appealed	TBD	TBD
Office Examinations (Form 1040 Series)		
No change rate ⁱ	13.5%	12.2%
Agreed rate ^j	44.7%	43.4%
Non-response rate ^k	19.8%	20.6%
Percentage of cases appealed	TBD	TBD
Math Error Adjustments	TBD	TBD
Math Error Abatements	TBD	TBD
Number of Statutory Notices of Deficiency Issued	TBD	TBD
Number of Statutory Notices of Deficiency Appealed	TBD	TBD
Number of Collection Appeals Program Conferences	TBD	TBD
Number of Collection Appeals Program Conferences Reversing IRS position	TBD	TBD
Number of Collection Due Process Conferences	TBD	TBD
Number of Collection Due Process Conferences Reversing IRS position	TBD	TBD

- a W&I, BPR, 4th Quarter, FY 2016 (Nov. 9, 2016), at 4.
 b *Id.*
 c IRS, CDW, Audit Information Management System, Closed Case Database.
 d *Id.*
 e *Id.*
 f *Id.*
 g *Id.*
 h *Id.*
 i *Id.*
 j *Id.*
 k *Id.*

- 4. THE RIGHT TO CHALLENGE THE IRS'S POSITION AND BE HEARD** – Taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions, to expect that the IRS will consider their timely objections and documentation promptly and fairly, and to receive a response if the IRS does not agree with their position.

Measure/Indicator	FY 2015	FY 2016
Individual Correspondence Volume (adjustments) ^a	4,358,447	4,817,708
Average cycle time to work Individual Master File Correspondence ^b	80 days	84 days
Inventory overage ^c	68.3%	49.1%
Business Correspondence Volume (adjustments) ^d	2,952,329	2,940,925
Average cycle time to work Business Master File Correspondence ^e	46 days	47 days
Inventory overage ^f	18.8%	8.6%
Percentage of Math Error Adjustments Abated	TBD	TBD
Percentage of Statutory Notices of Deficiency Appealed to Tax Court	TBD	TBD
Number of Collection Appeal Program (CAP) Conferences Requested by Taxpayers ^g	TBD	TBD
Percentage of CAP Conferences that Reversed the IRS Position	TBD	TBD
Number of Collection Due Process (CDP) Hearings Requested by Taxpayers ^h	TBD	TBD
Percentage of CDP Hearings that Reversed the IRS Position	TBD	TBD

a IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2016). The FY 2015 figure has been updated from what we reported in the 2015 Annual Report to Congress.

b IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2016).

c IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2016* (week ending Oct. 1, 2016).

d IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2016).

e IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2016).

f IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2016* (week ending Oct. 1, 2016).

g Taxpayers may request a Collection Appeals Process review as the result of IRS actions such as filing a Notice of Federal Tax Lien, an IRS levy or seizure of property, and termination, rejection, or modification of an installment agreement. See IRS Pub. 1660, *Collection Appeal Rights*.

h Taxpayers may request a Collection Due Process review when the IRS plans to take actions such as filing a federal tax lien or levy. See IRS Pub. 1660, *Collection Appeal Rights*.

- 5. THE RIGHT TO APPEAL AN IRS DECISION IN AN INDEPENDENT FORUM** – Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals' decision. Taxpayers generally have the right to take their cases to court.

Measure/Indicator	FY 2015	FY 2016
Number of Cases Appealed ^a	113,870	114,362
Appeals Staffing (On-rolls) ^b	1,569	1,449
Number of States without an Appeals or Settlement Officer ^c	11	10
Customer Satisfaction of Service in Appeals ^d	TBD	TBD
Average Days in Appeals to Resolution	TBD	TBD
Percentage of Statutory Notices of Deficiency Appealed to Tax Court	TBD	TBD

a Office of Appeals, BPR, 4th Quarter FY 2016 (Nov. 7, 2016), at 8.

b *Id.* at 10.

c IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/posrpt.htm>. Employee Position (OF8) Listing for weeks ending Oct. 3, 2015 and Oct. 1, 2016.

d Appeals awarded a new contract for collecting customer satisfaction data during FY 2016; data not yet available. Office of Appeals, BPR, 4th Quarter FY 2016 (Nov. 7, 2016), at 8.

- 6. THE RIGHT TO FINALITY** – Taxpayers have the right to know the maximum amount of time they have to challenge the IRS’s position as well as the maximum amount of time the IRS has to audit a particular tax year or collect a tax debt. Taxpayers have the right to know when the IRS has finished an audit.

Measure/Indicator	FY 2015	FY 2016
Average Days to Complete Correspondence Examination (non-EITC) ^a	231 days	196 days
Average Days to Complete Correspondence Examination (EITC) ^b	221 days	217 days
Average Days to Reach Determination on Applications for Exempt Status ^c	83 days	54 days
Average Days for Exempt Organization Function to Respond to Correspondence ^d	175 days	45 days

a W&I, BPR, 4th Quarter, FY 2016 (Nov. 9, 2016), at 8.

b *Id.*

c Tax Exempt and Government Entities (TE/GE), Business Performance Review, 4th Quarter FY 2016 (Dec. 5, 2016), at 18.

d TE/GE, BPR, 4th Quarter FY 2016 (Dec. 5, 2016), at 20.

- 7. THE RIGHT TO PRIVACY** – The right to privacy goes to the right to be free from unreasonable searches and seizures and that IRS actions would be no more intrusive than necessary. Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary, and will respect all due process rights, including search and seizure protections and will provide, where applicable, a collection due process hearing.

Measure/Indicator	FY 2015	FY 2016
Number (or percentage) of Collection Due Process cases where IRS cited for Abuse of Discretion	TBD	TBD
Number of Offers in Compromise Submitted using ‘Effective Tax Administration’ as Basis	TBD	TBD
Percentage of Offers in Compromise Accepted that used ‘Effective Tax Administration’ as Basis	TBD	TBD
Number of cases where taxpayer received repayment of attorney fees as result of final judgment.	TBD	TBD

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

Measure/Indicator	FY 2015	FY 2016
Number of Closed Unauthorized Access of Taxpayer Account (UNAX) Investigations ^a	173	147
UNAX Investigations Resulting in Prosecution, Removal, Resignation or Suspension of Employee ^b	70	38
UNAX Investigations Resulting in other Administrative Dispositions ^c	83	81
UNAX Investigations Where Employee Cleared of Wrongdoing ^d	20	28

a Automated Labor and Employee Relations Tracking System (ALERTS). The number of IRS employees averaged 89,251 in FY 2015 and 85,002 in FY 2016. IRS, Human Resources Reporting Center, *Fiscal Year Population Report*.

b ALERTS.

c *Id.* Administrative dispositions includes alternative discipline in lieu of suspension; case cancelled or merged with another case; caution letter; last chance agreement; oral counseling; reprimand; written counseling; etc.

d ALERTS.

9. THE RIGHT TO RETAIN REPRESENTATION – Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford representation.

Measure/Indicator	FY 2015	FY 2016
Percentage of Power of Attorney Requests overage (as of 9/26/15, 10/1/16) ^a	0%	0%
Number of Low Income Taxpayer Clinics Funded (calendar year) ^b	132	138
Funds Appropriated for Low Income Taxpayer Clinics ^c	\$10.0 million	\$12.0 million
Number of States with a Low Income Taxpayer Clinic (calendar year) ^d	49	49
Number of Low Income Taxpayer Clinic Volunteer Hours (calendar year) ^e	54,164	60,669

a IRS, JOC, *Customer Account Services, Accounts Management Paper Inventory Reports* (weeks ending 9/26/2015 and 10/1/2016).

b IRS Pub. 5066, *Low Income Taxpayer Clinics Program Report* (Dec. 2015, Jan. 2017).

c Consolidated and Further Continuations Appropriations Act, 2015, Pub. L. No. 113-235, enacted Dec. 16, 2014. Consolidated Appropriations Act, 2016, Pub. Law 114-113, enacted Dec. 18, 2015. The amounts actually awarded to Low Income Taxpayer Clinics (LITCs) are made on a calendar year basis, and differed from the appropriated amounts. The IRS contributed an additional \$0.25 million in 2015 bringing the total to \$10.25 million. The amount awarded to clinics in 2016 was \$11.4 million based on the number of available grantees who met the requirements.

d IRS Pub. 5066, *Low Income Taxpayer Clinics Program Report* (Dec. 2015, Jan. 2017). Forty-nine states and the District of Columbia have at least one LITC. Currently there is no LITC in North Dakota.

e Form 13424-A, *Low Income Taxpayer Clinic (LITC) General Information Report* (Apr. 2016). LITC grantees are required to submit this form which includes the number of volunteer hours. The LITC program office aggregates the calendar year totals. The FY 2015 figure reflects volunteer hours from calendar 2014. The FY 2016 figure reflects volunteer hours from calendar 2015.

10. THE RIGHT TO A FAIR AND JUST TAX SYSTEM – Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers have the right to receive assistance from TAS if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.

Measure/Indicator	FY 2015	FY 2016
Offer in Compromise (OIC): Number of Offers Submitted ^a	66,600	64,479
Offer in Compromise: Percentage of Offers Accepted ^b	42.5%	42.5%
Installment Agreements (IAs): Number of Individual & Business IAs ^c	2,986,121	3,115,404
Streamlined Installment Agreements: Number of Individual & Business IAs ^d	2,567,623	2,630,811
Installment Agreements: Number of Individual & Business IAs ^e	52,053	42,978
Streamlined Installment Agreements (CFF): Number of Individual & Business IAs ^f	10,679	8,477
Number of OICs Accepted per Revenue Officer ^g	7.4	7.7
Number of IAs Accepted per Revenue Officer ^h	14.0	12.0
Percentage of Cases in the Queue (Taxpayers) ⁱ	15.7%	15.5%
Percentage of Cases in the Queue (Modules) ^j	24.7%	23.9%
Percentage of TDAs reported Currently Not Collectible - Tolerance ^k	16.3%	16.9%
Age of Delinquencies in the Queue ^l	4.5 years	4.5 years
Percentage of Modules in the Queue prior to three tax years ago ^m	79.2%	78.7%
Percentage of Cases where the taxpayer is fully compliant after five years ⁿ	44%	48%

a IRS, Collection Activity Report No. 5000-108, FY 2015 (Oct. 4, 2015) and (Oct. 7, 2016).

b *Id.*

c IRS, Collection Activity Report No. 5000-6, FY 2015 (Dec. 9, 2015) and FY 2016 (Oct. 3, 2016).

d *Id.*

e *Id.*

f *Id.*

g *Id.* See also IRS Human Resources Reporting Center – number of revenue officers in SB/SE as of the end of FY 2015 and FY 2016 (pay period 19).

h *Id.*

i IRS, Collection Activity Report No. 5000-2, FY 2015 (Oct. 5, 2015) and (Oct. 3, 2016).

j *Id.*

k IRS Collection Activity Report No. 5000-149 FY 2015 (Oct. 5, 2015) and FY 2016 (Oct. 3, 2016).

l Accounts Receivable Dollar Inventory. Age of cases in the collection queue as of cycle 37 of 2015 and 2016.

m IRS, Collection Activity Report No. 5000-2, FY 2015 (Oct. 5, 2015) and (Oct. 3, 2016).

n Calculation by TAS Research. Percentage of taxpayers with tax delinquent accounts in 2010 and 2011, respectively, and who have no new delinquencies five years later. IRS, CDW, Individual Master File (IMF).

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 2016, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS and Congress in resolving 20 such problems.

NECESSARY ELEMENTS OF THE FUTURE STATE

MSP #1 VOLUNTARY COMPLIANCE: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance

Problem

The IRS reports “enforcement” revenue more routinely than it reports “service” revenues from alternative treatments. As a result, it may be more likely to use coercive treatments than to implement effective alternatives that rely on the latest behavioral science insights (*e.g.*, insights from psychology and behavioral economics). However, the taxpayer’s *right to privacy*, which includes the right to expect that any IRS inquiry or enforcement action will “be no more intrusive than necessary,” requires the IRS to try alternative treatments before resorting to coercion. Further, when coercion is unnecessary, it wastes resources, burdens taxpayers and probably reduces voluntary compliance and overall tax revenue indirectly (*i.e.*, in future years or due from other taxpayers).

Analysis

Behavioral science insights reveal that people generally do not perform an elaborate economic analysis when making decisions. For example, they often do what is easy, respond only to messages that are clear and relevant, do what others are doing, and cheat only if they can maintain a positive self-image. The IRS is using randomized controlled trials (RCTs) to measure revenue from alternative treatments that use behavioral insights. However, the IRS labels all revenue it receives while an account is assigned to an “enforcement” function as “enforcement” revenue, and ignores the indirect effects of coercion on voluntary compliance. If the IRS could collect one percent more direct revenue through an enforcement strategy that causes taxpayers to reduce voluntary compliance by one percent, voluntary compliance revenue would decline by about 60 times as much as “enforcement” revenue would increase. Thus, if the IRS tries to maximize direct enforcement revenue, it risks misallocating its resources.

Recommendations

The National Taxpayer Advocate recommends that the IRS routinely test alternative treatments that apply behavioral insights using RCTs to identify which ones are most effective; timely disclose the results of IRS studies; routinely measure and report the resulting “service” revenue; discontinue or modify reports that highlight “enforcement” revenue (as currently defined); and incorporate behavioral response metrics into IRS programs.

MSP #2 WORLDWIDE TAXPAYER SERVICE: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges As Other Tax Administrations

Problem

The IRS and tax administrations elsewhere have reacted to budgetary constraints in recent years by shifting taxpayer services to online channels, often without fully understanding what drives taxpayers to use or prefer alternative service delivery channels. “Best practices” begin with looking at taxpayers’ — as opposed to the tax administration’s — view of reality.

Analysis

The information and surveys relating to taxpayer service the IRS has relied on in developing its “Future State” vision have important limitations. Some are conducted exclusively online and thus do not capture the needs and preferences of the 33 percent of American households without broadband access. Pew Research found that panelists in online surveys who are members of racial and ethnic minority groups may not be representative of these groups more broadly. The IRS’s vision of how taxpayers will use online accounts does not recognize that taxpayers need to perform tasks of varying levels of complexity, and does not accommodate taxpayers’ needs when confronted with complex or emotionally charged transactions.

Recommendations

The National Taxpayer Advocate recommends that the IRS conduct any taxpayer service surveys by calling taxpayers’ landline telephones or cellphones, or by mail, and include open-ended menu options (such as “other”); surveys of Taxpayer Assistance Centers (TACs) should include those who were turned away without receiving service; and in developing taxpayer service surveys, the IRS should use focus groups and pre-testing with real taxpayers to ensure the surveys reflect all the potential preferences of taxpayers.

