

## INTRODUCTION: The Most Serious Problems Encountered by Taxpayers

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to prepare an Annual Report to Congress that contains a summary of at least 20 of the most serious problems encountered by taxpayers each year. For 2017, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS and Congress in resolving 21 such problems.

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

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

### Methodology of the Most Serious Problem List

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

- *Significant Challenges in Tax Administration;*
- *The Right to Quality Service;*
- *The Right to a Fair and Just Tax System: Special Taxpayer Populations;*
- *The Right to an Independent Administrative Appeal;* and
- *Challenges in Revenue Protection.*

The 21 issues in this year's report are ranked according to the following criteria:

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

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

### **Taxpayer Advocate Management Information System (TAMIS) List**

The identification of the Most Serious Problems reflects not only the mandates of Congress and the IRC, but TAS's integrated approach to advocacy — using individual cases as a means for detecting trends and identifying systemic problems in IRS policy and procedures or the Code. TAS tracks individual taxpayer cases on TAMIS. The top 25 case issues, listed in Appendix 1, reflect TAMIS receipts based on taxpayer contacts in fiscal year 2017, a period spanning October 1, 2016 through September 30, 2017.

### **Use of Examples**

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

MSP  
#1**PRIVATE DEBT COLLECTION: The IRS's Private Debt Collection Program Is Not Generating Net Revenues, Appears to Have Been Implemented Inconsistently with the Law, and Burdens Taxpayers Experiencing Economic Hardship****RESPONSIBLE OFFICIAL**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

In 2015, Congress enacted legislation requiring the IRS to enter into “qualified tax collection contracts” for the collection of “inactive tax receivables.”<sup>2</sup> The National Taxpayer Advocate cautioned that the initiative as it was being implemented appeared inconsistent with the law and would disproportionately burden taxpayers experiencing economic hardship.<sup>3</sup>

The IRS assigned the first tax debts to private collection agencies (PCAs) in April 2017.<sup>4</sup> According to the IRS, for fiscal year (FY) 2017:

- The IRS received \$6.7 million of payments from taxpayers whose debts were assigned to PCAs; and

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).

2 Fixing America's Surface Transportation Act, Pub. L. No. 114-94, Div. C, Title XXXII, § 32102, 129 Stat. 1312, 1733-36 (2015) (FAST Act), (adding subsections (c) and (h) to IRC § 6306).

3 See National Taxpayer Advocate 2016 Annual Report to Congress 172-191 (Most Serious Problem: *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*).

4 IRS News Release IR-2017-74, *Private Collection of Some Overdue Federal Taxes Starts in April; Those Affected Will Hear First From IRS; IRS Will Still Handle Most Tax Debts* (Apr. 4, 2017), <https://www.irs.gov/newsroom/private-collection-of-some-overdue-federal-taxes-starts-in-april-those-affected-will-hear-first-from-irs-irs-will-still-handle-most-tax-debts>.

- The total cost of the PDC program was \$20 million, three times the amount collected.<sup>5</sup>

Thus, the initiative is not raising net revenue. Moreover, the IRS letter advising taxpayers that their account is being assigned to a PCA is generating 40 percent as many dollars for the public fisc as collection activity by PCAs does.<sup>6</sup> At the same time, the IRS pays commissions to PCAs on payments from taxpayers that are attributable to IRS, rather than PCA, action.<sup>7</sup>

The recent returns of approximately 4,100 taxpayers who made payments to the IRS after their debts were assigned to PCAs show:

- Median income was about \$41,000;
- Over 1,100 taxpayers, or 28 percent, had incomes below \$20,000; and
- 44 percent had incomes below 250 percent of the federal poverty level.<sup>8</sup>

Among these 4,100 taxpayers were those who receive Social Security Disability Insurance (SSDI) benefits, even though the IRS agreed to exclude the debts of SSDI recipients from assignment to PCAs.<sup>9</sup>

Approximately 1,700 taxpayers entered into installment agreements while their debts were assigned to PCAs, made payments on which the PCAs were paid commissions, and have filed recent returns.<sup>10</sup> According to these taxpayers' returns, 45 percent had income that was less than their allowable living expenses (ALE).<sup>11</sup> Thus, these taxpayers could not afford the payments due under the installment agreements organized by the PCAs. The IRS refuses to allow TAS to participate in its procedures for monitoring calls between taxpayers and PCAs, which could provide insight into why so many of these vulnerable taxpayers are entering into installment agreements they cannot afford.

## ANALYSIS OF PROBLEM

### Background

In 2016, the IRS entered into contracts with four PCAs that allow the PCAs to contact taxpayers, solicit payment of past-due taxes, offer payment arrangements that may, with IRS approval, extend to

5 IRS, *Private Debt Collection (PDC) Program Scorecard for Fiscal Year (FY) 2017*, reporting operational data through Sept. 14, 2017 and IRS costs through Sept. 30, 2017.

6 As discussed below, the IRS paid commissions to private collection agencies (PCAs) at the rate of 20 percent of the amount of payments taxpayers made, and is authorized to keep for itself an additional 25 percent. Thus, up to 45 percent of the receipts attributable to PCA activity was paid in commissions or may be retained by the IRS, rather than being paid to the Treasury.

7 IRS response to TAS information request (Nov. 21, 2017), discussed below.

8 Individual Returns Transaction File (IRTF), Information Returns Master File (IRMF), Compliance Data Warehouse (CDW), data current through Sept. 28, 2017, showing there were 4,141 taxpayers who made payments while their debts were assigned to a PCA and who filed a return for tax year 2014 or later. Their income characteristics are discussed in more detail below.

9 IRTF, IRMF, CDW, data current through Sept. 28, 2017.

10 *Id.* There were 1,676 taxpayers who entered into an installment agreement after their debts were assigned to a PCA, made a payment, and filed a recent return. As discussed below, some of these taxpayers entered into an installment agreement by contacting the IRS directly, rather than working with the PCA.

11 *Id.*

seven years, and receive a commission of up to 25 percent of the amount collected.<sup>12</sup> The IRS is also authorized to retain for itself an additional amount up to 25 percent of the amount collected.<sup>13</sup> The IRS is required to assign to PCAs tax debts that the IRS includes in “potentially collectible inventory” (PCI), a term not defined in the statute or in Treasury regulations.<sup>14</sup>

### *The PDC Program Thus Far Is Not Producing Net Revenue*

The IRS periodically summarizes PDC program performance in program “scorecards.”<sup>15</sup> The FY 2017 Scorecard shows:

- The IRS had assigned about \$920 million of inactive tax receivables to PCAs;<sup>16</sup>
- About \$7 million, or less than one percent of the dollars assigned for collection, had been collected;<sup>17</sup> and
- The total program cost was about \$20 million, consisting of about \$1 million in commissions paid to PCAs and \$19 million of other PDC program costs.<sup>18</sup>

Thus, it does not appear that PCAs are particularly effective in collecting the debts assigned to them. In any event, the cost of the PDC program thus far exceeds the revenue it generates. It appears that a little over half of the total program costs incurred in FYs 2016 and 2017 combined were one-time startup costs, as opposed to continuing costs of oversight and assignment.<sup>19</sup> The IRS is in the process of developing a model for projecting program revenues and costs.<sup>20</sup>

### *The IRS Pays Commissions to PCAs for Work Done by the IRS, Which May Be Inconsistent With IRC § 6306*

The National Taxpayer Advocate has previously expressed concern that PCAs may receive commissions on payments taxpayers make in response to the IRS’s letter advising them their debts were assigned to

12 IRC § 6306(c) requires the IRS to enter into “qualified collection contracts” with respect to “inactive tax receivables.” However, a “qualified collection contract,” as defined in IRC § 6303(b)(1), would allow PCAs to offer installment agreements for “a period not to exceed 5 years.” Thus, the National Taxpayer Advocate is not persuaded that the IRS’s contracts with PCAs meet the statutory definition of “qualified collection contracts.” See National Taxpayer Advocate 2016 Annual Report to Congress 172, 179 (Most Serious Problem: *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*). IRC § 6306(e) authorizes the IRS to pay commissions pursuant to a “qualified collection contract.” The National Taxpayer Advocate does not find any statutory authority for paying commissions to PCAs with respect to installment agreements of more than five years’ duration.