MSP #3 **IRS STRUCTURE: The IRS's Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply**

Problem

The IRS's functional structure is a barrier to multi-functional coordination. As a result, enforcement functions focus on completing tasks quickly without sufficient regard for the downstream consequences to other functions or taxpayers. Moreover, the root cause of noncompliance and the appropriate treatment is not the same for every taxpayer population segment. Thus, without multi-functional coordination, the IRS is likely to miss opportunities to prevent noncompliance by addressing its root causes.

Analysis

The IRS Restructuring and Reform Act of 1998 (RRA 98) required the IRS to give organizational units end-to-end responsibility for providing service to specific taxpayer segments. After RRA 98, the IRS created national operating divisions (ODs) named after four broad taxpayer population segments: Small Business/Self-Employed (SB/SE), Wage and Investment (W&I), Tax Exempt and Government Entities (TE/GE), and Large Business and International (LB&I). However, taxpayers generally do not receive end-to-end service from a single OD. SB/SE, LB&I, and TE/GE allocate only about one percent, zero percent, and four percent, respectively, to service, whereas W&I allocates 82 percent to service. For example, wage earners may be subject to enforcement by SB/SE while receiving most services from W&I. IRS functions need to work together to understand the root causes of noncompliance and implement the most effective and least burdensome alternative treatment(s) (e.g., educating taxpayers, alerting them to apparent discrepancies, and improving guidance, forms, communications, and outreach). If the IRS has not tried alternatives before resorting to enforcement, then the enforcement may be unnecessary. The use of unnecessary coercion violates the *taxpayer rights to quality service, to be informed, to finality, to a fair and just tax system, to privacy*, and in some cases *to pay no more than the correct amount of tax*. When the IRS violates taxpayer rights, it likely reduces voluntary compliance by eroding trust for the IRS and promoting the view that noncompliance is justified.

Recommendations

The National Taxpayer Advocate recommends that the IRS remove servicewide functions from W&I so that it can focus on providing end-to-end service to W&I taxpayers; establish cross-functional units that have true end-to-end responsibility for voluntary compliance (e.g., on-time filing and payment rates), satisfaction with, and trust for the agency by narrow taxpayer segments; and require the ODs to implement alternative treatments before applying coercion.

MSP #4 GEOGRAPHIC FOCUS: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance

Problem

The overriding purpose of tax administration is to enable voluntary compliance. This goal can be significantly furthered by providing service, creating a culture of trust, and promoting an understanding of the role taxes play “in a civilized society.” The IRS Restructuring and Reform Act of 1998 (RRA 98) required the IRS to replace its geographic-based structure with organizational units serving specific groups of taxpayers. In doing so, the importance of having a local, engaged presence in taxpaying communities was minimized. Failing to maintain a robust geographic presence hinders the IRS’s ability to achieve its mission.

Analysis

Prior to 1998, the IRS served every taxpayer at one of ten centralized IRS service centers and 33 local district offices. Post-RRA 98, the IRS shifted its community-based resources to campuses relying on national “one-size-fits-all” service and “enforcement” policies for each category of taxpayer. This centralization has resulted in the IRS not addressing the particular attributes of local taxpayer populations.

Reductions in IRS geographic presence permeate the entire organization. Twelve states and the territory of Puerto Rico lack a permanent Appeals presence, leaving taxpayers in these states to either wait for a circuit-riding employee to visit their area, or to travel to the nearest state with an Appeals presence to obtain an in-person hearing. Additionally, 16 states and Puerto Rico lack a Settlement Officer. The IRS consolidated 33 geographically dispersed lien units into a single centralized unit in 2005, virtually eliminating taxpayers’ ability to walk in and obtain an immediate release of a lien. Localized outreach and education have all but disappeared.

Recommendations

The National Taxpayer Advocate recommends that the IRS expand partnerships with private and non-profit organizations, similar to the Alaska Volunteer Tax and Loan Program, to visit most remote and underserved regions, and provide tax education and preparation to taxpayers within their communities; use the Service Priorities Project model to make decisions on taxpayer services, including the location of Taxpayer Assistance Centers; work with community partners to host virtual service delivery terminals for taxpayers located in remote and otherwise underserved communities; re-staff Appeals Officers and Settlement Officers locally so that one of each employee is located and regularly available in every state, the District of Columbia, and Puerto Rico; re-staff local outreach and education positions to bring an actual presence to every state; and provide face-to face service through the use of mobile taxpayer assistance stations (vans) in each state.

MSP #5 TAXPAYER BILL OF RIGHTS (TBOR): The IRS Must Do More to Incorporate the Taxpayer Bill of Rights into Its Operations

Problem

In 2014, the IRS officially adopted the Taxpayer Bill of Rights (TBOR), on the National Taxpayer Advocate's recommendation. Congress followed in late 2015, by adding to the Internal Revenue Code the list of fundamental rights and a requirement for the Commissioner to "ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title." Although the IRS has commendably done much to make the public aware of the TBOR, it has not fulfilled Congress's mandate internally. The IRS has inadequately incorporated the TBOR into many areas of its operations, including employee training and messaging, internal guidance, employee awards, internal measures, customer satisfaction surveys, policy decisions, and strategic plans.

Analysis

The IRS has incorporated taxpayer rights into some of its training courses and has disseminated messages to IRS employees emphasizing the importance of observing TBOR; however, it has not issued any kind of operating division-wide or servicewide guidance on incorporating the TBOR into training materials, resulting in taxpayer rights information being inserted in a piecemeal and boilerplate manner. Employee messaging about the TBOR should be ongoing and motivate employees to improve the protection of taxpayer rights — not merely uphold the status quo. The IRS has not used the TBOR in the creation of new customer satisfaction survey questions, quality measurements, and Critical Job Elements (CJEs) used to measure employee performance. Creating an employee award for supporting the TBOR would help ingrain it within the IRS's culture. IRS functions could hold themselves accountable for recognizing the TBOR by grouping together actions and successes that further the TBOR in their quarterly performance reports. Finally, the IRS should consider and specifically address aspects of the TBOR and the effect upon taxpayer rights when it formulates policy decisions and strategic plans, including its Future State plans.

Recommendations

The National Taxpayer Advocate recommends that the IRS issue guidance at a servicewide level and an operating division-wide level to employees who author training materials, internal guidance, and correspondence with detailed instructions regarding how to incorporate the TBOR into those materials; collaborate with TAS to create an annual briefing on the TBOR that is mandatory for all employees; create an award to be given by the Commissioner of Internal Revenue to recognize special achievements in supporting taxpayer rights and the TBOR; require operating divisions and functions to report the results of their performance measurements and quality measurements according to the relevant TBOR rights associated with each measure; update the IRS's guidance for developing CJEs to instruct employees to incorporate the TBOR into the CJEs for all positions; and provide instructions from senior leadership to all Future State teams to consider the TBOR in developing the IRS's Future State plans, and to document how Future State plans affect taxpayer rights.

NECESSARY TOOLS FOR ACHIEVING THE FUTURE STATE

MSP #6 ENTERPRISE CASE MANAGEMENT (ECM): The IRS's ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Integrated System (TASIS) As a Quick Deliverable and Building Block for the Larger ECM Project

Problem

The IRS currently has between 60 and approximately 200 different case management systems. The age, number, and lack of integration across these systems, as well as the lack of digital communication and record keeping, cause waste, delay, and make it difficult for IRS employees, including those in TAS, to perform their jobs efficiently and provide quality service to taxpayers.

Analysis

As a part of its "Future State" vision, the IRS is currently pursuing a solution to unify these disparate case management systems through an enterprise case management (ECM) project intended to deal with the issues of automation, records management, and integration. However, the IRS is failing to design the ECM project from the ground up to comprehensively engage its employees, taxpayers, and tax professionals and seek their suggestions as to how to make processes and procedures more efficient to maximize employee productivity and improve the quality of taxpayer service. Without this critical foundational step, the ECM system ultimately designed will not be employee-centric and will ultimately adversely impact taxpayers. If the IRS is unable to successfully integrate its 60 to 200 case management systems, then it is unlikely that it will be able to create robust online services for taxpayers, thus jeopardizing its "Future State" goals.

In addition, the IRS's current ECM strategy appears to be inefficient and does not reflect lessons learned from its past case management project failures that, to date, have resulted in abandoned, wasteful, and incomplete initiatives costing tens of millions of dollars. Finally, the IRS is failing to leverage the extensive investment of time, money, and effort expended on the Taxpayer Advocate Service Integrated System (TASIS) in order to incorporate the largely completed elements of TASIS as building blocks for the servicewide ECM solution.

Recommendations

The National Taxpayer Advocate recommends that the IRS develop its ECM solution from the ground up by actively and comprehensively engaging all its employees and seeking their specific suggestions as to how to make processes and procedures more efficient and maximize employee productivity in order to provide quality customer service to taxpayers; use TASIS and its foundational work as part of the ECM effort, for example, by using TASIS modules that are adaptable for ECM; provide the funding necessary to complete TASIS Release 1; and prioritize and fund the development of an electronic Operations Assistance Request (OAR) process.

MSP #7 ONLINE ACCOUNTS: Research Into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System

Problem

A main component of the IRS's Future State vision is the development of an online taxpayer account application. While the National Taxpayer Advocate has proposed for years that the IRS develop an online account for taxpayers, we are concerned that the IRS is now doing so without first developing an overarching long term service strategy that focuses on taxpayer needs and preferences. The current vision focuses on business needs rather than taxpayer and practitioner needs. To properly focus on taxpayer and practitioner needs, the IRS must rely on research, including third party research and TAS research. If the IRS does not "do digital right" from the start, it may build a system that few will choose to use. In addition, the online strategy must acknowledge that the necessary strict e-authentication standards mean that only about one-third of taxpayers will be able to create such an account.

Analysis

The IRS released the first phase of the online account on November 16, 2016. Accessed through the IRS payments page, individual taxpayers who access their account can view the account balance, and select payment options such as IRS Direct Pay, debit or credit card, or apply for an installment agreement. During the initial launch of the program, about one-third of individuals attempting to register passed the e-authentication strategies. In addition, despite the fact that practitioners have expressed a real interest in using the online account, the IRS has not shared any detailed plans about practitioner access to the account, the procedures to authorize such access, or planned account features and capabilities geared toward practitioners. Furthermore, despite efforts by TAS, the first phase of the online account does not provide taxpayers with any information on how to dispute the account balance provided. It also does not provide links for different options, including: amending a return, audit reconsideration, refund claims, penalty abatement, innocent spouse, injured spouse, identity theft, return preparer fraud, and doubt as to liability for offer in compromise.

Recommendations

The National Taxpayer Advocate recommends that the IRS make available 24 months of payment history on the online account in order to provide information necessary for refund claims; provide a link on the payments page to dispute the balance due shown; work collaboratively with the National Taxpayer Advocate to review the recommendations from participants in the 2016 National Taxpayer Advocate Public Forums, the 2016 IRS Nationwide Tax Forum TAS Focus Groups, as well as the findings of TAS and third party research, and address the public's recommendations in the plans for the online account. Additionally, the IRS should incorporate into the Future State vision realistic expectations for access to and use of the online account program given robust e-authentication measures, and limit access to the online account to only those practitioners who are subject to Circular 230 oversight.

MSP #8 EARNED INCOME TAX CREDIT (EITC): The Future State's Reliance on Online Tools Will Harm EITC Taxpayers

Problem

The Earned Income Tax Credit (EITC) has become one of the government's largest means-tested anti-poverty programs. In tax year 2014, 27.5 million taxpayers received about \$66.7 billion in EITC benefits. However, the IRS recently announced its intention to pursue a "Future State" plan. Major goals of the plan are to improve tax processing systems, increase electronic filing and payment options, and expand services available on irs.gov. The IRS's Future State, which emphasizes a reliance on technology and taxpayer self-help as opposed to one-on-one communication, will do a disservice for many low income taxpayers by compounding existing obstacles facing this population.

Analysis

The IRS primarily relies on the correspondence audit process in order to address questionable claims *after* a return has been filed. In fact, EITC audits make up approximately 36 percent of all IRS individual audits despite the fact that EITC returns account for only about 19 percent of all individual tax returns filed. The National Taxpayer Advocate has consistently argued that low income taxpayers need customer service approaches fine-tuned for their specific needs and preferences, including an emphasis on communication and education. This is because low income taxpayers, generally speaking, often share a unique set of attributes that may prevent them from navigating the audit process successfully on their own. These attributes include having lower levels of education, being more likely to speak English as a second language, and being less likely to have a bank account. The IRS's Future State plans will likely be a disservice for many low income taxpayers by compounding these obstacles. In particular, the Future State is not reflective of low income taxpayers' experiences. In addition, recent legislative changes, including expansion of math error authority and the underpayment penalty, make unintentional EITC errors very harmful to taxpayers. Given the increased harms that taxpayers may experience from unintentional errors, it is particularly concerning that the IRS has proceeded with the Future State without sufficient research into how it will affect low income taxpayers. TAS is conducting a study to evaluate the compliance impact of education and outreach on potentially noncompliant EITC taxpayers. In conjunction with IRS Online Services, TAS is also developing Taxpayer Digital Communication (TDC), a pilot project. These research initiatives will provide much needed information on the impact of the Future State on this important taxpayer population.

Recommendations

The National Taxpayer Advocate recommends that the IRS amend Internal Revenue Manual 4.19.14.5.4, *EITC Qualifying Child*, to allow an IRS employee to use a state agency's determination that a taxpayer has qualified for certain public benefits as substantiation for EITC with a qualifying child; hire or train employees with social work skillsets in order to meet the needs of taxpayers claiming the EITC; and postpone its planning of any EITC Future State technology until the TDC data is available. Instead, the IRS should invest its resources into person-to-person communication for EITC taxpayers, including a dedicated "Extra Help" line for EITC taxpayers.

MSP #9 FRAUD DETECTION: The IRS's Failure to Establish Goals to Reduce High False Positive Rates for Its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights

Problem

Over the past decade, the IRS has been significantly impacted by fraud and identity theft. To detect and prevent identity theft and other tax refund fraud, the IRS has established a complicated screening process. When a return is flagged by one of the multiple IRS systems that scrutinize returns for characteristics of refund fraud or identity theft, the refund is held until the taxpayer can authenticate his or her identity, or until the information on the return can be verified. Although these systems do identify improper returns and prevent improper refunds from being issued, they also have a high degree of inaccuracy — with false positive rates (FPRs) between 38 and 55 percent in its most prevalent fraud detection systems. IRS systems that improperly flag legitimate tax returns and delay refund issuance can create a financial hardship for taxpayers, expend unnecessary IRS resources to resolve the issues, and negatively impact taxpayers' voluntary compliance.

Analysis

The IRS's ability to adjust fraud detection systems in real time is limited, placing them outside the industry standard. These limitations on adjusting system filters and rules result in high FPRs, which occur when a system selects a legitimate return and delays the refund past the prescribed review period. For calendar year 2016 through September, IRS filters and business rules used for detecting fraudulent returns and identity theft had many FPRs over 50 percent. These incorrect selections delayed approximately 1.2 million tax returns associated with about \$9 billion in legitimate refunds for more than an additional 30 days on average. During the same time period, the three systems on which the IRS is largely reliant in its return screening process had the following FPRs: the Dependent Database (DDb) — 49 percent, the Return Review Program (RRP) — 38 percent, and the Electronic Fraud Detection System (EFDS) — 55 percent. Notably, one IRS process for scrutinizing returns for identity theft had an FPR of roughly 91 percent. As a result, more than one million taxpayers with legitimate returns were forced to engage in a frustrating process to rectify the IRS's error. For example, the IRS phone line dedicated to identity theft issues had a level of service of 31.7 percent for fiscal year 2016 and a wait time of almost 11 minutes for affected taxpayers.

Recommendations

The National Taxpayer Advocate recommends that the IRS establish aspirational FPR goals and a schedule to meet them; continue to build, maintain, and improve private-public partnerships to implement techniques to fight fraud; establish relationships with other government agencies that use data mining and risk detection systems to learn better techniques for lowering FPRs; and create a dedicated governance board to adjust filters in real time during the filing season, and include TAS on this board.

MSP #10 TIMING OF REFUNDS: The Speedy Issuance of Tax Refunds Drives Refund Fraud and Identity Theft, As More Research Is Needed on the Costs and Benefits of Holding Refunds Until the End of the Filing Season

Problem

The speed with which a tax agency issues refunds requires the balancing of two compelling interests. That is, there is an inherent tension between the need to get refunds out to taxpayers quickly and the need to protect against refund fraud. The IRS processes more than 150 million tax returns each year and issues refunds to taxpayers in about 70 percent of the returns received. Although the IRS prides itself in delivering 90 percent of refunds in less than 21 days, this waiting period can cause significant hardship to taxpayers (with an average refund of \$2,800) who rely on this refund. Low income taxpayers are particularly affected by any refund delays, with refunds constituting 16 percent of their total positive income, on average.

Analysis

Because Congress has chosen to deliver many social benefit programs through the tax system, and because the IRS has done a good enough job of delivering the resulting tax refunds timely, a cultural phenomenon has developed — many U.S. taxpayers now have an expectation that they will receive a sizable refund shortly after the beginning of each tax filing season. With tax refund fraud becoming a significant problem, costing the government billions of dollars each year, it may make sense for the IRS to delay the issuance of tax refunds while it verifies taxpayer-reported data. If the IRS held off issuing refunds until the end of the filing season, it would have an opportunity to validate return information using Form W-2 data, check for duplicate dependency exemption claims, reconcile child support and alimony reporting, and conduct Automated Underreporter matching, enabling it to process error-free returns and deliver accurate refunds. The IRS should quantify the compliance impact of administering these programs in real time. Once it does, the IRS would be much better positioned to determine whether delaying the issuance of refunds by a couple of months will be justified, after balancing it against the very real financial impact of the delay on taxpayers, particularly low income taxpayers. Participants in the 2016 IRS Nationwide Tax Forum focus groups cautioned that changing their clients' mindsets and expectations about the timing of refund delivery would be difficult. With their clients' urgent need for the refunds, practitioners felt it would take quite a bit of time to change behavior.

Recommendation

The National Taxpayer Advocate recommends that the IRS, in collaboration with TAS, initiate a research study on the potential savings to the government from reducing improper payments and the potential impact to taxpayers, particularly low income taxpayers, if refund issuance is delayed until after the filing season.

MSP #11 PAYMENT CARDS: Payment Cards Are Viable Options for Refund Delivery to the Unbanked and Underbanked, But Security Concerns Need to Be Addressed

Problem

With over 68 million adults in the U.S. either unbanked or “underbanked,” taxpayers can request that the IRS load their tax refund onto a reloadable debit card, rather than to a conventional bank account. However, the convenience offered by the IRS delivering refunds via prepaid debit cards comes at a cost — in the form of refund fraud. Because the IRS receives little information about the owner of the prepaid debit card (compared to a traditional savings or checking account), identity thieves and perpetrators of refund schemes may opt to avoid detection by requesting refunds via prepaid debit cards. By the time the IRS learns of the refund fraud, the money is already loaded onto prepaid debit cards, leaving the IRS with little chance of recouping those funds.

Analysis

Despite obvious benefits, there are some downsides to the use of prepaid debit cards to deliver tax refunds. First, taxpayers can incur numerous fees to enjoy the benefits of prepaid debit cards, including an enrollment fee, a monthly maintenance fee, ATM withdrawal fees, ATM balance inquiry fees, or a fee to convert the remaining balance into a bank check. Second, prepaid debit cards can be used to help facilitate refund fraud. The use of prepaid debit cards may be appealing to perpetrators of tax refund fraud, since no information other than a bank routing number and account number is required to request that a refund be loaded onto a prepaid debit card. The Department of Treasury now requires that all federal benefit payments be delivered electronically, and recommends that those without a bank account use the Direct Express debit card. However, the Treasury-sponsored Direct Express debit card does not accept tax refund payments from the IRS at this time, which is perplexing, given that the Earned Income Tax Credit (EITC) is one of the government’s largest means-tested anti-poverty programs. With the EITC, taxpayers are left to pay for debit cards on the market, with no bargaining power like that which the federal government has for the Direct Express debit cards. Employers are increasingly using payroll cards to load money for employees who do not have bank accounts. An estimated 12.2 million workers will receive their wages via payroll cards by 2019. The IRS should evaluate the efficacy of using payroll cards to deliver federal tax refunds.

Recommendations

The National Taxpayer Advocate recommends that the IRS participate in a government-sponsored prepaid debit card (such as Direct Express) offered at no cost to taxpayers; add “Direct Express” and “Other Payment Card” as additional refund type options in the Refund section of each of the Form 1040 series; conduct a pilot comparing the refund fraud rate of refunds delivered to the Direct Express debit card versus non-government-sponsored prepaid debit cards; and work with large employers and major providers of payroll services to conduct a pilot evaluating the efficacy of using payroll cards to deliver federal tax refunds.

TAXPAYER RIGHTS AND ISSUE RESOLUTION IN THE FUTURE STATE

MSP #12 PRIVATE DEBT COLLECTION (PDC): The IRS Is Implementing a PDC Program in a Manner That Is Arguably Inconsistent With the Law and That Unnecessarily Burdens Taxpayers, Especially Those Experiencing Economic Hardship

Problem

In 2015, Congress enacted legislation requiring the IRS to assign certain tax receivables to private collection agencies (PCAs). Under the law, PCAs are permitted to offer taxpayers installment agreements (IAs) not to exceed five years. The IRS plans to implement the PDC program in ways that are arguably inconsistent with the law and plans to assign to PCAs the accounts of taxpayers the IRS itself would not subject to Federal Payment Levy Program (FPLP) levies.

Analysis

The IRS plans to allow PCAs to “monitor” and receive commissions on payments taxpayers make pursuant to IAs that exceed five years. The IRS intends to assign to PCAs accounts of taxpayers who receive Social Security or Railroad Retirement Board retirement benefits despite having a median income below \$19,000. These taxpayers’ payments are not subject to FPLP levies if their incomes are less than 250 percent of the federal poverty level. The federal poverty level was about \$11,880 for a single person in 2016; 250 percent of that level is about \$29,700. The IRS has not provided adequate guidance to PCAs on when they are required to refer a taxpayer to TAS and does not intend to recall accounts from PCAs when the taxpayers request assistance from TAS.

Recommendations

The National Taxpayer Advocate recommends that the IRS revise its contract with PCAs to allow PCAs to offer IAs of up to five years — rather than for the period that remains on the collection statute expiration date — to comply with the law; to clarify that PCAs are not authorized to monitor IAs arranged by the IRS or TAS, and are not entitled to commissions on payments taxpayers make pursuant to those IAs; to remove the option of soliciting voluntary payments that do not satisfy the liability and are not made pursuant to an IA in order to comply with the law; and to provide that PCAs must refer taxpayers to TAS where the taxpayer so requests, where payment of the balance due immediately or through a payment arrangement would create a significant hardship, including long term or adverse impact, where the taxpayer is unable to pay necessary living expenses, or where the taxpayer is experiencing systemic burden in resolving his or her issue. She also recommends that the IRS assign a Master File code to open TAS cases and systemically prevent open TAS cases from being assigned to PCAs; recall cases from PCAs when taxpayers request assistance from TAS and TAS opens a case; implement the necessary programming as soon as possible to remove recipients of SSDI or SSI payments from the population of accounts that are eligible for assignment to PCAs; adopt an interpretation of “potentially collectible inventory” that excludes the accounts of taxpayers whose SSA and RRB retirement benefits are not subject to FPLP levies because their incomes are less than 250 percent of the federal poverty level and develop a filter to identify those who appear to have significant assets; revise the contract with PCAs to require PCAs to disclose all materials that impact taxpayers’ contacts with PCAs, including operational plans, training materials, instructions to staff, the content and format of taxpayer letters, and calling scripts; include in required training for all PCA employees the National Taxpayer Advocate’s taped training on taxpayer rights; send taxpayers whose accounts will be assigned to PCAs the IRS initial contact letter at least 14 days before transferring their accounts to PCAs and do not pay commissions to PCAs on any payments received after the initial IRS contact letter is sent and before the first PCA contact with the taxpayer; and designate a group of Collection employees to work to completion cases that are recalled from PCAs.

MSP #13 ALLOWABLE LIVING EXPENSE (ALE) STANDARDS: The IRS's Development and Use of ALEs Does Not Adequately Ensure Taxpayers Can Maintain a Basic Standard of Living for the Health and Welfare of Their Households While Complying With Their Tax Obligations

Problem

Internal Revenue Code (IRC) § 7122(d)(2)(A) mandates that the IRS develop allowances designed to provide that taxpayers entering into an offer in compromise have an adequate means to provide for basic living expenses. The resulting Allowable Living Expense (ALE) standards have come to play a major role in IRS collection cases. However, the current standards are based on outdated measurements and are implemented in a way that keeps some taxpayers in or near poverty in order to meet their taxpayer obligations.

Analysis

In its efforts to base the allowed expenses on reliable and consistent data, the IRS relies heavily on the Consumer Expenditure Survey (CES), which gathers expenditure information for consumers. Since this survey measures what people spend on average to live, it does not take into account what the goods or services actually cost to live. This system does not recognize that taxpayers of limited means may forego otherwise necessary expenses.

Furthermore, spending is not consistent over income levels. While housing costs now account for about 25 percent of a family's pre-tax income, some low income renters may spend up to half of their pre-tax income on rent. The standards are also out of date. There is no standard allotment for child care expenses, and no allotment at all for basic digital technology or retirement savings. There are alternative methods to measure the cost of maintaining the health and welfare of a household. These alternative methods provide better insight into necessary expenses and also establish the expenses as a floor rather than a cap.

Recommendations

The National Taxpayer Advocate recommends that the IRS, in conjunction with TAS, consider alternative methods to calculate the cost of maintaining the health and welfare of households; define what taxpayers need for expenses; expand the standards to include additional expenses for basic technology, child care, and retirement savings; and reconsider the decrease in expenses for national standards, as well as out-of-pocket healthcare, housing, and transportation.

MSP #14 APPEALS: The Office of Appeals' Approach to Case Resolution Is Neither Collaborative Nor Taxpayer Friendly and Its "Future Vision" Should Incorporate Those Values

Problem

In several Annual Reports to Congress, the National Taxpayer Advocate has detailed a variety of concerns regarding programs and policies adopted by the IRS Office of Appeals (Appeals) that continue to disadvantage taxpayers. Among other things, taxpayers are experiencing limitations on their ability to obtain in-person conferences and are encountering Appeals proceedings with narrowing scopes of substantive review. Appeals' proposed five-year trajectory is set forth in its preliminary design for a Future State. However, this Concept of Operations (CONOPS) is limited by its reliance on a "one size fits all" model that is primarily bureaucratic- and enforcement-oriented.

Analysis

The resource constraints to which Appeals recently has been subject present challenging issues that underlie Appeals' CONOPS. For example, between fiscal years 2013 and 2016, the number of Appeals cases has dropped by seven percent, whereas the number of Appeals Hearing Officers (Hearing Officers) available to resolve those cases has dropped by 24 percent. Appeals' need for operational efficiency and cost-effectiveness, however, is not, in the long run, best served by such steps as limiting access to in-person conferences or reducing the quality of substantive review. Rather, taxpayers who choose to engage in dialogue with the IRS through participation in the Appeals process should be encouraged, educated, and welcomed as partners in the voluntary tax system. The National Taxpayer Advocate urges Appeals to embrace a Future State that is premised on a collaborative model of tax administration, that recognizes the desire of most taxpayers to be compliant, and that is designed to work with them in furtherance of this goal.

Recommendations

The National Taxpayer Advocate recommends that the IRS adopt an Appeals future vision in which Appeals adopts policies and organizes itself in a way that makes in-person Appeals conferences readily available to good-faith taxpayers who request a live conference as part of the case resolution process; Appeals expands its geographic footprint and strategically reallocates Campus-based and Field-based Hearing Officers to increase the confidence of taxpayers that they will have access to Hearing Officers with requisite local knowledge and substantive expertise, regardless of the assigned location; and Appeals revises its procedures to allow Hearing Officers additional discretion and time to personally undertake factual development and provide more in-depth substantive review in seeking fair and efficient resolutions of Examination-based and Collection-based Appeals cases.

MSP #15 ALTERNATIVE DISPUTE RESOLUTION (ADR): The IRS Is Failing to Effectively Use ADR As a Means of Achieving Mutually Beneficial Outcomes for Taxpayers and the Government

Problem

The IRS acknowledges that alternative dispute resolution (ADR) can play a useful role as part of its operations. Nevertheless, the IRS is underutilizing this potentially valuable tool and administering ADR in a way that is unattractive to taxpayers. Taxpayers can reasonably question the accessibility, cost effectiveness, and impartiality of IRS ADR proceedings. These concerns, together with unfamiliarity and a lack of demonstrably positive outcomes, cause taxpayers to overlook ADR as a means of resolving their tax controversies. To this point, the IRS is failing to take advantage of what could be a highly effective mechanism for administrative dispute resolution.