13 IRC § 6306(e).

14 IRC § 6306(c) generally requires the IRS to assign to PCAs all “inactive tax receivables,” defined as any “tax receivable” that meets any one of three criteria. A “tax receivable” for purposes of the statute is an account the IRS includes in “potentially collectible inventory” (PCI).

15 The PDC Program Scorecard for Fiscal Year 2017 reports operational data through Sept. 14, 2017 and IRS costs through Sept. 30, 2017.

16 *Id.*, showing \$919,593,380 of tax receivables were assigned.

17 *Id.*, showing \$6,698,661 were collected.

18 *Id.*, showing commissions were paid of \$1,068,944. Under the IRS’s contract with the PCAs, commissions are generally payable with respect to payments taxpayers make beginning after ten days from the assignment of the debt to the PCA. Other PDC program costs were \$18,967,203.

19 IRS response to TAS information request (Dec. 19, 2017), providing combined costs for FYs 2016 and 2017, showing total costs of \$35,321,078, of which \$18,818,397 (53 percent) are one-time costs and \$16,502,681 (47 percent) are recurring costs.

20 SB/SE response to TAS information request (Nov. 21, 2017).

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The IRS is aware that it is paying commissions to Private Collection Agencies (PCAs) with respect to work done by the IRS, but has no plans to change its procedures to attempt to identify payments that were clearly not attributable to PCA action.

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a PCA, rather than due to any action on the part of the PCA.<sup>21</sup> As the PDC program has unfolded, inappropriate commission payments have emerged in another context, as an example illustrates:

- On April 10, a taxpayer's debt was assigned to a PCA;
- On May 24, the taxpayer contacted the IRS and the IRS assisted the taxpayer in entering into an installment agreement. This caused the case to be recalled from the PCA, but the recall was not recorded in IRS databases until June 19; and
- In the meantime, on June 5, the taxpayer made a payment pursuant to the installment agreement the IRS had organized. The IRS paid the PCA a commission on that payment.<sup>22</sup>

The IRS is aware that it is paying commissions to PCAs with respect to work done by the IRS, but has no plans to change its procedures to attempt to identify payments that were clearly not attributable to PCA action.<sup>23</sup> The IRS's position is that its contract with the PCAs requires this outcome.<sup>24</sup> However, this practice appears inconsistent with IRC § 6306(e), which authorizes commissions on amounts collected "under any qualified tax collection contract." According to IRC § 6306(d), a tax debt that is subject to a pending or active installment agreement "shall not be eligible for collection pursuant to a qualified tax collection contract." Thus, from the moment an installment agreement is pending as a result of the taxpayer requesting an installment agreement directly from the IRS, the debt is not eligible for collection pursuant to a qualified tax collection contract, and commissions to PCAs are not authorized on ensuing payments.<sup>25</sup>

### *The IRS Ten-Day "Pre-PDC Assignment" Letter Generates 40 Percent As Much for the Treasury As PCA Activity Does*

Taxpayers whose accounts were assigned to PCAs made payments totaling \$6.7 million.<sup>26</sup> About \$1.2 million of these payments were not commissionable because they were made within ten days after the IRS notified the taxpayers that their debts were being assigned to a PCA, but before the taxpayers had

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21 See National Taxpayer Advocate 2016 Annual Report to Congress 172, 190-191 (Most Serious Problem: *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*).

22 IRS response to TAS information request (Nov. 21, 2017).

23 *Id.*

24 IRS response to TAS information request (Dec. 19, 2017). Section 2.3 of the IRS's contract with the PCAs specifies, with exceptions not relevant here, that commissions are payable on any payment received 11 days or more after the date the account is transferred to a PCA and up to ten calendar days after the account is returned to the IRS.

25 IRS employees are required to record a pending installment agreement within 24 hours after contact with a taxpayer. IRM 5.14.1.3, *Identifying Pending, Approved and Rejected Installment Agreement Proposals on IDRS* (Jan. 1, 2016).

26 IRS, *PDC Program Scorecard for Fiscal Year 2017*, showing total payments of \$6,698,661.

any contact with a PCA.<sup>27</sup> Thus, about 18 percent of the payments were generated in response to the IRS letter and without any action on the private collector's part.

The IRS received about \$5.4 million of payments that were subject to commissions.<sup>28</sup> The IRS actually paid commissions of \$1.1 million, a rate of 20 percent.<sup>29</sup> The IRS is also authorized to retain for itself 25 percent of the amount collected by PCAs.<sup>30</sup> Thus, up to 45 percent of the \$5.4 million of commissionable payments, or about \$2.4 million, will be diverted from the public fisc.<sup>31</sup> The remaining \$3 million is the minimum amount that would be paid to the Treasury. As noted above, the IRS's letter brought in \$1.2 million, which is 40 percent as much as the amount PCA activity contributes to the public fisc.<sup>32</sup> The National Taxpayer Advocate is not surprised that a simple letter from the IRS can induce compliance.<sup>33</sup> The IRS might obtain even better results (in terms of adding to public coffers and increasing compliance) by sending periodic letters to taxpayers monthly throughout the year reminding them of their tax debt rather than only sending the annual reminder required by statute.<sup>34</sup>

### *The PDC Program Burdens Taxpayers Who Are Likely Experiencing Economic Hardship*

Of the 4,905 taxpayers who made payments after their debts were assigned to PCAs, 4,141 had filed recent returns as of September 28, 2017.<sup>35</sup>

The returns filed by the 4,141 taxpayers show:

- Overall median income of \$40,955;
- 28 percent, or 1,170, had annual income of less than \$20,000;

27 IRS, *PDC Program Scorecard for Fiscal Year 2017*, showing the IRS received \$1,187,238 in payments that are not subject to commissions to PCAs. PCAs conduct operations in compliance with the most current version of the Private Collection Agency Policy and Procedures Guide (PPG). References to the PPG are to the Sept. 29, 2017 version. PPG section 5.3, *Initial Contact Letters*, provides that PCAs are permitted to send their first contact letter to taxpayers ten days after the IRS sends its initial contact letter. PPG section 6.3, *Telephone Contact with Taxpayers*, provides that PCAs may telephone taxpayers five days after sending their first contact letter.

28 *Id.*, showing the IRS received \$5,363,918 in payments subject to commissions (and showing the IRS received \$147,505 in payments that are not categorized as either commissionable or non-commissionable).

29 *Id.*, showing the IRS actually paid commissions of \$1,068,944. Under IRC § 6306(e)(1), the IRS is authorized to pay commissions to PCAs of up to 25 percent.

30 IRC § 6306(e)(2).

31 Of the \$5,363,918 collected, 45 percent is \$2,413,763. The remaining 55 percent is \$2,950,155.

32 The amount of non-commissionable payments, \$1,187,238, is equal to 40 percent of \$2,950,155, the minimum amount payable to the Treasury.

33 See National Taxpayer Advocate 2016 Annual Report to Congress, vol. 2, 31, 42 (Research Study: *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*). See also Research Study: *Second 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*, vol. 2, *supra*, describing situations in which a targeted, educational letter may deter noncompliance.

34 IRC § 7524 provides “[n]ot less often than annually, the Secretary shall send a written notice to each taxpayer who has a tax delinquent account of the amount of the tax delinquency as of the date of the notice.” The IRS meets this requirement by sending taxpayers with delinquent accounts Notice CP-71, *Reminder Notice*, once a year.

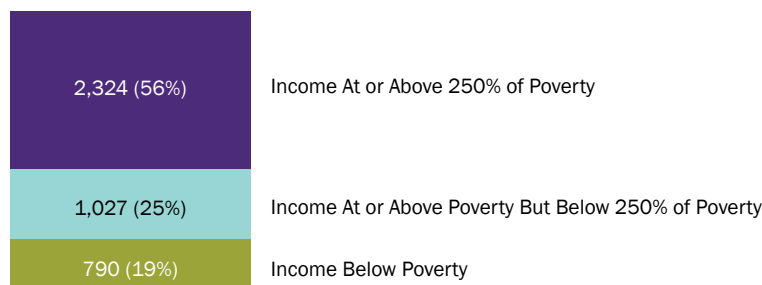
35 Accounts Receivable Dollar Inventory (ARDI), IRTF, IRMF, CDW, data current through Sept. 28, 2017. TAS Research identified 4,905 taxpayers who made commissionable payments to the IRS (generally, payments taxpayers make more than ten days after their accounts are assigned to a PCA) 4,141 of whom filed a return for tax year 2014 or later. As discussed below, the income characteristics of taxpayers who did not file returns may differ from those who filed returns.

- 19 percent, or 790, had incomes below the federal poverty level; median income for these taxpayers was \$6,386;<sup>36</sup>
- 25 percent, or 1,027, had incomes at or above the federal poverty level but below 250 percent of the federal poverty level; median income for these taxpayers was \$23,096; and
- Five percent, or 205, received Social Security retirement or disability income; median income for these taxpayers was \$14,365.<sup>37</sup>

Figure 1.1.1 below shows the proportion of the 4,141 taxpayers whose incomes were below the federal poverty level, the proportion whose incomes were at or above the federal poverty level but less than 250 percent of the federal poverty level, and the proportion whose incomes were 250 percent or more of the federal poverty level.

**FIGURE 1.1.1**<sup>38</sup>

**Taxpayers Who Made Payments After Their Debts  
Were Assigned to a Private Collection Agency, by Income Level**



Recent returns of taxpayers who made payments after their debts were assigned to Private Collection Agencies show: Overall median income of \$40,955; 28 percent had annual income of less than \$20,000; 19 percent had incomes below the federal poverty level; and 25 percent had incomes at or above the federal poverty level but below 250 percent of the federal poverty level.

36 U.S. Dept. of Health and Human Resources, *Poverty Guidelines* (Jan. 31, 2017), <https://aspe.hhs.gov/poverty-guidelines>, showing that the poverty level for a single person in 2017 was \$12,060. Thus, 250 percent of the 2017 federal poverty level for a single person was \$30,150.

37 IRTF, IRMF, CDW, data current through Sept. 28, 2017. As discussed below, for purposes of administering the IRS's automatic levy program, the Federal Payment Levy Program (FPLP), the IRS adopted 250 percent of the federal poverty level as a measure that serves as a proxy for economic hardship.

38 The figure represents the income shown on the recent returns of 4,141 taxpayers who made payments to the IRS after their debts were assigned to private collection agencies, compared to the federal poverty level for the taxpayer's household size.



As Figure 1.1.1 above demonstrates, slightly less than half of the taxpayers (44 percent) have incomes that indicate they are at risk of economic hardship.

Of the 4,141 taxpayers described above who made payments after their debts were assigned to a PCA:

- 1,676 taxpayers, or 40 percent, agreed to installment agreements.<sup>39</sup> Almost half of these taxpayers, 46 percent, had incomes below 250 percent of the federal poverty level;
- 2,465 taxpayers, or 60 percent, made payments that were not pursuant to an installment agreement — their payments may have been “voluntary payments” solicited by the PCA, discussed below. Of these taxpayers, 43 percent had incomes below 250 percent of the federal poverty level.

The income characteristics of the 4,141 taxpayers, according to whether their payments were made pursuant to an installment agreement, are summarized in Figure 1.1.2 below:

**FIGURE 1.1.2, Income Shown on Recent Returns Filed by 4,141 Taxpayers Who Made Payments After Their Debts Were Assigned to PCAs, Compared to the Federal Poverty Level and Dollars Collected**

Income Group	Number (and percent) of Taxpayers with No Installment Agreement	Number (and percent) of Taxpayers with an Installment Agreement	Total	Dollars Collected (and percent)
Below Federal Poverty Level	477 (19 percent)	313 (19 percent)	790	\$ 863,731 (14 percent)
At or Above Federal Poverty Level but Below 250 Percent of Federal Poverty Level	577 (23 percent)	450 (27 percent)	1,027	\$ 1,303,384 (20 percent)
Subtotal, below 250 percent Federal Poverty Level	1,054 (43 percent)	763 (46 percent)	1,817	\$ 2,167,114 (34 percent)
At or Above 250 Percent Federal Poverty Level	1,411 (57 percent)	913 (54 percent)	2,324	\$ 4,215,883 (66 percent)
<b>Overall</b>	<b>2,465</b>	<b>1,676</b>	<b>4,141</b>	<b>\$6,382,998</b>

As Figure 1.1.2 above shows, 14 percent of the dollars collected from these 4,141 taxpayers came from taxpayers whose incomes are below the federal poverty level.

As Figure 1.1.2 above also shows, of the 4,141 taxpayers, 1,817 (44 percent) had incomes below 250 percent of the federal poverty. Of these 1,817 taxpayers, 169 were recipients of Social Security

<sup>39</sup> Of these 1,676 taxpayers, 67 entered into their installment agreement by contacting the IRS directly rather than through the PCA. As noted above, whether the installment agreement is organized by a PCA or by the IRS does not affect the extent to which PCAs receive commissions on payments taxpayers make pursuant to installment agreements.

retirement (SSA) or disability (SSDI) benefits.<sup>40</sup> Their incomes, and the amount collected from them, is shown in Figure 1.1.3 below.<sup>41</sup>

**FIGURE 1.1.3, Taxpayers Who Paid After Their Debts Were Assigned to PCAs and Filed Recent Returns Showing Income Less Than 250 Percent of the Federal Poverty Level for Their Household Size**

	Income Below the Federal Poverty Level			Income At or Above Federal Poverty Level and Below 250% of the Federal Poverty Level			Total
	Number of Taxpayers	Median Income (\$)	Amount Collected (\$)	Number of Taxpayers	Median Income (\$)	Amount Collected (\$)	
SSA Recipients	70	4,730	46,415	50	19,542	60,335	120
SSDI Recipients	26	3,436	33,721	23	24,999	16,302	49
<b>Total</b>	<b>96</b>	<b>4,201</b>	<b>80,136</b>	<b>73</b>	<b>20,003</b>	<b>76,637</b>	<b>169</b>