Analysis

The IRS could benefit a great deal from the ADR lessons learned by commentators, businesses, various federal agencies, and tax authorities of certain foreign countries. For example, in a range of different situations, ADR consistently generates quicker, more cost-effective case resolutions with higher levels of participant satisfaction and compliance as compared with cases following the more standard litigation path. Likewise, a quality ADR program can be a substantial contributor to successful tax administration and can significantly improve the taxpayer experience. Among other things, studies in this area demonstrate that efficient ADR can have a positive impact on tax compliance. Nevertheless, the IRS is failing to realize the potential advantages offered by ADR. During fiscal year 2016, the IRS reported only 306 ADR case receipts — less than one half of one percent of the total Appeals case receipts for that same year. Many reasons contribute to the underutilization of ADR within the IRS, including significant limitations on its availability, IRS veto power (effectively) over the initiation and outcome of proceedings, and questions regarding the neutrality of facilitators. If thoughtfully and creatively implemented, however, ADR could substantially increase the efficiency and timeliness of case resolutions. In turn, an effective ADR program would protect taxpayer rights, reduce taxpayer burden and cost, encourage voluntary compliance, and economize scarce IRS resources.

Recommendations

The National Taxpayer Advocate recommends that the IRS expand the ADR program to all taxpayers upon request, including at the Compliance level, as well as at the Appeals stage; publish quarterly data relating to the settlement percentages and the cost-effectiveness of ADR; reduce the administrative burdens surrounding ADR, allow video conferencing where desired by the parties, and examine scenarios in which a redesigned arbitration option can represent an attractive alternative to litigation; and establish a separate unit to house IRS personnel assigned exclusively to the ADR program.

MSP #16 FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA): The IRS's Approach to International Tax Administration Unnecessarily Burdens Impacted Parties, Wastes Resources, and Fails to Protect Taxpayer Rights

Problem

The Foreign Account Tax Compliance Act (FATCA) was passed in 2010 in response to IRS and congressional concerns that U.S. taxpayers were not fully disclosing the extent of financial assets held abroad. The concerns giving rise to FATCA are understandable. Nevertheless, the IRS's approach to implementing FATCA and related international provisions has created significant compliance burdens and risk exposures to a variety of impacted parties including non-resident aliens, U.S. citizens living abroad, and foreign financial institutions (FFIs).

Analysis

The IRS has adopted an enforcement-oriented regime with respect to international taxpayers. Its operative assumption is that all such taxpayers should be suspected of fraudulent activity, an outlook that causes the IRS to mistrust stakeholders, dismiss useful comments and suggestions, and misallocate resources. This perspective has resulted in the IRS unnecessarily freezing over 102,000 refund claims of non-resident aliens, many of which were filed by low risk international students, and proposing Internal Revenue Code (IRC) Chapter 3 and Chapter 4 regulations that would explicitly make the availability of credits and refunds to covered taxpayers contingent on the actions of withholding agents. U.S. expatriates have also reported suffering significant banking "lock-out" as a result of FATCA, while all U.S. citizens are potentially subject to the revocation or denial of passports in the case of certain tax liabilities. FFIs also continue to face regulatory uncertainty, reputational risk, and ongoing expenditures regarding FATCA and related information reporting obligations. The IRS could achieve better results and reduce hardships placed on taxpayers and FFIs if it took a collaborative, service-based approach that focused on identifying the relatively few bad actors and recognizing the good faith efforts of the compliant majority.

Recommendations

The National Taxpayer Advocate recommends that the IRS implement policies and procedures for reviewing and issuing Chapter 3 and Chapter 4 refund claims that mirror those processes currently in place with respect to domestic taxpayers under IRC § 31 and related regulations; adopt a same country exception that excludes from FATCA coverage financial accounts held in the country in which a U.S. taxpayer is a bona fide resident; protect taxpayers from harsh application of the law allowing revocations and denials of passports by broadly interpreting discretionary exclusions, encouraging expansive definitions of humanitarian exceptions, and allowing for an administrative appeal and notification of TAS assistance before passport revocation or denial occurs; and reduce burdens on FFIs by adopting a collaborative model of tax administration that encourages FFIs to correct erroneous reporting and focuses on providing the clarity and consistent guidance needed for reasonable, cost-effective compliance with FATCA.

MSP #17 INSTALLMENT AGREEMENTS (IAs): The IRS Is Failing to Properly Evaluate Taxpayers' Living Expenses and Is Placing Taxpayers in IAs They Cannot Afford

Problem

The IRS is authorized by law to enter into an agreement with a taxpayer to pay any tax due in installments to facilitate full or partial collection of the tax. Installment Agreements (IAs) are offered as a collection alternative mutually beneficial to taxpayers and the IRS — taxpayers can make payments to the IRS over time and spread out the burden of paying their tax accounts, and the IRS can increase revenue by collecting portions of tax due rather than collecting nothing. However, certain types of IAs result in higher rates of taxpayers failing to make payments as agreed (defaulting) while other taxpayers are being placed in IAs where their income is less than the living expenses permitted by the IRS, and potentially not meeting their basic needs in order to pay the IRS instead.

Analysis

TAS analysis of IRS IA data suggests that the IRS is placing taxpayers into IAs where their total positive income (TPI) is less than their allowable living expenses (ALEs). Nearly 300,000 taxpayers who should have qualified for currently not collectible (CNC) status had entered into installment agreements in calendar year 2014 despite their income being below the IRS ALEs. Taxpayers may agree to an IA they can't afford out of fear of the IRS, a misunderstanding of the options available, or out of obligation to repay their debts at any cost. The IRS has the data available to determine if a taxpayer has enough income to support payments under an IA. However, the IRS does not use this information to estimate the taxpayer's ability to pay or to determine the appropriate collection alternatives for each taxpayer in order to prevent rework for the IRS, reduce burden and frustration for taxpayers, and craft individual taxpayer solutions that encourage current and future compliance. As the IRS moves on its "Future State" plans, it should focus on using data and technology to assist taxpayers entering into realistic and affordable payment arrangements instead of relying on a one-size-fits-all strategy.

Recommendations

The National Taxpayer Advocate recommends that the IRS modify the ALEs in accordance with the recommendations in the Most Serious Problem on ALEs; develop an internal ability-to-pay estimator that will populate with the most current taxpayer income information for use by all employees offering IAs; and revise Internal Revenue Manuals and employee training to require use of the estimator even in streamlined IA applications, and provide employees with a decision tree indicating where other collection alternatives are more appropriate than IAs.

MSP #18 INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS (ITINs): IRS Processes for ITIN Applications, Deactivations, and Renewals Unduly Burden and Harm Taxpayers

Problem

Each year, approximately 4.6 million taxpayers ineligible for Social Security numbers (SSNs) require Individual Taxpayer Identification Numbers (ITINs) to comply with their tax filing and payment obligations, claim dependents, and receive tax benefits. Changes in application requirements, program administration, and insufficient staffing have contributed to delays in obtaining ITINs for thousands of taxpayers in recent years. The new law passed in late 2015 made major changes to the ITIN program, which create significant challenges for taxpayers and the IRS related to the schedule for deactivating ITINs, math error procedures for disallowing claims filed with deactivated ITINs, and the disallowance of the Child Tax Credit (CTC) and American Opportunity Tax Credit (AOTC) if an ITIN is not issued timely. Despite the flexibility allowed under the law, the IRS has not exercised discretion to expand what is considered acceptable documentation for an ITIN application and to extend the timeframe for filing all applications to throughout the year.

Analysis

Because the IRS is unable to meet the rigid deactivation schedule mandated by the law it has had to implement an alternative schedule, causing taxpayer confusion and uncertainty. Of the over 11 million taxpayers whose ITINs the IRS will deactivate in January 2017, the IRS sent a letter to only 440,000 taxpayers notifying them of the need to renew. Although the law allows the IRS discretion to determine alternatives to taxpayers mailing in original documents or copies certified by the issuing agency, the IRS maintains restrictions that leave many applicants still needing to mail in their original documents. The law's extension of math error authority to situations where the taxpayer lists a deactivated ITIN on a return will likely exacerbate existing problems with the IRS's use of math error procedures. Because the new law requires an ITIN to be issued by the tax return due date in order to claim the CTC or AOTC, taxpayers may miss out on these credits if they do not understand the need to timely file their ITIN applications and returns, or if the IRS mishandles or loses them. The IRS's longstanding requirement for new applicants to apply for an ITIN during the filing season will continue to burden applicants, create delays, hamper fraud detection, and exacerbate the other problems ITIN applicants face.

Recommendations

The National Taxpayer Advocate recommends that the IRS prioritize and accelerate the programming and implementation of the necessary systems to process ITIN renewal applications and reissue ITINs upon receipt of renewal applications; identify additional types of documentation that can be considered "certified copies," such as copies certified by state or other Federal agencies other than the issuing agency, copies certified by clerks of courts, copies properly apostilled and authenticated by U.S. diplomatic missions abroad, and notarized copies from specific jurisdictions; and allow all ITIN applicants to apply for an ITIN at any time of the year without a tax return as long as they provide evidence of a legitimate tax administration purpose for the ITIN.

MSP #19 FORM 1023-EZ: The IRS's Reliance on Form 1023-EZ Causes It To Erroneously Grant Internal Revenue Code (IRC) § 501(c)(3) Status to Unqualified Organizations

Problem

Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, requires applicants to merely attest that they meet the requirements for qualification as Internal Revenue Code (IRC) § 501(c)(3) organizations. Most applications for such status are now submitted on Form 1023-EZ and the IRS approves 94 percent of Form 1023-EZ applications. The IRS erroneously approves Form 1023-EZ applications at an unacceptably high rate. The IRS agreed to revise Form 1023-EZ to require a narrative statement of applicants' activities, but additional information is needed.

Analysis

Treasury regulations generally require IRC § 501(c)(3) organizations to pass an "organizational test" by including acceptable purpose and dissolution clauses in their organizing documents. According to the IRS's pre-determination reviews of a portion of Form 1023-EZ applicants, 25 percent do not qualify for exempt status because they do not meet this organizational test. A 2015 TAS study of a representative sample of approved Form 1023-EZ applicants in 20 states that make articles of incorporation viewable online at no cost showed that 37 percent do not meet the organizational test. A similar 2016 TAS study showed that 26 percent of approved organizations do not meet the organizational test. In the 2016 TAS study, four percent of the approved organizations consisted of two limited liability companies; two churches; seven schools, colleges, or universities or supporting organizations; and one private operating foundation. Such organizations are never eligible to file Form 1023-EZ.

Recommendations

The National Taxpayer Advocate recommends that the IRS require Form 1023-EZ applicants to submit their organizing documents, unless they are already available online at no cost, and summary financial information; and make a determination only after considering narrative statements and this additional information.

MSP #20 AFFORDABLE CARE ACT (ACA): The IRS Has Made Progress in Implementing the Individual and Employer Provisions of the ACA But Challenges Remain

Problem

In order to ensure that taxpayer rights are protected, TAS has been actively involved with the implementation of the tax provisions of the Patient Protection and Affordable Care Act of 2009 (ACA). Premium Tax Credit cases rose to become the fourth highest category of TAS case receipts during fiscal year (FY) 2016. In addition to the existing provisions impacting individuals, some provisions of the ACA impacting employers became effective in tax year (TY) 2015. We are particularly concerned with whether employees in the newly-established ACA Business Exam unit would receive appropriate training on topics including concepts such as applicable large employer (ALE), minimum essential coverage (MEC), and the employer shared responsibility payment (ESRP). In addition, we will monitor IRS preparedness to handle the additional volume of information-reporting data expected for the 2017 filing season.

Analysis

Taxpayers claiming the advanced PTC (APTC) are required to file Form 8962, *Premium Tax Credit (PTC)*, to reconcile the APTC received during the year with the PTC the taxpayer is actually entitled to receive. Taxpayers use Form 1095-A, *Health Insurance Marketplace Statement*, to prepare Form 8962. When the taxpayer files the return, IRS Submission Processing checks the ACA Verification System (AVS) on all individual tax returns to verify if the taxpayer received APTC and reconciled the APTC on Form 8962. If the AVS indicates that the taxpayer received the APTC, but the taxpayer does not reconcile APTC on Form 8962, the IRS will hold the return in an Error Resolution/Rejected Returns unit as the IRS issues Letter 12C, *Individual Return Incomplete for Processing*. In FY 2016, TAS received 10,910 cases with PTC issues. Based on an analysis of a random sample of those cases, 90 percent involved the IRS Error Resolution/Reject unit and 87 percent did not reconcile the APTC.

We are also concerned about the IRS's preparedness in administering certain business provisions in the 2017 filing season. For example, it is unclear if the scheduled training for employees on ACA-related issues concerning business taxpayers is sufficient. TAS is also concerned that the IRS's inability to test the accuracy of information reports before the filing season may cause significant taxpayer burden.

Recommendations

The National Taxpayer Advocate recommends that the IRS apply the Individual Shared Responsibility Payment (ISRP) overpayment recovery procedures used for TY 2014 to TY 2015 ISRP overpayments and to subsequent tax years; take preventive measures to avoid ISRP overpayments in the future; reject electronic filed returns when the taxpayer received APTC and did not reconcile on Form 8962; develop procedures to periodically review the AVS for updates after the IRS issues Letter 12C; ensure instructions to the Form 1040 series returns and the Forms 8962 clearly state that APTC recipients cannot file Form 1040-EZ; and conduct outreach and education on the consequences of receiving large, lump sum Social Security Disability Insurance distributions to APTC recipients and the Social Security Administration.

LEGISLATIVE RECOMMENDATIONS

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

The National Taxpayer Advocate places a high priority on working with the tax-writing committees and other interested parties to try to resolve problems encountered by taxpayers. In addition to submitting legislative proposals in each Annual Report, the National Taxpayer Advocate meets regularly with members of Congress and their staffs and testifies at hearings on the problems faced by taxpayers to ensure that Congress considers a taxpayer perspective.

LR #1 TAX REFORM: Simplify the Internal Revenue Code Now

Problem

It has now been more than 30 years since Congress enacted the Tax Reform Act of 1986 to substantially simplify the tax code, and since that time, the code has grown more complex by the year, as evidenced by the fact that Congress has made more than 5,900 changes to the code — an average of more than one a day — just since 2001. The compliance burdens the tax code imposes on taxpayers and the IRS alike are overwhelming.

Analysis

A TAS analysis of recent IRS data shows that taxpayers and businesses spend about six billion hours a year complying with tax-filing requirements. To place this in context, it would require three million full-time employees to work six billion hours, making “tax compliance” one of the largest industries in the United States.

Tax law complexity imposes monetary costs on taxpayers as well. More than half of individual taxpayers pay professionals to prepare their returns, and roughly 40 percent use tax software to assist them, with leading software packages typically costing \$50 or more.

Another perspective: The federal government now “spends” more money through the tax code each year than it spends to fund the entire federal government through the appropriations process. In fiscal year (FY) 2016, the Treasury Department estimated that “tax expenditures” (deductions, credits, and the like) amounted to more than \$1.4 trillion, while discretionary appropriations were less than \$1.2 trillion.

Indeed, individual income tax revenue was projected to be about \$1.63 trillion in FY 2016. This implies that if Congress were to eliminate all tax expenditures, it could cut individual income tax rates by *nearly half* and still generate current levels of revenue.

Recommendation

The National Taxpayer Advocate recommends that Congress vastly simplify the tax code.