Taxpayers' SSDI payments or Supplemental Security Income (SSI) payments are not subject to levies pursuant to the Federal Payment Levy Program (FPLP).<sup>42</sup> At the National Taxpayer Advocate's urging, the Commissioner of Internal Revenue agreed that the debts of SSDI and SSI recipients would not be assigned to PCAs.<sup>43</sup> However, as shown above, TAS identified SSDI recipients among those whose debts were assigned to PCAs. When TAS asked the IRS to describe the obstacles that prevent it from honoring its commitment to exclude these taxpayers' debts from assignment to PCAs, the IRS specified that "the unpaid assessment file" system it uses to identify potential new inventory for PDC "is not able to distinguish the type of retirement or government payment."<sup>44</sup> The IRS requested the Social Security Administration to identify or verify accounts of taxpayers who receive SSDI or SSI, which would enable the IRS to systemically exclude these taxpayers' debts from assignment to PCAs. The Social Security Administration denied the request, and the IRS is considering whether and how to request the Social Security Administration to reconsider its position.<sup>45</sup>

The IRS could identify SSDI recipients without assistance from the Social Security Administration and it is unclear why the IRS has not done so. Information about Social Security Administration benefits and the nature of those benefits (retirement or disability) is included in the Information Returns Master

40 IRMF, a database stored in the CDW, currently contains third-party information documents through tax year 2016. It includes information from Form SSA-1099, on which Social Security benefits, including Social Security Disability Income (SSDI) (but not Supplemental Security Income (SSI), discussed below) is reported.

41 Additional income characteristics of the 1,676 taxpayers who entered into installment agreements is discussed below. For more detail about taxpayers who entered into installment agreements while their debts were assigned to a PCA, including those who did not file recent returns, see Research Study: *Study of Financial Circumstances of Taxpayers Who Entered Into Installment Agreements and Made Payments While Their Debts Were Assigned to Private Collection Agencies*, vol. 2, *infra*.

42 IRM 5.19.9.3.1(7)(f), *What is FPLP?* (Oct. 20, 2016).

43 National Taxpayer Advocate 2016 Annual Report to Congress 172, 186 (Most Serious Problem: *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*).

44 IRS response to TAS information request (Oct. 06, 2017).

45 Letter from Stephen Evangelista, Social Security Administration Associate Commissioner, Office of Data Exchange and Policy Publications to Bill Banowski, IRS, Collection Planning & Enforcement Analysis (June 7, 2017), citing the IRS's request that the Social Security Administration share information regarding SSI recipients. The Small Business/Self-Employed Division (SB/SE), in its response to agenda items for a Nov. 9, 2017 meeting with TAS, reiterated that it had requested assistance in identifying both SSDI and SSI recipients.

File (IRMF), a database the IRS uses for other programs.<sup>46</sup> Instead, the IRS intends to first exhaust its efforts with the Social Security Administration before adopting an alternative method of systemically identifying SSDI and SSI recipients.<sup>47</sup> Until the IRS actually honors its commitment to exclude these taxpayers' debts from assignment to PCAs these vulnerable taxpayers will be solicited to make payments they may not be able to afford.

The IRS generally does not subject SSA retirement income to FPLP levies when the recipient's income is less than 250 percent of the federal poverty level, a measure that serves as a proxy for economic hardship.<sup>48</sup> Thus, the 120 taxpayers who received SSA retirement income, shown in Figure 1.1.3 above, would generally not be subject to FPLP levies. However, as noted, the analysis above encompasses only taxpayers who filed recent returns. To overcome this limitation, we estimated the incomes of taxpayers using a method similar to that adopted for the FPLP low income filter.<sup>49</sup> We identified 161 SSA retirement income recipients who would generally not be subject to FPLP levies, but who made commissionable payments while their debts were assigned to a PCA.

The IRS has in the past suggested that these taxpayers, although earning relatively small amounts, may have substantial assets with which to pay their tax debt.<sup>50</sup> We are unable to find any indication that this concern is justified. On the contrary, for the 120 SSA retirement income recipients whose incomes were less than 250 percent of the federal poverty level, who made payments after their debts were assigned to a PCA, and filed returns:

- Median income was \$9,472;
- They received on average \$35 in interest;
- They received on average \$13 in dividends;
- They received on average \$2,176 of other retirement income, such as pensions;
- None realized any capital gains, other than from the sale of stock; and
- They realized on average \$18 from the sale of stock.<sup>51</sup>

46 The IRMF contains third-party information documents used, for example, by the IRS's Automated Underreporter matching program. Because the data on IRMF is generally at least a year old, relying on IRMF may mean, for example, that the debt of a taxpayer who received SSDI in 2016 would be excluded from assignment to a PCA although that taxpayer no longer received SSDI in 2017. The National Taxpayer Advocate believes this risk is outweighed by the harm to SSDI recipients whose debts are assigned to PCAs. Moreover, as discussed below, the IRS uses older data (such as a taxpayer's return from a previous return) to determine whether a taxpayer's account should be excluded from FPLP levies. See IRM 5.19.9.3.2.3 (2) *Low Income Filter (LIF) Exclusion* (Oct. 20, 2016), noting "If the taxpayer has filed an income tax return for one of the last three years and has no outstanding return delinquencies following the last return filed they will be processed through the LIF [low income filter]."

47 SB/SE response to agenda items for Nov. 9, 2017 meeting between TAS and SB/SE.

48 IRM 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (Oct. 20, 2016), which also describes conditions under which taxpayers can be excluded from the LIF. For a description of the TAS model to estimate the income and expenses of taxpayers whose federal payments had been subject to FPLP levies, which led to the adoption of the 250 percent proxy for economic hardship, see National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 48 (Research Study: *Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).

49 See IRM 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (Oct. 20, 2016). We estimated income using a subset of the most common income sources but did not apply the exclusion conditions.

50 See National Taxpayer Advocate 2016 Annual Report to Congress 172, 187 (Most Serious Problem: *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*).

51 IRTF, IRMF, CDW, data current through Sept. 28, 2017.

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Recent returns of taxpayers who entered into installment agreements while their debts were assigned to PCAs show: Median income of \$38,021; 28 percent have incomes of less than \$20,000; and Allowable Living Expenses exceeded total positive income for 45 percent of taxpayers.

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These 120 taxpayers received in the aggregate \$269,028 in income from assets.<sup>52</sup>

*The IRS Recalls Debts From PCAs, and PCAs Are Required to Return Cases to the IRS, But the Reasons for Recalls and Returns Are Unclear*

As of September 14, 2017, the IRS had recalled the debts of more than 3,800 taxpayers.<sup>53</sup> Of these recalled cases, about 700 were recalled because one of the statutory conditions prohibiting assignment of the debt applied (*e.g.*, the taxpayer was in an active installment agreement).<sup>54</sup> An additional 85 cases were recalled because the taxpayer's account was in Currently Not Collectible (CNC) hardship status.<sup>55</sup> For about 3,000 cases, however, the reason given for recall is "other."<sup>56</sup> The IRS expects to be able to provide a complete breakdown of the "other" category beginning in January 2018.<sup>57</sup>

In FY 2017, PCAs returned to the IRS the debts of about 1,500 taxpayers.<sup>58</sup> PCAs are required to return to the IRS as "unable to collect" those cases in which "the taxpayer indicates that payment of the balance due immediately or through a payment arrangement would leave him or her unable to pay necessary living expenses or a medical hardship is reported."<sup>59</sup> PCAs are also required to return cases to the IRS after requesting a single "voluntary payment," *i.e.*, a payment that does not fully pay the liability and is not made pursuant to an installment agreement.<sup>60</sup> These two conditions requiring return of a case are related, however. While PCAs are not permitted to request a voluntary payment "when the taxpayer expresses they are unable to pay," PCAs *are* permitted to request a voluntary payment when the taxpayer cannot pay the liability immediately or pursuant to an installment agreement, which itself suggests that the taxpayer is experiencing economic hardship.<sup>61</sup> PCAs are required to report the reasons for returning

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52 *Id.*

53 IRS response to TAS information request (Oct. 06, 2017), indicating that the IRS had recalled the debts of 3,781 taxpayers as of Sept. 14, 2017.