General Principles

To achieve comprehensive simplification, tax expenditures would be pared back substantially and the additional revenue would be used to substantially reduce tax rates, leaving the average taxpayer with

about the same tax bill he or she has now — but with the ability to compute it much more simply and accurately.

In practice, simplifying the tax code requires important policy trade-offs. For example, Congress historically has allowed married couples and heads-of-households with children to claim larger standard deductions than single taxpayers, thus taxing them less on equivalent incomes. It has allowed a personal exemption for each taxpayer who participates in the filing of a joint return and a dependency exemption for each eligible child, again reflecting a social policy that taxes married couples and larger families less than single taxpayers and smaller families on equivalent incomes. In enacting the earned income tax credit (EITC), Congress on a bipartisan basis created a social benefits program styled as a work incentive, so that only taxpayers who work are eligible to receive program benefits. And on the business side, Congress has provided incentives for research, among other things.

In fact, virtually every provision in the tax code was enacted for a policy reason, and it is not likely Congress will choose to eliminate all tax expenditures, nor do we recommend that it do so.

However, we strongly recommend significant tax simplification, and to accomplish it, we recommend Congress approach tax reform in a manner similar to zero-based budgeting. Under that approach, the starting point would be a tax code without any exclusions or reductions in income or tax. Tax breaks and IRS-administered social programs would be added back only if lawmakers decide on balance that the public policy benefits of running the provision or program through the tax code outweigh the tax complexity challenges that doing so creates for taxpayers and the IRS.

Factors to consider in making this assessment include whether the government continues to place a priority on encouraging the activity for which the tax incentive is provided, whether the incentive is accomplishing its intended purpose, and whether a tax expenditure is more effective than a direct expenditure or another approach for achieving that purpose.

In addition to suggesting a zero-based budgeting approach to tax reform, we believe the protection of taxpayer rights and minimization of taxpayer burden should be emphasized, along with the IRS's ability to administer the law. Toward these ends, we have suggested six core principles that should help guide the development of tax reform legislation:

1. The tax system should not “entrap” taxpayers.
2. The tax laws should be simple enough so that most taxpayers can prepare their own returns without professional help, simple enough so that taxpayers can compute their tax liabilities on a single form, and simple enough so that IRS telephone assistants can fully and accurately answer taxpayers' questions.
3. The tax laws should anticipate the largest areas of noncompliance and minimize the opportunities for such noncompliance.
4. The tax laws should provide some choices, but not too many.
5. Where the tax laws provide for refundable credits, they should be designed in a manner that the IRS can effectively administer.
6. The tax system should incorporate a periodic review of the tax code — in short, a sanity check.

Specific Areas for Focus

To help guide tax reform discussions — or in the event Congress determines comprehensive tax simplification is not feasible at this time — we identify nine specific areas for simplification. These include:

1. Repeal the Alternative Minimum Tax for individuals.
2. Consolidate the “family status” provisions (including filing status, personal and dependency exemptions, the child tax credit, the earned income tax credit, the child and dependent care credit, and the separated spouse rule under IRC § 7703(b)).
3. Improve other provisions that govern taxation of the family unit, including “joint and several liability” and the “kiddie tax.”
4. Consolidate the incentives to encourage savings for education (there are now at least 12 separate incentives).
5. Consolidate the incentives to encourage savings for retirement (there are now at least 15 separate incentives).
6. Simplify the worker classification rules to reduce disputes over employee-versus-independent contractor status.
7. Reduce procedural incentives to use tax sunsets (more than 70 provisions in the tax code are temporary and thus require periodic renewal).
8. Reduce income phase-outs, which affect roughly half of all returns each year and add considerable complexity to tax computations.
9. Streamline the penalty regime for tax violations (there are now more than 170 penalty provisions, up from 14 in 1955).

LR #2 TAX REFORM: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden

Problem

A taxpayer's "family status" is central to the calculation of his or her taxable income and computation of tax. Despite several legislative improvements, this fundamental component of taxation remains one of the most complex issues facing each and every taxpayer. The Family Status provisions include: filing status (*i.e.*, single, married filing jointly, married filing separately, and head of household); personal and dependency exemptions; Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC); Earned Income Tax Credit (EITC); Child and Dependent Care Credit (CDCC); and separated spouse rules. While literally every tax return involves at least two of these Family Status provisions, these rules fail to account for the fluid nature of household composition. A narrow conception of a "family" can deny Family Status benefits to many households with children, but an overly expansive definition may be impossible for the IRS to administer without unacceptably intrusive inquiries. Nowhere is this conflict more apparent than in EITC administration — one of the government's largest means-tested, anti-poverty programs that has a participation rate of between 75 and 79 percent. However, the easy application process of the EITC is also associated with a high improper payment rate. Furthermore, there are areas of EITC administration that can be vastly improved. For example, the IRS has not yet embraced its dual mission as a tax collection and benefits disbursement agency. This failure to acknowledge its role as an administrator of one of the largest anti-poverty programs in the federal government leads to enforcement-oriented compliance approaches that are particularly unsuitable and counter-productive, given the characteristics of the EITC population.

Analysis

A recent Tax Policy Center Study found that between 1996 and 2008, the proportion of children living with married couples dropped from 70.9 percent to 67.3 percent, and the number living with cohabitating parents increased from 3.6 percent to 6.2 percent. In 2008, nearly 20 percent of children living in single-parent households also lived in multigenerational households, as was the case with households headed by non-parent relatives or foster parents. Only 51.6 percent of children living in families with income at or below 200 percent of the federal poverty level were in families headed by married couples. Children in low and moderate income single parent families, cohabiting couple families, and relative/foster care families all experienced greater change in family type from one year to the next. For example, in 2008, a third of low and moderate income children in single parent families with some biological children changed family type. Because the Family Status rules generally contemplate more "traditional" households and award tax benefits to only one person with respect to each child, the disconnect between the Code and the reality of many taxpayers' lives has led to mistakes on the part of taxpayers who misunderstand the rules; it also prevents some primary caregivers for children in certain low income households from receiving the EITC. With the recent enactment of accelerated due dates for Form W-2 and Form 1099-MISC (*Nonemployee Compensation*) and the delayed EITC refund issuance date, in effect for the 2017 Filing Season, what remains are some of the more factually complex sources of EITC error, including the residency test, competing claims for the same child, and whether separated parents are considered "unmarried" under the tax code and thus able to file as single or head of household. These issues also arise under other Family Status provisions. Finally, the EITC also provides an extremely small benefit to low income childless workers between the ages of 25 and 64, even though a little over 20 percent of Millennials with only a high school education are living in poverty, and 4.2 million people aged 65 and older were living in poverty in 2015 (representing a poverty rate of 8.8 percent among people age 65 and over). The participation rate for this benefit

is extremely low, even though it is very easy to calculate, because it based on the earnings of a single taxpayer. The IRS does not adjust a taxpayer's return to claim this credit where the taxpayer has not done so and appears eligible.

Recommendations

To provide the Code's Family Status provisions with the necessary flexibility to adapt to the evolving U.S. family composition, and to improve the administration of the EITC and other Family Status provisions, including reducing the EITC improper payment rate, the National Taxpayer Advocate recommends that Congress: require the IRS to revise its mission statement to recognize the dual roles of revenue collector and benefits administrator; consolidate the numerous family status provisions into two: the refundable Family Credit, which would reflect the cost of maintaining a household and raising a family; and the refundable EITC, which would be awarded per individual worker and provide a work incentive and subsidy for low income workers; repeal the personal and dependency exemptions, CTC/ACTC, Head of Household filing status, and the family-size differential of the EITC, all of which would be replaced by the Family Credit; amend the Qualifying Relative test of IRC § 152(d)(2)(H) to provide a child must share the same principal place of abode as the taxpayer and be a member of the taxpayer's household for more than six months of the taxable year; provide for certain add-on credits under the Family Credit for child and dependent care, disabled taxpayers or family members, and consider providing for noncustodial parents of qualifying children who pay substantially all child support legally due for that tax year; amend IRC § 152(f) to provide a definition of "support" that excludes any means-tested federal, state, or local benefits paid on behalf of or for the benefit of the qualifying child or qualifying relative; expand the eligibility age for the modified refundable EITC to include workers 18 years of age and older, with no age cap; amend IRC § 7703(b) to permit taxpayers who have a legally binding separation agreement and who live apart on the last day of the tax year to be considered "not married" for purposes of filing status; amend IRC § 6402 to limit offsets of refunds attributable to the Family Credit and EITC to 25 percent of the taxpayer's refundable portion of these credits; amend IRC § 6402 to authorize the IRS to calculate overpayments and make refunds with respect to the new per-worker EITC refundable credit, where the taxpayer's reported income demonstrates eligibility and the taxpayer has not claimed the credit on his or her return; mandate the IRS assign one employee to each audit involving a questionable Family Credit claim where the taxpayer has responded (by phone or in writing) to an IRS audit notice; and mandate the IRS establish a dedicated, year-round toll-free help line staffed by IRS personnel to respond to Family Credit questions.

LR #3 **OUTSIDE RESEARCH: Expand Opportunities for the IRS to Collaborate With Outside Researchers**

Problem

Private sector and academic researchers can help policymakers improve tax administration and achieve public policy goals by studying tax microdata (*i.e.*, data that is not aggregated into summary statistics). Some are willing to provide cutting-edge research for free. Collaboration with outsiders can also help IRS researchers learn the latest data analysis techniques. The U.S. generally lags behind other countries in making microdata available to researchers who want to help. Resource constraints limit the IRS's ability to collaborate. In addition, the IRS's research agenda may not always coincide with the outside researchers' interests. Unlike other agencies, the IRS does not use an external peer review process to help identify the most promising research proposals. Thus, the IRS may be missing opportunities to collaborate on important projects.

Analysis

To collaborate with outside researchers, the IRS typically must pair them with an internal researcher who can help identify and understand relevant data, oversee the project, provide him or her with limited data extracts, and implement other measures to protect the data from unauthorized disclosure. To protect taxpayer privacy, the IRS must also conduct a background check, administer annual training on data security, and provide computer equipment, software, and provide the researcher with space in a government facility. Because of the resources this requires, the IRS only solicits proposals through its Joint Statistical Research Program about every two years during a 60-day window. The length of time between solicitations, the uncertainty about whether proposals will be accepted, the short period during which they will be considered, and the delay in getting started after acceptance could discourage outside researchers from offering to collaborate. In addition, the lack of an independent review process means that the IRS's short-term research priorities can crowd out more promising proposals.

Recommendation

Congress should establish an independent Tax Research Review Board (TRRB) comprised of external researchers, as well as representatives from the IRS, TAS, and the Treasury Department to vet and prioritize research proposed by outsiders. The TRRB would help ensure the government pursues important questions. The TRRB should have independent funding and a technical staff to help it evaluate proposals and fully support those it accepts.

LR #4 COLLECTION DUE PROCESS (CDP): Amend Internal Revenue Code § 6330 to Provide That the Standard and Scope of Tax Court Review in CDP Cases Is De Novo Whether the Underlying Liability Is at Issue

Problem

In *Robinette v. Commissioner*, the Tax Court held that in collection due process (CDP) cases the scope of its review is *de novo*, meaning its consideration is not limited to evidence already contained in the IRS's administrative record. However, not all appellate courts agree with the Tax Court.

The *standard* of review in CDP cases when the underlying liability is not at issue is for abuse of discretion; the Tax Court overturns the IRS's determination only where it is shown to be arbitrary, capricious, or without sound basis in fact. If the standard of review were *de novo*, the Tax Court would consider the case anew, without deference to the IRS's determination.

Analysis

Restricting judicial review to the administrative record in CDP cases harms taxpayers, especially those who cannot afford representation or assistance during administrative proceedings. Most taxpayers proceed in Tax Court without representation.

The abuse of discretion standard serves no stated congressional objective and results in minimal scrutiny of the very IRS determinations that have the greatest impact on taxpayers. Adopting a *de novo* standard could promote efficiency of IRS collection activities, and would thus be consistent with fundamental principles of administrative law.

Recommendation

Amend Internal Revenue Code (IRC) § 6330 to specify that the standard and scope of review in Tax Court determinations under IRC § 6330 is *de novo*, whether or not the underlying liability is at issue.

LR #5 **COLLECTION DUE PROCESS (CDP): Amend Internal Revenue Code § 6330 to Require Appeals Officers, in Considering Collection Alternatives, to Suspend CDP Hearings Pending Resolution of Challenged Non-CDP Liabilities or Precluded CDP Liabilities**

Problem

In considering collection alternatives during a Collection Due Process (CDP) hearing, Appeals Officers must include all open years in the resolution, including non-CDP years. Of the 22,300 taxpayers whose CDP cases were closed in fiscal year 2016, 44 percent also had liabilities for non-CDP years. Non-CDP years may be eligible for audit reconsideration, or capable of resolution through an offer in compromise based on doubt as to liability. However, Appeals Officers are not required to suspend the CDP hearing pending those outcomes for the non-CDP years. Moreover, an Appeals Officer may refuse to consider a taxpayer's challenge to the existence or amount of a liability for a CDP year on the basis that such a challenge is a "precluded" issue. Reconsideration of the CDP year liability could also affect the availability of collection alternatives.

Analysis

The CDP provisions were intended to remedy unfair aspects of IRS collection processes, resolve collection cases early in the process, and ensure that the IRS solves taxpayer problems rather than simply close cases. If Appeals Officers are not required to suspend a CDP hearing while appropriate collection alternatives for non-CDP years can be identified, the IRS may improperly collect tax and create costly rework downstream. Similar results may follow from an Appeals Officer's refusal to consider a taxpayer's challenge to the existence or amount of a liability for a CDP year, on the basis that such a challenge is a "precluded" issue.

Recommendation

Amend IRC § 6330 to require Appeals Officers, in considering collection alternatives in CDP cases, to suspend the hearing while a taxpayer is challenging the existence or amount of a non-CDP liability or a CDP liability that the Appeals Officer is precluded from considering.

LR #6 **NOTICES OF FEDERAL TAX LIEN (NFTL): Amend the Internal Revenue Code to Require a Good Faith Effort to Make Live Contact With Taxpayers Prior to the Filing of the NFTL**

Problem

The National Taxpayer Advocate has repeatedly discussed the importance of attempting meaningful in-person contact with taxpayers to improve tax compliance instead of only relying on mailed notices. Internal Revenue Manual (IRM) § 5.12.2.2(1) instructs employees to make “reasonable efforts” when contacting taxpayer before filing a Notice of Federal Tax Lien (NFTL), but this generally involves the issuance of the statutory assessment notices and the balance due notices in efforts “to advise that an NFTL may be filed if full payment is not made when requested.” It does not include a requirement for meaningful or live contact with the taxpayer. The lack of meaningful or live contact results in unnecessary NFTLs filed in situations where they could have been avoided if the taxpayer was reached in person or via telephone and a discussion took place about the negative effects of the NFTL, the taxpayer’s financial information, and other collection options for resolving the tax liability.

Analysis

Without any meaningful contact with the taxpayer, determinations to file NFTLs may be made without a full financial evaluation of the taxpayer and without consideration of collection alternatives. The IRS may view taxpayers as unresponsive, but in fiscal year (FY) 2016 only 44 percent of taxpayers could reach the IRS using the installment agreement telephone number on the notices they were provided with. This allows for situations where NFTLs may then be filed against taxpayers who are trying to reach the IRS and cannot, and such situations clearly erode taxpayers’ trust in fair tax administration and can undermine future compliance. In contrast, private sector creditors routinely use early intervention as a pre-collection mechanism. 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 mitigation options available. The Mortgage Servicing Rules require that the first contact, which must take place by the 36th day of delinquency, must be either a “live contact,” or a good faith effort thereof. The National Taxpayer Advocate previously recommended the IRS 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. However, the IRS has declined to adopt this recommendation administratively stating that requiring “live” contact “would inappropriately reward taxpayers actively avoiding the IRS.” This response reflects a profound misunderstanding of the value of “nudging” and taxpayer behavior, as well as an attitude toward taxpayers that assumes the worst about them.

Recommendation

The National Taxpayer Advocate recommends that Congress amend Internal Revenue Code (IRC) § 6323 to require that prior to making the determination to file an NFTL, the IRS must make a “live contact,” or at least a good faith effort for “live contact,” telephonically or in-person, with the taxpayer to obtain financial information and discuss collection alternatives.

LR #7 **INTERNATIONAL DUE DATES: Amend Internal Revenue Code § 6213(b)(2)(A) to Provide Additional Time to Request Abatement of a Mathematical or Clerical Error Assessment to Taxpayers Living Abroad Similar to the Timeframe Afforded to Taxpayers to Respond to a Notice of Deficiency**

Problem

Internal Revenue Code (IRC) § 6213(a) allows taxpayers living or traveling abroad an additional 60 days to respond to the statutory notice of deficiency (SNOD), for a total of 150 days compared to 90 days allowed to domestic taxpayers. However, the IRC provides only 60 days for taxpayers abroad to request an abatement of the mathematical or clerical error assessment, the same time frame as is allowed to domestic taxpayers.

The difficulty in accessing IRS services from abroad, combined with international mail delays, makes 60 days to respond to an IRS math error notice an insufficient time, and undermines these taxpayers' right to challenge the IRS's decision in an independent forum, because if the taxpayer fails to timely respond to a math error notice, he or she may not petition the Tax Court, the only prepayment judicial forum. Given the complexity of the international tax rules and reporting requirements, and the potentially devastating penalties for even inadvertent noncompliance, increasing the response time to 120 days similar to the framework for extending the time to respond to a SNOD, would provide these taxpayers parity with domestic taxpayers and enhance their *rights to challenge the IRS position, to pay no more than the correct amount of tax, and to a fair and just tax system.*

Analysis

Approximately nine million U.S. citizens live abroad, along with over 170,000 U.S. military service personnel and their families, and hundreds of thousands of students and foreign taxpayers with U.S. tax obligations. Taxpayers abroad face unique challenges in complying with complex international tax obligations that may result in inadvertent errors and mistakes. These errors can result in the IRS making a summary assessment of tax based on a mathematical or clerical error, bypassing regular deficiency procedures. IRC § 6213(a) provides 150 days for taxpayers outside of the United States to file a petition after the SNOD is mailed compared to domestic taxpayers who may file a petition for a redetermination of the deficiency with the Tax Court within 90 days from the date that the notice is mailed. With both subsections providing for the same extension of time to respond, *i.e.*, 60 additional days, taxpayers will not be prevented from contesting IRS math error notices and subsequently requesting judicial review of the deficiency in the Tax Court. Amending IRC § 6213(b)(2)(A) to provide additional time for taxpayers residing abroad would bring parity with IRC § 6213(a), eliminate confusion of international taxpayers about their responsibilities, address issues with international mail, improve access to the IRS, and protect taxpayer rights.

Recommendation

Amend IRC § 6213(b)(2)(A) to allow 120 days for taxpayers outside the U.S. to file a request for an abatement of an assessment arising from math or clerical errors.

LR #8 **INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS (ITINs): Amend the Protecting Americans from Tax Hikes (PATH) Act of 2015 to Revise the Expiration Schedule for ITINs**

Problem

Individual Taxpayer Identification Numbers (ITINs) are intended to be used only for tax administration purposes. In late 2015, Congress passed legislation, which created a schedule for expiring ITINs based either on their failure to be used on a tax return for three consecutive years, or based on the year the ITIN was issued. The expiration schedule sets rigid timeframes, which the IRS is unable to meet because of technology and resource limitations. The current expiration schedule may create multiple problems for affected taxpayers. First, there will be a discrepancy between when an ITIN is considered expired under the law and when the IRS deactivates it. Second, the expiration schedule has pressured the IRS to deactivate ITINs without having the proper systems in place to process renewal applications prior to the deactivation. Third, because of the sheer volume of ITINs requiring deactivation in a short time period, the IRS faces challenges in informing taxpayers of the upcoming deactivations and the need to renew their ITINs.

Analysis

The IRS's inability to meet the legislatively mandated schedule for deactivating all ITINs issued prior to 2013 gives rise to a discrepancy between which ITINs have expired under the law and which ITINs the IRS has deactivated. Those taxpayers whose ITINs have expired under the law, but who are told by the IRS they do not need to renew, may face consequences if they choose to challenge an IRS determination in court. Trying to comply with the legislatively mandated timeline has pressured the IRS into deactivating ITINs before the necessary systems are in place to process renewal applications. A more gradual schedule for deactivating ITINs would provide the IRS with more time and resources to conduct outreach and notify taxpayers at their last known address prior to deactivation. To remedy these problems facing taxpayers and to protect *taxpayers' right to be informed*, Congress should develop a new expiration schedule in consultation with the IRS that (1) the IRS is capable of implementing given the volume and timing of the deactivations, (2) would allow the IRS to notify all taxpayers in advance of a deactivation, to the extent feasible, and (3) would provide sufficient time for renewal applications to be received and fully processed prior to the deactivations occurring.

Recommendation

The National Taxpayer Advocate recommends that Congress amend Internal Revenue Code (IRC) § 6109(i)(3)(B) to create a revised schedule for expiring ITINs issued prior to 2013 that is developed in consultation with the IRS.

LR #9 **CERTIFIED ACCEPTANCE AGENTS (CAAs): Amend the PATH Act to Authorize CAAs to Certify Individual Taxpayer Identification Number Applications for Taxpayers Residing Abroad**

Problem

Taxpayers ineligible for Social Security numbers require Individual Taxpayer Identification Numbers (ITINs) to comply with their tax filing and payment obligations, claim dependents, and receive tax benefits, such as the benefits of a tax treaty. In recent years, options for taxpayers abroad to apply for ITINs have been reduced. Although the Protecting Americans from Tax Hikes Act of 2015 (hereinafter PATH Act) specifically authorizes ITIN applicants residing outside the United States to apply in person to an IRS employee, there are no IRS offices abroad at which an applicant can apply since the IRS closed the tax attaché offices. The PATH Act also authorizes applicants outside the United States to apply in person to a designated official at a U.S. diplomatic mission or consular post, but the IRS has not designated any such officials in response to the PATH Act. Finally, the PATH Act takes away the option for taxpayers residing abroad to apply through a Certified Acceptance Agent (CAA). The restriction on CAAs leads to many applicants who reside abroad having to send their original documents to the IRS through international mail, which requires giving them up for long periods of time and risking their loss.

Analysis

The CAA restriction comes at an especially bad time as the IRS has plans to deactivate millions of ITINs in the coming years, requiring taxpayers to apply to renew their ITINs if they need to file individual returns. At a time when ITIN applications are expected to increase, and when strained IRS resources have led to a timeframe of 11 weeks to process ITIN applications submitted during the filing season or from abroad, there is no compelling reason to remove the option for ITIN applicants who reside abroad to use CAAs. Because of the lack of IRS offices abroad and the failure to appoint designated officials at U.S. diplomatic missions or consulates, applicants residing abroad are effectively limited to applying for an ITIN by international mail. Problems with handling and returning original identification documents are likely to grow as more applicants abroad feel compelled to send in original documents. The restriction on using CAAs infringes on a taxpayer's *right to a fair and just tax system* because applicants who reside abroad are already at a disadvantage when applying for ITINs, due to their inability to apply in person to an IRS employee. By prohibiting applicants abroad from using CAAs, the PATH Act now removes another option that is still available to domestic applicants and impairs the *right to quality service* for taxpayers abroad.

Recommendation

Amend Internal Revenue Code (IRC) § 6109(i)(1)(B) to clarify that ITIN applicants residing outside the United States may apply for an ITIN in person to a CAA while located outside the United States.

LR #10 STREAMLINE RELIGIOUS EXEMPTIONS: Streamline the Religious Exemption Process for the Individual Shared Responsibility Payment (ISRP)**Problem**

Taxpayers in the Amish and Mennonite communities have voiced concerns regarding unnecessary compliance burdens when applying for an Individual Shared Responsibility Payment (ISRP) exemption based on religion. Taxpayers in certain recognized religious sects file their exemption applications with the Marketplace and experience significant delays in processing such applications. Many of these taxpayers already apply for a similar exemption from Social Security and Medicare taxes with the Social Security Administration (SSA) by submitting Form 4029, *Application for Exemption from Social Security and Medicare Taxes and Waiver of Benefits*, to the SSA. Once the SSA approves the exemption request, SSA submits it to the IRS. Therefore, the IRS already has a record of a federal determination on a similar exemption request. Requiring an additional certification is unnecessary and burdensome for the taxpayer and wasteful for the government.

Analysis

Pursuant to Internal Revenue Code (IRC) § 5000A, a taxpayer can obtain an exemption from ISRP for any month in which he or she is a member of a recognized religious sect or division thereof that is recognized by the SSA as conscientiously opposed to accepting any insurance benefits, including Medicare and Social Security. Despite the fact that the Affordable Care Act defines the ISRP exemption through reference to the Social Security and Medicare tax provisions, to receive an ISRP exemption, eligible taxpayers must apply to the relevant health insurance marketplace for an Exemption Certificate Number (ECN). The procedure is time-consuming, confusing, and many applicants have experienced delays in receiving their ECN from the marketplace. The taxpayer must then enter the ECN on Form 8965, *Health Coverage Exemptions*, to claim the exemption.

A less burdensome solution would be to discard the ECN application process and allow taxpayers to enter “4029 exempt” instead of an ECN on the applicable line in Part 1 of Form 8965. The IRS would be able to verify the information internally, because it already receives Form 4029 after it is approved by the SSA and such approval is easily accessible on IRS information systems.

Recommendation

To reduce unnecessary burden on both taxpayers and the government, the National Taxpayer Advocate recommends that Congress amend Internal Revenue Code (IRC) § 5000A(d)(2) to provide that the Secretary of Treasury has the authority to grant the religious exemption for purposes of the ISRP if the taxpayer has already received approval by the SSA and the IRS for the exemption set forth in IRC § 1402(g)(1), and the regulations thereunder, and such exemption is still valid. The amendment should also provide that such exemption applies to the taxpayer and all individuals for whom the taxpayer is liable under IRC § 5000A(a).

THE MOST LITIGATED ISSUES

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(x) requires the National taxpayer advocate to include in her annual report to congress the ten tax issues most litigated in the federal courts, classified by the type of taxpayer affected. The cases we reviewed were decided during the 12-month period that began on June 1, 2015, and ended on May 31, 2016.

MLI #1 **Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)**

Internal Revenue Code (IRC) § 6662(b)(1) and (2) authorize the IRS to impose a penalty if a taxpayer's negligence or disregard of rules or regulations causes an underpayment of tax required to be shown on a return, or if an underpayment exceeds a computational threshold called a substantial understatement, respectively. IRC § 6662(b) also authorizes the IRS to impose the accuracy-related penalty on an underpayment of tax in six other circumstances.

We identified 122 opinions issued between June 1, 2015 and May 31, 2016, where taxpayers litigated the negligence or disregard of rules or regulations, or substantial understatement components of the accuracy related penalty. The IRS prevailed in full in 86 cases, taxpayers prevailed in full in 20 cases, and 16 cases resulted in split decisions.

MLI #2 **Appeals From Collection Due Process (CDP) Hearings Under IRC §§ 6320 and 6330**

The IRS Restructuring and Reform Act of 1998 (RRA 98) created Collection Due Process (CDP) hearings to provide taxpayers with an independent review by the IRS Office of Appeals (Appeals) of the decision to file a Notice of Federal Tax Lien (NFTL) or the IRS's proposal to undertake a levy action. In other words, a CDP hearing gives taxpayers an opportunity for a meaningful hearing before the IRS issues its first levy or immediately after it files its first NFTL with respect to a particular tax liability. At the hearing, the taxpayer has the statutory right to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy, including the appropriateness of the collection action, collection alternatives, spousal defenses, and under certain circumstances, the underlying tax liability.

Taxpayers have the right to judicial review of Appeals' determinations if they timely request the CDP hearing and timely petition the United States Tax Court. Generally, the IRS suspends levy actions during a levy hearing and any judicial review that may follow.

Since 2001, CDP has been one of the federal tax issues most frequently litigated in the federal courts and analyzed in the National Taxpayer Advocate's Annual Reports to Congress. The trend continues this year, with our review of litigated issues finding 99 opinions on CDP cases during the review period of June 1, 2015 through May 31, 2016, which is an increase of 25 percent since last year's report. Taxpayers prevailed in full in ten of these cases (ten percent) and, in part, in six others (six percent). The 16 percent success rate for the taxpayers is one of the highest success rates since the inception of CDP hearings. Of the 16 opinions where taxpayers prevailed in whole or in part, eight taxpayers appeared *pro se* and eight were represented.

The cases discussed demonstrate that CDP hearings serve an important role in providing taxpayers with a venue to raise legitimate issues before the IRS deprives the taxpayer of property. Many of these decisions shed light on substantive and procedural issues.

MLI #3 Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Pursuant to Internal Revenue Code (IRC) § 7602, the IRS may examine any books, records, or other data relevant to an investigation of a civil or criminal tax liability. To obtain this information, the IRS may serve a summons directly on the subject of the investigation or any third party who may possess relevant information. If a person summoned under IRC § 7602 neglects or refuses to obey the summons; to produce books, papers, records, or other data; or to give testimony as required by the summons, the IRS may seek enforcement of the summons in a United States district court.