54 *Id.*, indicating that 693 cases were recalled because a statutory exception applied.

55 *Id.* These accounts were designated as in currently not collectible (CNC) hardship status after assignment. IRS response to TAS information request (Dec. 19, 2017).

56 IRS response to TAS information request (Oct. 06, 2017), indicating that 3,003 cases had been recalled for the reason of "other."

57 IRS response to TAS information request (Dec. 19, 2017), clarifying that "the ability to detail the recall reasons in the 'other' category will be available for recalls beginning January 2018 and forward. The IRS won't have the ability to provide detail for any periods prior to January 2018."

58 IRS, *PDC Program Scorecard for Fiscal Year 2017*, showing the PCAs had returned debts of 1,538 taxpayers.

59 PPG section 12.3, *PCA Unable to Collect*.

60 PPG section 10.2.1, providing: "If the taxpayer cannot full pay, within 120 days or with a payment arrangement, the PCA will make one attempt to verbally secure a voluntary payment" and directing PCAs: "After making the one attempt to secure a voluntary payment, the PCA will hold the account 10 business days from the date the voluntary payment was request [sic] and initiate the return of the account back to the IRS."

61 PPG section 10.2 provides "When the taxpayer cannot full pay the tax debt within the Collection Statute Expiration Date (CSED) or 7 years, whichever less [sic], the PCA will attempt to secure a voluntary payment." PPG section 10.2.1, *Voluntary Payments*, provides that voluntary payments are not to be solicited "when the taxpayer expresses they are unable to pay."

cases to the IRS.<sup>62</sup> However, as the IRS has explained “[t]he voluntary payment information that we have received to date is inconsistent and we are in the process of refining the criteria for reporting the data. The PDC Project Office is working on a mechanism to capture the number of accounts with voluntary payments and the total voluntary payment dollars collected, verified by the IRS.”<sup>63</sup>

### *With Unacceptable Frequency, Taxpayers Whose Debts Are Assigned to PCAs Are Placed in Installment Agreements They Cannot Afford*

There were 2,102 taxpayers who entered into installment agreements and made commissionable payments while their debts were assigned to PCAs. Of these, 1,676 filed recent returns.<sup>64</sup> The recent returns of the 1,676 taxpayers who entered into installment agreements and made a payment while their debts were assigned to PCAs show:

- Median income of \$38,021;
- 473 taxpayers, or 28 percent, have incomes of less than \$20,000; and
- ALEs exceeded total positive income for 755, or 45 percent of taxpayers.<sup>65</sup>

Even when their debts are not assigned to PCAs, taxpayers agree to installment agreement payments they cannot afford.<sup>66</sup> Insight into why taxpayers whose debts were assigned to PCAs enter into installment agreements they cannot afford, apparently at a higher rate, has been hindered by the IRS’s refusal to allow TAS to listen to calls between PCA employees and taxpayers.<sup>67</sup>

## CONCLUSION

IRC § 6306(c) requires the IRS to outsource some tax debt. However, the PDC program as implemented has not generated net revenues and results in the IRS improperly paying commissions to PCAs for work they did not perform. In the meantime, the most vulnerable taxpayers are making payments and entering into installment agreements they cannot afford according to the IRS’s own measures. The IRS should honor its commitment to taxpayers and do more to ensure that its PDC program operates in accordance with the law and respects taxpayers’ rights.

62 PPG section 17.1, *Production Management Reports*, section 17.3.2, *Return Tracking Report*.

63 IRS response to TAS information request (Oct. 06, 2017).

64 The income characteristics of all 2,102 taxpayers who entered into installment agreements, including the 426 who did not file returns, are described in Research Study: *Study of Financial Circumstances of Taxpayers Who Entered Into Installment Agreements and Made Payments While Their Debts Were Assigned to Private Collection Agencies*, vol. 2, *infra*.

65 IRTF, IRMF, CDW, data current through Sept. 28, 2017. The IRS publishes ALE standards, which determine how much money taxpayers need for basic living expenses. See IRS, *Collection Financial Standards*, <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>. We calculated the total monthly ALE for each taxpayer by summing the monthly national standards for housing, health, and transportation costs based on the zip code, primary and secondary taxpayer age, and total number of exemptions shown on each taxpayer’s most recently filed return. The annual ALE total for a given taxpayer was computed by multiplying the monthly ALE total by twelve. A taxpayer was designated as below ALE when his or her income from that taxpayer’s most recently filed return was lower than that taxpayer’s annual ALE total.

66 See National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 53 ,60, (Research Study: *The Importance of Financial Analysis in Installment Agreements (IAs) in Minimizing Defaults and Preventing Future Payment Noncompliance*), reporting that nearly 40 percent of individual taxpayers entering into installment agreements in 2014 had incomes below their allowable living expenses.

67 TAS received 38 PDC cases during FY 2017. In 30 cases, the taxpayer asked for assistance in stopping contact from PCAs.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Do not pay commissions on payments taxpayers make that are the result of interaction with the IRS, rather than with PCAs.
2. Provide that the IRS will receive a credit for any improperly paid commissions, such as where a taxpayer enters into an installment agreement directly with the IRS and makes a payment before the recall of the cases is reflected on IRS databases.
3. Without waiting for collaboration from the Social Security Administration, use available IRS data to exclude the debts of SSDI recipients from assignment to PCAs.
4. Adopt a definition of “potentially collectible inventory” that does not include debts of Social Security retirement recipients whose incomes are less than 250 percent of the federal poverty level.
5. Require PCA employees to actively inquire, when speaking with taxpayers, whether a proposed payment arrangement will leave the taxpayer unable to pay reasonable basic living expenses, and to return such cases to the IRS.
6. Develop procedures for including a TAS representative in the process of monitoring or reviewing phone calls between taxpayers and PCAs.
7. Develop procedures for sending letters to taxpayers soliciting payment of their past due taxes more frequently than annually.