A person who has a summons served on him or her may contest its legality if the government petitions to enforce it. Thus, summons enforcement cases are different from many other cases described in other Most Litigated Issues (MLIs) because often the government, rather than the taxpayer, initiates the litigation. If the IRS serves a summons on a third party, any person entitled to notice of the summons may challenge its legality by filing a motion to quash or by intervening in any proceeding regarding the summons. Generally, the burden on the taxpayer to establish the illegality of the summons is heavy. When challenging the summons's validity, the taxpayer generally must provide "some credible evidence" supporting an allegation of bad faith or improper purpose. The taxpayer is entitled to a hearing to examine an IRS agent about his or her purpose for issuing a summons only when the taxpayer can point to specific facts or circumstances that plausibly raise an inference of bad faith. Naked allegations of improper purpose are not enough, but because direct evidence of IRS's bad faith "is rarely if ever available," circumstantial evidence can suffice to meet that burden.

We identified 87 federal cases decided between June 1, 2015, and May 31, 2016 involving IRS summons enforcement issues. The government was the initiating party in 58 cases, while the taxpayer was the initiating party in 29 cases. Overall, taxpayers fully prevailed in three cases, while five cases were split. The IRS prevailed in the remaining 79 cases.

MLI #4 Gross Income Under IRC § 61 and Related Sections

When preparing tax returns, taxpayers must complete the crucial calculation of gross income for the taxable year to determine the tax they must pay. Gross income has been among the MLIs in each of the National Taxpayer Advocate's Annual Reports to Congress. For this report, we reviewed 81 cases decided between June 1, 2015, and May 31, 2016. Several of the cases involved taxpayers failing to report items of income, including some specifically mentioned in IRC § 61 such as wages, interest, dividends, and annuities.

In the 81 opinions involving gross income issued by the federal courts and reviewed for this report, gross income issues most often fall into two categories: (1) what is included in gross income under IRC § 61 and (2) what can be excluded under other statutory provisions. In 32 cases, taxpayers were represented, while the rest were *pro se* (without counsel). Represented taxpayers prevailed in full or in part in five of 32 cases, whereas *pro se* taxpayers prevailed in full or in part in three of 49 cases. Overall, taxpayers prevailed in full or in part in eight of 81 cases.

MLI #5 Trade or Business Expenses Under IRC § 162 and Related Sections

Internal Revenue Code (IRC) § 162(a) permits a taxpayer to deduct ordinary and necessary trade or business expenses paid or incurred during the taxable year. These expenses include:

- Reasonable allowance for salaries or other compensation for personal services actually rendered;
- Travel expenses while away from home in the pursuit of a trade or business; and
- Rentals or other payments for use of property in a trade or business.

In addition to the general allowable expenses described above, IRC § 162 addresses deductible and nondeductible expenses incurred in carrying on a trade or business, and special rules for health insurance costs of self-employed individuals.

The deductibility of trade or business expenses has long been among the ten MLIs since the first edition of the National Taxpayer Advocate's Annual Report to Congress in 1998. We identified 73 cases involving a trade or business expense issue that were litigated in federal courts between June 1, 2015 and May 31, 2016. The courts affirmed the IRS position in 50 of these cases, or about 68 percent, while taxpayers fully prevailed in only five cases, or about seven percent of the cases. The remaining 18 cases, or about 25 percent, resulted in split decisions.

MLI #6 Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654

We reviewed 45 decisions issued by federal courts from June 1, 2015, to May 31, 2016, regarding the additions to tax for:

- Failure to file a tax return by the due date under IRC § 6651(a)(1);
- Failure to pay an amount shown on a tax return under IRC § 6651(a)(2);
- Failure to pay an amount shown on a tax return within 21 days of the issuance of a notice and demand under IRC § 6651(a)(3);
- Failure to pay installments of the estimated tax under IRC § 6654; or
- Some combination of the four.

The phrase “addition to tax” is commonly referred to as a penalty, so we will refer to these additions to tax as the failure to file penalty, the failure to pay penalty, and the estimated tax penalty. Eight cases involved the imposition of the estimated tax penalty in conjunction with the failure to file and failure to pay penalties; four cases involved the estimated tax penalty and either the failure to file penalty or the failure to pay penalty under IRC § 6651(a)(2) or (a)(3); 32 involved the failure to file or failure to pay penalties; one case involved only the estimated tax penalty.

The IRS imposes the failure to file and failure to pay penalties unless the taxpayer can demonstrate the failure is due to reasonable cause and not willful neglect. The estimated tax penalty is imposed unless the taxpayer can meet one of the statutory exceptions. Taxpayers were unable to avoid a penalty in 41 of the 45 cases.

MLI #7 Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

Internal Revenue Code (IRC) § 7403 authorizes the United States to file a civil action in U.S. District Court against a taxpayer who has refused or neglected to pay any tax, to enforce a federal tax lien, or to subject any of the delinquent taxpayer's property to the payment of tax. We identified 32 opinions issued between June 1, 2015, and May 31, 2016 that involved civil actions to enforce liens under IRC § 7403. The IRS prevailed in 30 of these cases. One case was a split decision. The total number of cases represents approximately a 27 percent decrease from the previous year. This is the second consecutive year that the number of lien enforcement cases decreased. The number of cases dropped by approximately 15 percent in the 2015 reporting period compared to the number of cases in 2014.

MLI #8 Charitable Deductions Under IRC § 170 Summary

Subject to certain limitations, taxpayers can take deductions from their adjusted gross incomes (AGIs) for contributions of cash or other property to or for the use of charitable organizations. To take a charitable deduction, taxpayers must contribute to a qualifying organization and substantiate contributions of \$250 or more. Litigation generally occurred in this reporting cycle in the following three areas:

- Substantiation of the charitable contribution;
- Valuation of the charitable contribution; and
- Requirements for a qualified conservation easement.

TAS reviewed 26 cases decided between June 1, 2015, and May 31, 2016, with charitable deductions as a contested issue. The IRS prevailed in 19 cases, taxpayers prevailed in three cases, and the remaining four cases resulted in split decisions. Taxpayers represented themselves (appearing *pro se*) in ten of the 26 cases, with one taxpayer prevailing in full, the IRS in seven cases, and the remaining two resulted in split decisions.

MLI #9 Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

From June 1, 2015 through May 31, 2016, the federal courts issued decisions in at least 19 cases involving IRC § 6673 "frivolous issues" penalty and in at least five cases involving similar penalties at the appellate level. These penalties are imposed for maintaining a case primarily for delay, raising frivolous arguments, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal.

In five of the cases TAS reviewed, taxpayers escaped liability for the penalty and two cases resulted in a split decision on the requested penalties. Additionally, in three cases, the courts raised the issue of penalties *sua sponte* and did not impose the contemplated penalties but warned the taxpayers they could face sanctions for similar conduct in the future. Nonetheless, TAS included these cases in its analysis to illustrate what conduct will and will not be tolerated by the courts.

MLI #10 Trust Fund Recovery Penalty (TFRP) Under IRC § 6672

The trust fund recovery penalty (TFRP) (also known as the 100 percent penalty) applies to a person who has a responsibility to collect, truthfully account for, and pay over "trust fund" taxes imposed on another person that he or she willfully fails to remit such taxes to the IRS. Typically, a TFRP arises when a struggling business fails to remit withheld income taxes, Social Security and Medicare taxes,

railroad retirement taxes, or collected excise taxes to the IRS. To establish liability under IRC § 6672, the IRS must conclude a person was responsible for withholding and paying over to the IRS payroll taxes and that the failure to do so was willful. The statute does not contain a reasonable cause exception. Whether a person actually had the responsibility to withhold payroll taxes and whether he or she willfully failed to do so are mixed questions of law and fact frequently litigated in United States district courts, bankruptcy courts, and the Court of Federal Claims. The TFRP has not been an MLI since 2005.

We reviewed 21 opinions issued by federal courts in which the TFRP was an issue. Taxpayers prevailed in whole or in part in four of the 21 cases. In one of these cases the court denied the IRS's motion for summary judgment, thereby requiring the parties to go to trial on any remaining contested issue. In the remaining cases, the taxpayer prevailed for procedural reasons.

VOLUME 2: TAS Research and Related Studies

#1 Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups

Introduction

In response to the National Taxpayer Advocate's concerns that the ongoing cuts to the IRS's budget in fiscal year (FY) 2010 – 2015 have resulted in unacceptable reductions and changes in taxpayer service, TAS and the Wage & Investment (W&I) Division are developing a ranking methodology for the major taxpayer service activities offered by W&I. We refer to the initiative to develop this methodology as the Service Priorities Project.

Limitations imposed by the lack of available data have, however, delayed implementation. To address some of these "data gaps," TAS contracted for services in March 2016 to advise on survey development, administer the survey, and compile the results. Our targeted completion date for survey administration was the end of September, 2016, but due to unanticipated difficulties, our contractor has been unable to complete the 4,000 surveys specified in the contract in accordance with the agreed to schedule.

In the interim, TAS has obtained data for the 1,910 surveys completed through November 16, 2016. While we do not have a sufficient sample size to do rigorous analysis of service usage by major service activity (*e.g.*, tax law questions, help with notices) within channel required for the Service Priorities Project, we can begin to explore the broader issue of how a transition to predominantly web-based services impacts the various demographic groups that comprise the taxpayer population.

Objectives

This report focuses on how taxpayers' service preferences, usage patterns, and usage effectiveness vary by demographic group within the taxpayer population. Our principal objective is to quantify and characterize the demographics of taxpayer groups that appear to have an on-going need for the IRS personal services provided by phone and in person at the Taxpayer Assistance Centers (TACs). To explore this objective, we conducted the following analyses with demographic breakouts for the taxpayer groups comprising the vulnerable taxpayer population (*i.e.*, low income, seniors, the disabled, and limited English proficiency (LEP) taxpayers):

- Internet access, proficiency, and concerns;
- Service usage by channel (*i.e.*, web, phone, TAC); and
- Willingness and importance scores for service activities (*e.g.*, tax law questions, help with notices, obtaining a copy of a prior year return) by channel.

Methodology

The analyses in this report are based on the 1,910 survey responses obtained as of November 16, 2016 in accordance with the study design methodology. The design calls for the contractor to use Random Digit Dialing (RDD) to contact and recruit eligible survey respondents, all of whom must have either used IRS services or filed a Form 1040 return within the preceding 12 months. The RDD sampling frame must be representative of the population of both land line and cell phone numbers.

TAS developed demographic criteria that are used to assign appropriate weights to all respondents.

Findings

The numbers shown in this narrative represent the point estimate values. Data tables include the lower and upper bound estimates (*i.e.*, confidence intervals), as well as the point estimate.

The vulnerable populations, *i.e.*, low income taxpayers (at or below 250 percent of poverty level based on household size, income, and location), seniors (age 65 and older), those with disabilities (long term condition self-reported in the survey), and taxpayers with LEP, face greater challenges accessing and navigating the Internet than other taxpayers generally do. In this report we identify these challenges by comparing the vulnerable groups to all taxpayers who are not categorized as low income taxpayers in our analyses. Important results that highlight these challenges include:

- All of the vulnerable groups are less likely to have broadband access at home than the not low income and are also less likely to have internet access at home. Estimates for broadband access at home for the vulnerable groups range between about 60 percent and 72 percent, while approximately 87 percent of the not low income group have broadband access;
- Overall, we found that about 23 percent of taxpayers do not have broadband access, which translates to over 33 million taxpayers without this type of access;
- We estimate that more than 14 million taxpayers do not have internet access at home;
- The vulnerable groups are more likely to access the internet infrequently (less than once a week or not at all) than the not low income group. Millions of taxpayers, particularly those in the vulnerable population groups, only access the Internet infrequently or don't access the internet at all. We estimate that almost 21 million taxpayers access the Internet less than once a week or not at all;
- The vulnerable groups report that they feel less skilled doing internet research than the not low income group. With respect to more basic skills, the vulnerable groups are also less likely than the not low income group to report that they feel comfortable sending emails. Millions of taxpayers in all the demographic groups, however, appear to be uncomfortable sending emails, even though this is a basic internet skill. We estimate that nearly 20 million taxpayers do not feel comfortable sending emails; and
- The vulnerable groups report that they feel less secure sharing personal financial information over the internet than the not low income group. It should be noted, however, that only a minority of respondents in all of the groups report that they feel secure sharing personal financial information over the internet. Conversely, over half of all taxpayers, or more than 74 million, stated they were not comfortable sharing personal financial information over the internet.

These findings show that millions of taxpayers are still reliant on personal services to address their taxpayer service needs and would face challenges if only online services were available.

#2 Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently in Error and Were Sent an Educational Letter from the National Taxpayer Advocate

Introduction

In January of 2016, the National Taxpayer Advocate sent 6,564 letters (the Taxpayer Advocate Service, or TAS letter) to taxpayers who appeared to have erroneously claimed the Earned Income Tax Credit (EITC) on their 2014 returns, whose 2014 returns were not audited. The express purpose of the TAS letter was “so that you can avoid an error in the future.” The TAS letter explained the requirements for claiming EITC, identified the specific requirement the recipient did not appear to meet, and suggested sources of additional information and assistance, including TAS. TAS then undertook a study to compare the level of compliance shown on taxpayers’ 2015 returns among three groups:

- Taxpayers who were sent the TAS letter;
- A representative sample of taxpayers whose 2014 returns had similar characteristics as those who received the TAS letter and whose 2014 returns were not audited, but who were not sent the TAS letter (the control group); and
- A representative sample of taxpayers whose 2014 returns had similar characteristics as those who received the TAS letter but were not sent the TAS letter and whose 2014 returns were audited.

Objective

The objective of the study is to ascertain the extent to which the opportunity to educate taxpayers may be followed by increased compliance.

Findings

Unless otherwise noted, the study findings for the populations studied are statistically significant at least at the 95 percent confidence level.

- The TAS letter averted noncompliance on 2015 returns where:
 - The 2014 return appeared erroneous because the relationship test was not met. Taxpayers who were sent the TAS letter were less likely to repeat the same error on their 2015 returns than unaudited taxpayers who did not receive TAS letters. Sending the TAS letter to all taxpayers whose 2014 returns appeared to be erroneous because the relationship test was not met would have averted about \$47 million of erroneous EITC claims;
 - The 2014 return appeared erroneous because another taxpayer claimed the same qualifying child. Taxpayers who were sent the TAS letter were less likely to claim EITC on their 2015 returns than unaudited taxpayers who did not receive the TAS letter. This averted noncompliance for these taxpayers and reduced the number of EITC returns the IRS would have included in its inventory of accounts potentially selected for audit. However, taxpayers who received the TAS letter and did file EITC returns were more likely to make a different mistake on the 2015 return than 2015 filers who did not receive the TAS letter. Thus, the extent to which the TAS letter prevented erroneous EITC claims in these situations is unclear;
- Audited taxpayers whose 2014 return appeared to contain a duplicate claim for EITC were more likely to make different errors on their 2015 returns than taxpayers in either of the other two groups; and

- Regardless of the apparent error on the 2014 return, audited taxpayers were less likely to file 2015 returns or to claim EITC on their 2015 returns, and less likely to repeat the error than taxpayers in either of the other two groups.

#3 The Importance of Financial Analysis in Installment Agreements (IAs) in Minimizing Defaults and Preventing Future Payment Noncompliance

Introduction

Internal Revenue Code (IRC) § 6159 authorizes the IRS to enter into an agreement with a taxpayer to pay any tax due in installments to facilitate full or partial collection of the tax. Collectively, these agreements are known as installment agreements (IAs). The IRS offers several types of IAs to assist taxpayers in resolving their liabilities. Across all types of IAs, the annual default rate — the rate at which taxpayers fail to make payments as agreed on or to remain in filing, and payment compliance on current tax obligations — was over 13 percent in fiscal year (FY) 2016. However, when looking at IAs initiated in 2014, taxpayers had a much higher default rate by the end of FY 2016.

The IRS uses Allowable Living Expenses (ALEs) to calculate a taxpayer's ability to make IA payments. The IRS allows expenses if they are necessary to provide for a taxpayer's, and his or her family's health and welfare and/or ability to produce income. IRC § 7122(d)(2)(A) mandates that the IRS "develop and publish schedules of national and local allowances designed to provide guidelines so that taxpayers entering into a payment agreement have an adequate means to provide for basic living expenses." However, the IRS permits about 85 percent of taxpayers to enter into streamlined IAs, which do not require any financial analysis, meaning that the IRS does not consider ALEs.

Objectives

TAS Research examined and answered the following research questions:

1. Regarding taxpayers who had an IA opened in calendar year (CY) 2014, what was their default rate and subsequent compliance as of September 2016?
2. What was the subsequent filing and payment compliance behavior of TAS taxpayers and non-TAS taxpayers who had an IA initiated in CY 2010?

Findings

- Nearly 38 percent of taxpayers owing over \$10,000 defaulted on their 2014 IA by the end of FY 2016.
- The default rate was higher for taxpayers whose incomes do not exceed their ALEs. For those taxpayers who owed between \$1,001 and \$10,000, the default rate was nearly 43 percent; however, for taxpayers with an income of more than 250 percent of their ALE, the default rate was only about 34 percent.
- Taxpayers whose incomes do not exceed their ALEs are less likely to file and pay subsequent tax obligations, suggesting that the payment arrangement does not always allow taxpayers the funds necessary to meet ongoing federal income tax obligations.
- Taxpayers who received assistance with their IAs from TAS were more likely to be compliant with paying current tax obligations and to not default their IAs when compared to similar taxpayers who obtained their agreements directly from the IRS.

Recommendations

The IRS should provide taxpayers with a mechanism to conduct their own financial analysis and should assist taxpayers with such analysis, as necessary. Specifically, the National Taxpayer Advocate recommends that the IRS:

1. Create an online financial calculator, which will assist taxpayers with establishing IAs that they can afford, while paying current tax liabilities. This calculator should consider various financial circumstances, and not just compute the ratio of taxpayers' delinquencies and a stated number of payments.
2. Provide basic financial analysis for taxpayers who are not comfortable with the online experience to determine the appropriate amount for an IA.
3. When financial analysis shows taxpayers as being unable to afford an IA, report the delinquencies as Currently Not Collectible.

#4 IRS Should Use Its Internal Data to Determine If Taxpayers Can Afford to Pay Their Tax Delinquencies

Introduction

The IRS Collection division is charged with collecting taxes from taxpayers with balances due from various tax obligations. In general, taxpayers are required to pay the delinquency in full, if the taxpayer has the means to do so. The IRS generally assigns all delinquencies remaining unsatisfied to Taxpayer Delinquent Accounts (TDA) status, after it sends the taxpayers a series of three to four notices requesting that the liability be paid either immediately or through monthly installments. The National Taxpayer Advocate would like to determine if the IRS could use internally available information on the taxpayer's financial status to decide if it should code the liability as Currently Not Collectible (CNC)-hardship prior to its continuation as a TDA.

The IRS has developed allowable living expense (ALE) standards, also known as Collection Financial Standards, to provide for a taxpayer's and his or her family's health and welfare, and/or ability to produce income. The ALE standards determine how much money taxpayers need for basic living expenses in accordance with family size and where they live. When compared with taxpayer income, the ALE standards determine the taxpayer's ability to pay his or her tax debt, and at what level. In theory, the IRS will compare these standards to a taxpayer's income to determine if a taxpayer has the wherewithal to satisfy his or her tax delinquency.

Objective

Many taxpayers satisfy their TDAs, even though their incomes do not exceed their ALEs. These liabilities are often satisfied through the offset of other refunds due to the taxpayer, or through the abatement of the liability. Nevertheless, actively working these cases may be resource intensive for the IRS and burdensome for taxpayers. Therefore, TAS explored the possibility of using the IRS's internal data to systemically classify taxpayers with incomes not in excess of their ALE as CNC-hardship.

Findings

TAS Research compared taxpayer income and ALEs for taxpayers, who either full paid their delinquency, entered into an installment agreement (IA), or whose accounts were classified as CNC-hardship by the IRS in 2014. This analysis showed that 68 percent of taxpayers with incomes not in

excess of their ALE, who completely paid their TDA liabilities, did so because of the offset of another refund due to the taxpayer, the abatement of the liability, or after the IRS had already determined the taxpayer was in financial hardship. When considering the remaining taxpayers who directly paid their liabilities, the liabilities were generally small; however, these taxpayers likely paid these liabilities in lieu of other necessities. The data also shows that over two-thirds of the taxpayers with incomes at or below their ALE entered into an IA to pay their delinquencies, which has continued through fiscal year 2016. This fact is not surprising since the vast majority of IRS IAs are streamlined, requiring no financial analysis comparing income to ALEs. These taxpayers are also likely foregoing essential expenses in an effort to satisfy their delinquent tax liability.

Recommendations

In view of these findings, the National Taxpayer Advocate recommends that the IRS:

1. Consider the development of a filter which would use internal IRS data to classify taxpayer delinquencies as TDA hardship if their Total Positive Income is less than or equal to their ALE. This procedure could save IRS resources and reduce tax burden.
2. Require collection personnel to determine if taxpayers can actually afford the payment amount in all types of IAs.

#5 Collecting Business Debts: Issues for the IRS and Taxpayers

Introduction

In the preceding year, the Taxpayer Advocate Service published a study of the Individual Master File (IMF) Collectibility Curve, which focused on how dollars collected decrease as the years progress after the IRS assigns the case to Taxpayer Delinquent Account (TDA) status. To further explore the issue of collectibility, TAS Research conducted a study of IRS Business Master File (BMF) collections.

Objective

The study focuses on the collection of business debts from both the IRS and taxpayer perspectives. The IRS sees a significant decline in the reduction of the initial TDA balance as the years progress after the IRS assigns a liability to TDA status with collection often becoming non-existent after four years. Not unexpectedly, the percent of TDAs fully resolved also declines as the years progress.

Findings

The IRS is more likely to abate liabilities which are not self-reported by the taxpayer (*e.g.*, math error assessments or substitute for return assessments). Interestingly, the IRS is actually more effective at collecting larger liabilities. This phenomenon may stem from the method that the IRS used to prioritize collections. The IRS is more likely to assign larger liabilities for immediate collection action including the assignment of large delinquencies to a revenue officer for personal contact. However, when more time elapses from the return due date until an unpaid balance due return is filed by the taxpayer, the IRS is significantly less effective at collecting the resulting TDA. Another consequence is that the taxpayer becomes more likely to accrue additional unpaid liabilities. From the taxpayer's perspective, the delay in securing balance due returns also causes additional penalty and interest to accrue.

A clear relationship exists between the due date of a liability and additional penalty and interest, the percent of modules remaining open, and the percent of initial module balance remaining. Tax

liabilities due for longer periods are more likely to remain open because more penalty and interest will be charged. As a result, more of the dollars collected are applied to penalties and interest compared to those liabilities, which have been due for a shorter timeframe. Taxpayers are burdened as penalties and interest increase significantly, and may no longer have the ability to pay the debt. This is particularly true when multiple tax returns (employment tax returns are due quarterly) are unfiled for an extended period after their due date. The result is an overwhelming debt for the taxpayer and reduced revenue for the IRS.

The study includes detailed findings related to the following general conclusions:

- Collections decrease as more time elapses from the initial BMF TDA assignment.
- Penalties and interest are a significant component of the unpaid BMF liability, particularly for unresolved TDAs, likely overwhelming most taxpayers.
- Overall, the IRS is more effective at closing smaller BMF TDAs, but collects a larger percent of the TDA when balances are larger. However, the IRS is more effective collecting employment tax TDAs when the balance due is smaller.
- The IRS abates a significant amount of BMF TDA assessments; this means the IRS is using collection resources to resolve incorrect assessments.
- As more time passes from the due date of a tax return to BMF TDA assignment, the IRS is less likely to close the TDA or see as great of a reduction in the initial TDA balance. The likelihood of accruing sizable new delinquencies also increases when there are longer lapses between the BMF tax return due date and when the IRS secures the return and assesses the tax.

Recommendations

While we believe that the findings and conclusion in this study can have a positive impact on various IRS collection policies regarding BMF TDAs, we have also made the following specific recommendations:

1. The IRS should try to determine if unfiled BMF tax returns, particularly employment tax returns, have unpaid liabilities, and should secure those returns as soon as possible after the return due date.
2. The IRS should determine and, to the extent possible, mitigate the factors causing such a large percent of the tax assigned to TDA status to be abated, so that resources are not wasted on assessments not due.

VOLUME 3: Literature Reviews

The National Taxpayer Advocate is releasing this Volume III of literature reviews as a supplement to her 2016 Annual Report to Congress. These literature reviews contain additional commentary and an extensive listing of articles, reports, and discussions providing a broader context for seven of the Most Serious Problems presented in Volume I. To better understand the problems and burdens currently faced by taxpayers and develop effective remedies, it is helpful to look beyond the customer experience within the IRS.

The National Taxpayer Advocate hopes this resource inspires further informed conversation and research about strengthening taxpayer rights and developing innovative customer-centric tax administration.

#1 Taxpayer Service in Other Countries

As the National Taxpayer Advocate has repeatedly demonstrated, tax administrations in different countries can learn from each other with respect to a wide range of issues. A survey of taxpayer services in other jurisdictions reveals the widespread belief that effective taxpayer service enhances voluntary compliance. The Organization for Economic Cooperation and Development (OECD) reports indicate, among other things, that an expanded role of tax administrations, accompanied by reductions in resources, has often resulted in a shift to online services, but with an inadequate understanding of taxpayer preferences. Effective taxpayer service requires multiple service channels. Customer service in non-tax areas of government and in private industry is becoming more digital, but personal contact remains a pillar of service delivery.

#2 Incorporating Taxpayer Rights into Tax Administration

In 2014, the IRS adopted the Taxpayer Bill of Rights (TBOR), heralding it as “a cornerstone document to provide the nation’s taxpayers with a better understanding of their rights.” Prior to the adoption of the TBOR, a TAS survey revealed that taxpayers had little knowledge of their rights — fewer than half of taxpayers believed they have rights before the IRS and only 11 percent said they knew what those rights were. The National Taxpayer Advocate had long called for the IRS to adopt a TBOR as a framework for effective tax administration and for Congress to add the list of fundamental taxpayer rights to the Internal Revenue Code (IRC), which Congress did in late 2015.

In order to develop a vision for how the IRS could better implement and apply the TBOR, this Literature Review will analyze other countries’ experience with implementing and adhering to taxpayer rights. This discussion will include citizen charters focusing on rights as well as service, and will devote particular attention to taxpayer charters in the United Kingdom and Australia.

#3 Behavioral Science Lessons for Taxpayer Compliance

The National Taxpayer Advocate has long recommended the IRS conduct behavioral research on ways to improve voluntary tax compliance. The President also recently issued an Executive Order encouraging agencies to apply behavioral science insights to advance policy goals. For example, the IRS could use these insights to improve tax compliance by making it easier, or by making the agency’s messages clearer, more relevant, and more likely to resonate with taxpayers. These insights could improve the effectiveness of alternatives to enforcement (called “alternative treatments”).

#4 Geographic Considerations for Tax Administration

The National Taxpayer Advocate has long emphasized the importance of the IRS maintaining a local presence in both service and compliance operations. By having a local presence in the community, tax agencies are better equipped to improve tax morale by successfully encouraging voluntary compliance, creating a culture of compliance, and influencing prevailing social views in a locale. Voluntary tax compliance relies heavily on taxpayer discretion, integrity, and honesty. There is evidence that improvements in tax morale may be as important to tax compliance as tax enforcement. Local presence offers the advantage of having employees who are completely familiar with the local economy, culture, and social norms. Geographic presence is key to that service provision, creation of the trust culture, and promoting that understanding.

#5 Customer Considerations for Online Accounts

As the IRS incorporates an online account system into its Future State strategy, it is helpful to evaluate the experience of other organizations in private industry and government. This literature review covers various online services offered by foreign tax administrations as well as private industry reports on best practices. While the research shows a clear trend toward moving more services online, there is also a trend to continue to provide multi-channel options. The most pervasive best practice covered in the research is the need for organizations to understand the needs of the customer and let those needs drive the changes, rather than business or budget needs.

#6 Options for Alternative Dispute Resolution (ADR)

Alternative dispute resolution (ADR) is the process of resolving a dispute through non-judicial means, typically by placing the case in non-binding mediation or in binding arbitration. These proceedings are generally conducted by neutral parties, such as mediators, administrative law judges (ALJs), or ombudsmen. As will be developed in this literature review, researchers, commentators, and stakeholders have published substantial in-depth analysis regarding the effectiveness and flexibility of ADR in a variety of contexts. Studies in this area demonstrate that efficient ADR can have a beneficial impact on tax compliance and tax administration. Moreover, ADR has been widely embraced by businesses, various federal agencies, and tax authorities of certain foreign countries.

#7 Reducing “False Positive” Determinations in Fraud Detection

Over the past decade, fraud and identity theft have increasingly plagued consumers, businesses, and financial institutions. The IRS has also been impacted. In order to detect and prevent identity theft and potentially false wages and withholdings, the IRS established a complicated screening process. When a return is flagged by one of the multiple systems that scrutinize returns for characteristics of refund fraud or identity theft, the refund is stopped from being issued until the taxpayer can authenticate his or her identity or until the information on the return can be verified. Some returns flagged by these systems turn out to be false positives.

The National Taxpayer Advocate has consistently advocated for taxpayers whose legitimate refunds have been wrongly selected and unreasonably delayed with IRS Refund Fraud and Identity Theft Programs. This literature review explores the acceptable false positive rates in the public and private sectors and steps that can be taken to reduce false positive rates.