MSP  
#2**TELEPHONES: The IRS Needs to Modernize the Way It Serves Taxpayers Over the Telephone, Which Should Become an Essential Part of an Omnichannel Customer Service Environment****RESPONSIBLE OFFICIAL**

Kenneth Corbin, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

Taxpayers have the *right to quality service*, and expect the IRS to answer their questions and assist with resolving their tax problems.<sup>2</sup> Despite the IRS's efforts to direct taxpayers to use its online services for assistance, many taxpayers are unwilling or unable to use these resources and still depend on more personal forms of communication. The IRS has steadily decreased the availability of face-to-face assistance at Taxpayer Assistance Centers (TACs),<sup>3</sup> leaving taxpayers with few other options for communicating with the IRS, such as writing a letter or making a phone call.<sup>4</sup>

Each year, the IRS receives over 95 million telephone calls on its toll-free lines.<sup>5</sup> It reported higher service levels during fiscal year (FY) 2017, including an increase in the level of service (LOS) on its Accounts Management (AM) lines from 53 percent in FY 2016 to 77 percent in FY 2017.<sup>6</sup> However, service was not consistently high across channels, as the LOS on its Consolidated Automated Collection Service (ACS) lines dropped from 70 percent in FY 2016 to just 47 percent in FY 2017.<sup>7</sup> The IRS does

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).
- 2 IRS Restructuring and Reform Act of 1998 (RRA 98) § 3705(d), 105 Pub. L. No. 206, 112 Stat. 777 ("The Secretary of the Treasury or the Secretary's delegate shall provide, in appropriate circumstances, on telephone helplines of the Internal Revenue Service an option for any taxpayer to talk to an Internal Revenue Service employee during normal business hours. The person shall direct phone questions of the taxpayer to other Internal Revenue Service personnel who can provide assistance to the taxpayer."). See also RRA 98 § 3709, 105 Pub. L. No. 206, 112 Stat. 779.
- 3 See Most Serious Problem: *Taxpayer Assistance Centers (TACs): Cuts to IRS Walk-In Sites Have Left the IRS With a Substantially Reduced Community Presence and Have Impaired the Ability of Taxpayers to Receive In-Person Assistance*, *infra*.
- 4 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*).
- 5 IRS, Joint Operations Center (JOC), *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year (FY) for FY 2008 through FY 2017) (showing telephone call volumes exceeding 95 million in every year).
- 6 IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2017).
- 7 *Id.* The Consolidated Automated Collection Service (ACS) reporting included both ACS product lines in FY 2016 and included both ACS lines and the Installment Agreement/Balance Due lines in FY 2017).

not expect a high LOS in FY 2018, anticipating overall LOS below 40 percent.<sup>8</sup> Thus, in FY 2018, only four out of ten taxpayers calling to reach a live assistor will succeed.

The IRS's planned "Future State Initiative" asserts that taxpayers should "expect the same level of service when dealing with the IRS in the future as they have now from their financial institution or a retailer."<sup>9</sup> However, comparing the performance of IRS call centers to those in the private sector or even call centers at other government agencies demonstrates that IRS telephone service falls short of industry standards.

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### In fiscal year 2018, only four out of ten taxpayers calling to reach a live assistor will succeed.

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To meet the industry standard, the IRS must treat telephone service as an essential part of an omnichannel service environment — one that enables taxpayers to engage with the IRS through the channel of their choice and be heard.<sup>10</sup> To create an omnichannel environment, the IRS must ensure all channels of communication are alive, active, and interconnected, instead of advancing one means of communication while neglecting others.

The National Taxpayer Advocate remains concerned that the IRS is treating its telephone operations as a dying relic of taxpayer service as it moves forward with its plan to substantially reduce telephone interactions with taxpayers and rely instead on more web-based services and tax practitioners.<sup>11</sup> This approach allows the IRS to focus on the channels of communication it prefers, but not where taxpayers might find the best form of assistance. The IRS's "Future State" approach to taxpayer service lacks a comprehensive strategy that:

- Advances its telephone service as an integral part of an omnichannel customer service environment;
- Incorporates additional call quality measures to assess a taxpayer's overall experience and ability to resolve issues on a call;<sup>12</sup>
- Implements best practices for accuracy-related oversight and incorporates metrics to evaluate its telephone assistors' rates of satisfaction and engagement in the work they perform;<sup>13</sup> and
- Upgrades its outdated phone hardware technology to provide alternatives to waiting in a calling queue, improved call routing features, and more extensive services to taxpayers.<sup>14</sup>

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8 IRS, Wage & Investment (W&I), *Business Performance Review* (BPR) 4 (Nov. 9, 2017).

9 IRS, *Future State Initiative* (Aug. 27, 2017), <https://www.irs.gov/newsroom/future-state-initiative>.

10 For a discussion of telephone service measures, see Literature Review: *Improving Telephone Service Through Better Quality Measures*, vol. 2, *infra*.

11 The IRS reports that its focus will continue towards providing options for qualified customers online to reduce the need for telephone contact. IRS response to TAS information request (Nov. 29, 2017). See also 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*).

12 See Literature Review: *Improving Telephone Service Through Better Quality Measures*, vol. 2, *infra*.

13 *Id.*

14 The percentage of IRS IT hardware in service beyond its useful life rose steadily from 40 percent at the start of FY 2013 to 64 percent at the start of FY 2017. See Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2017-20-051, *Sixty-four Percent of the Internal Revenue Service's Information Technology Infrastructure Is Beyond Its Useful Life* (Sept. 2017).



## ANALYSIS OF PROBLEM

### Background

The IRS tracks the total number of calls it receives on its toll-free assistance lines, which is known as the “Enterprise Total”. Calls to the AM telephone lines account for over 75 percent of all “Enterprise Total” calls annually, and are where taxpayers go for answers to tax law and account inquiries.<sup>15</sup> The rest are a combination of calls to the Consolidated ACS lines, which include most of the IRS’s compliance service operations, and other low-volume telephone lines.<sup>16</sup> Depending on which telephone number the taxpayer calls and how the caller responds to the prompts he or she encounters, the call may be routed to a Customer Service Representative (CSR) and categorized as an “Assistor Answered Call,” or the call may be handled by the IRS’s automated processes.

When the IRS reports on the services it provides over the telephone, it typically uses the CSR LOS as the measure of taxpayer access to an assistor.<sup>17</sup> The IRS reported its overall LOS increased from FY 2016 to FY 2017, particularly during filing season.<sup>18</sup> However, this increase should not be taken as evidence of fundamental improvement in the IRS’s ability to provide service to taxpayers over the telephone.<sup>19</sup> Over the years, the IRS’s approach to telephone service has been to switch resources from one group of phone lines to another, essentially plugging the holes and masking underlying problems.<sup>20</sup> While AM lines had a higher LOS in FY 2017, AM telephone assistors actually answered fewer calls than in 2016 despite having more telephone assistors available.<sup>21</sup> In 2017, the Installment Agreement/Balance Due line, which received over 8.6 million calls in FY 2017, was moved from the AM umbrella to be grouped instead with the IRS’s Consolidated ACS lines.<sup>22</sup> While the IRS increased the amount of telephone assistors available on its Consolidated ACS lines in FY 2017,<sup>23</sup> the demand on those lines rose

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**To meet the industry standard, the IRS must treat telephone service as an essential part of an omnichannel service environment — one that enables taxpayers to engage with the IRS through the channel of their choice and be heard.**

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15 IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2017); IRM 21.1.1.1.3 (Oct. 1, 2017).

16 *Id.*

17 The IRS’s formula for determining LOS is more complex than just number of calls received divided by number of calls answered. The Customer Service Representative (CSR) Level of Service (LOS) formula is: (Assistor Calls Answered + Automated Calls Answered (Info Messages)) divided by (Assistor Calls Answered + Automated Calls Answered (Info Messages) + Emergency Closed + Secondary Abandons + (Add either Calculated Busy Signal OR Network Incompletes) + (Add either Calculated Network Disconnects OR Total Disconnects)). IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2017). Note that CSR LOS is the relative success rate of taxpayers that call for Customer Account Services (CAS) seeking assistance from a CSR. It does not represent the total number of callers who speak with a CSR.

18 IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Apr. 22, 2017) (showing “Enterprise Total” LOS increased from 72 percent in filing season (FS) 2016 to 79 percent in FS 2017).

19 See National Taxpayer Advocate FY 2018 Objectives Report to Congress 6.

20 *Id.* at 13.

21 IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2017); IRS response to TAS information request (Dec. 12, 2017).

22 *Id.*

23 IRS response to TAS information request (filing season (FS) Nov. 29, 2017) (showing the amount of telephone assistors available on Consolidated ACS lines rose from 1,588 in FS 2016 to 1,944 in FS 2017).

at a substantially higher rate.<sup>24</sup> As a result, the LOS on Consolidated ACS lines declined substantially.<sup>25</sup> The current projections for FY 2018 show a sharp drop in LOS, as AM predicts it will only offer a 60 percent LOS during filing season and a 49 percent LOS during all other periods.<sup>26</sup> The “Enterprise Total” LOS, which includes AM and Consolidated ACS lines, is expected to be below 40 percent for FY 2018.<sup>27</sup>

In its Strategic Plan for FY 2014-2017, the IRS committed to serving taxpayers by directing them to “the most appropriate digital or assisted service channel.”<sup>28</sup> However, the IRS has focused particularly on expanding online applications in hopes that this will allow it to deliver higher levels of service within current resources.<sup>29</sup> This plan fails to recognize the important role telephone service continues in customer service.

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**Over the years, the IRS’s approach to telephone service has been to switch resources from one group of phone lines to another, essentially plugging the holes and masking underlying problems.**

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### Telephone Service Is an Essential Part of an Omnichannel Taxpayer Service Environment

An omnichannel service environment “ensures the service level, responsiveness, and quality of service received on individual channels and across channels would be equally high.”<sup>30</sup> This type of environment is customer-centric, designed to provide service that meets diverse needs and preferences taxpayers have for communication. Relying on software, online resources, and tax practitioners does not address the ongoing need for high quality telephone assistance.<sup>31</sup> Despite increased internet availability, over 13 million taxpayers do not have internet access in their homes, and over 41 million do not have broadband

24 Consolidated ACS lines saw an increase in calls in FY 2017, partially because the Installment Agreement/Balance Due line, which received 8,625,539 calls in FY 2017, was moved in 2017 from the Accounts Management (AM) umbrella to be grouped instead with the IRS’s Consolidated ACS lines. IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2017).

25 The LOS on Consolidated ACS lines dropped from 70 percent with an average 18 minute wait time in FY 2016 to just a 47 percent LOS in FY 2017 with wait times of a staggering 30 minutes. IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2017).

26 IRS, W&I, *BPR 22* (Nov. 9, 2017).

27 *Id.* at 4.

28 IRS, *Strategic Plan FY 2014-2017*, <https://www.irs.gov/pub/irs-pdf/p3744.pdf> (including an objective to “Provide Timely Assistance Through a Seamless, Multichannel Service Environment to Encourage Taxpayers to Meet Their Tax Obligations and Accurately Resolve Their Issues”).

29 IRS response to TAS information request (Dec. 12, 2017).

30 Aspect, *What Is an Omnichannel Experience?*, <https://www.aspect.com/glossary/what-is-omni-channel-customer-service-experience>.

31 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*).

internet access there.<sup>32</sup> Vulnerable populations — seniors, low income taxpayers, and people with disabilities — are much less likely to have internet access available in their own home.<sup>33</sup>

Many taxpayers who do have internet access feel more comfortable receiving customer service over the phone, especially within the vulnerable populations previously mentioned.<sup>34</sup> TAS's Service Priorities Project Survey showed that among taxpayers who have internet access, only 60 percent chose the IRS's website as their first service channel of contact.<sup>35</sup> Over 20 percent chose the IRS's telephone lines as their primary channel of communicating with the IRS.<sup>36</sup> Service task complexity and the urgency of the task seem to influence the channel taxpayers choose for a service.<sup>37</sup> For instance, for a relatively simple task such as getting a form or instructions, or checking on a tax refund, most respondents chose to use the internet to obtain these services.<sup>38</sup> However, for services such as getting answers to tax law questions or assistance with an IRS notice, more respondents called or visited an IRS office.<sup>39</sup> Taxpayers also reported a higher success rate for resolving more complex issues like tax law questions over a phone call than for using online resources. For example, taxpayers reported a 72 percent "first contact resolution" rate (FCR) for phone calls concerning tax law compared to just 50 percent FCR for online inquiries about tax law.<sup>40</sup>

32 Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*.

33 Home internet access is an especially important statistic when considering implications for the IRS, as many in these groups may feel uncomfortable entering personal information related to tax obligations online over a computer that is not their own. Only 53 percent of lower income individuals and 51 percent of older individuals have home internet access. Pew Research Center, *Internet/Broadband Fact Sheet* (Jan. 12, 2017), <http://www.pewinternet.org/fact-sheet/internet-broadband/>. These percentages could drop further as the Federal Communications Commission (FCC) scales back its Lifeline program funding internet access for low income communities. Ali Breland, *FCC Votes to Limit Program Funding Internet Access for Low-Income Communities*, THE HILL (Nov. 16, 2017), <http://thehill.com/policy/technology/360818-fcc-moves-to-limit-program-funding-internet-access-for-low-income>.

34 Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*.

35 *Id.*

36 *Id.*

37 *Id.* On November 29, 2017, TAS interviewed several members of the Taxpayer Advocacy Panel (TAP) Toll-Free Phone Lines Committee, a federal advisory committee comprised of citizen volunteers who work to improve IRS services by providing the taxpayers' perspective to various IRS operations. During the interview, one taxpayer noted, "Taxpayers often use the IRS telephone lines when facing challenging problems that they have not been able to resolve on their own. On the phone, the relationship becomes more personal as taxpayers can communicate and connect with the telephone assistor handling their call. The telephone assistor can also engage more fully with the taxpayer to get to the heart of his or her concerns." TAP Toll-Free Phone Lines Interview (Nov. 28, 2017).

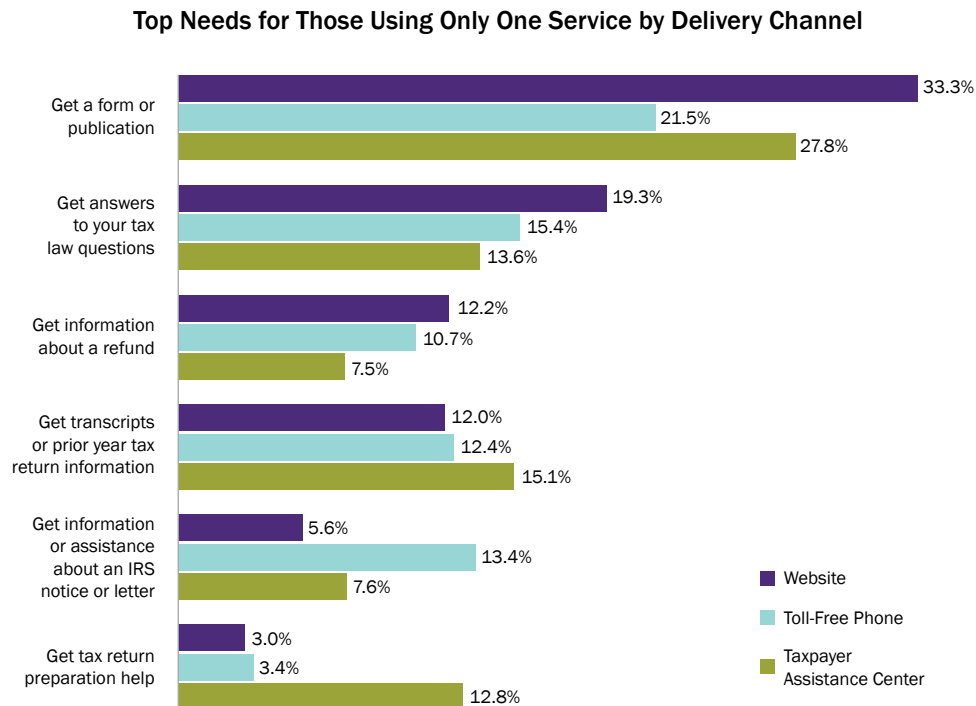
38 *Id.*

39 *Id.*

40 *Id.* See also Matthew Dixon, Karen Freeman, & Nicholas Toman, *Stop Trying to Delight Your Customers*, HARVARD BUSINESS REVIEW (July-Aug. 2010), <https://hbr.org/2010/07/stop-trying-to-delight-your-customers> (showing that 2.4 emails are used on average to resolve an issue, while just 1.7 calls are needed).

The following chart illustrates the frequency of service use by taxpayers by delivery channel:

**FIGURE 1.2.1**<sup>41</sup>



Rather than seeking to reduce the need for telephone communication with increased online resources,<sup>42</sup> the IRS should create a fluid omnichannel service environment in which taxpayers can begin a “support activity in one channel, and seamlessly transition to another.”<sup>43</sup> The IRS’s 2016 Customer Satisfaction Survey results for AM show that 46 percent of all callers reported using IRS.gov prior to calling its toll-free lines.<sup>44</sup> Thus, instead of driving taxpayers to faster but less helpful channels, the IRS must provide effective and consistent telephone service to complement information available on other channels in an omnichannel environment.<sup>45</sup>

41 Research Study: *A Further Exploration of Taxpayers’ Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*.

42 IRS response to TAS information request (Nov. 29, 2017).

43 Aspect, *What Is an Omnichannel Experience?*, <https://www.aspect.com/glossary/what-is-omni-channel-customer-service-experience>. See also The Northridge Group, *State of Customer Experience 2017*, 5 (2017), <https://www.northridgegroup.com/The-State-of-Customer-Service-Experience-2016> (“In business, we think about channels but customers just want to fix the problem they are trying to address. They begin a conversation with a brand in one channel and may attempt to continue it in another. Making that transition as seamless as possible through easy navigation, timely response and a consistent brand voice drives the most satisfying customer service experiences.”).

44 IRS response to TAS information request (Dec. 12, 2017). A study by the Harvard Business Review suggests an even higher percentage, finding that 57 percent of inbound call to commercial call centers come from customers that attempted to use web resources first. Matthew Dixon, Karen Freeman, & Nicholas Toman, *Stop Trying to Delight Your Customers*, HARVARD BUSINESS REVIEW (July-Aug. 2010), <https://hbr.org/2010/07/stop-trying-to-delight-your-customers>.

45 See John Horrigan, Pew Research Center, *How Americans Get in Touch With Government* (May 24, 2004), <http://www.pewinternet.org/2004/05/24/how-americans-get-in-touch-with-government/>.

### The IRS Should Use Qualitative Metrics That Capture the Caller's Overall Satisfaction to Evaluate and Improve Its Telephone Service

The IRS's current approach to telephone service does not incorporate an in-depth understanding of today's callers, nor has the IRS developed telephone service measures in terms of customer loyalty and satisfaction.<sup>46</sup> Operational measures, like the LOS, can yield a hollow result because they are only indicative of efficiency, not taxpayer satisfaction with the way the IRS handles calls or provides information.<sup>47</sup> Other measures used by the IRS, including adherence to telephone schedule and average speed of answer,<sup>48</sup> although important, are not necessarily outcomes in the mind of a caller and can mask problems that occur during the call if it is improperly handled.<sup>49</sup> While the IRS does use metrics that indicate quality, such as accuracy and professionalism,<sup>50</sup> these metrics should complement and be informed by measures gauging a taxpayer's overall experience on a call.<sup>51</sup> For example, the IRS should do more than just track the issue a taxpayer calls about, and collect information to understand why a taxpayer needed assistance with that particular issue and where any confusion arose. Similarly, metrics should be used to identify patterns of problems that IRS telephone assistors have trouble resolving.<sup>52</sup>

The metric that assesses the "single biggest driver of customer satisfaction" is the rate of FCR.<sup>53</sup> The IRS currently collects resolution data through its Quality Review Systems and the Customer Satisfaction Survey.<sup>54</sup> However, the response rate for Customer Satisfaction Surveys administered by the IRS is very

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**Instead of driving taxpayers to faster but less helpful channels, the IRS must provide effective and consistent telephone service to complement information available on other channels in an omnichannel environment.**

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46 "Just because the IRS does not operate on a profit margin like private sector companies does not make customer loyalty any less important. While the IRS does not directly "earn" profits as the result of a successful call, a customer-centric approach to telephone service would still benefit the IRS by improving its perception among taxpayers, increasing voluntary compliance, and reducing rework for the IRS down the road." TAP Toll-Free Phone Lines Interview (Nov. 28, 2017).

47 See Literature Review: *Improving Telephone Service Through Better Quality Measures*, vol. 2, *infra*.

48 IRS response to TAS information request (Dec. 12, 2017).

49 Darren Baguley, *Contact Centre Benchmarking*, AUSTRALIAN INSTITUTE OF MANAGEMENT (June 1, 2008), <http://blog.aim.com.au/contact-centre-benchmarking/>.

50 IRS response to TAS information request (Dec. 12, 2017).

51 See Government Accountability Office (GAO), GAO-15-84, *Managing for Results: Selected Agencies Need to Take Additional Efforts to Improve Customer Service* 29 (Oct. 2014), <http://www.gao.gov/assets/670/666652.pdf> (emphasizing "the need for a single, centralized management framework for receiving customer feedback so that all information about the customers can be linked together to facilitate a more complete knowledge of the customer").

52 This type of qualitative information helps the IRS understand not just that inaccurate information was given, but why the telephone assistor gave the wrong information. See GAO, GAO-15-84, *Managing for Results: Selected Agencies Need to Take Additional Efforts to Improve Customer Service* 29 (Oct. 2014), <http://www.gao.gov/assets/670/666652.pdf>.

53 Jeff Rumburg, *MetricNet, Metric of the Month: First Contact Resolution* 5 (2011), <http://www.thinkhdi.com/~media/HDI/Files/Library-Archive/Insider%20Articles/First%20Contact%20Resolution.pdf>. The first contact resolution rate is determined by measuring "the percentage of all calls that are resolved on the first attempt, without the agent needing to refer the customer to a colleague, their manager, or calling the customer back. International Finance Corp., *Measuring Call Center Performance: Global Best Practices* 7 (June 2010).

54 IRS response to TAS information request (Dec. 12, 2017).

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## First Contact Resolution is important because it shows whether telephone assistors are actually answering a caller's questions, not just their calls.

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small.<sup>55</sup> TAS recommends that the IRS incorporate a specific resolution metric to be uniformly assessed on each call.<sup>56</sup> While there are multiple ways to measure FCR, the most important consideration is that the caller, not telephone assistor, makes the determination of whether a problem was resolved.<sup>57</sup>

FCR is important because it shows whether telephone assistors are actually answering a caller's questions, not just their calls.<sup>58</sup> The industry standard for FCR is above 70 percent.<sup>59</sup> Yet TAS's Service Priorities Project Survey showed that almost 40 percent of taxpayers calling the IRS felt the call did not fully resolve their problem.<sup>60</sup> Issues such as return preparation assistance, information on a notice, and information on a refund had particularly low resolution rates over the telephone.<sup>61</sup> These results show that taxpayers are not getting the full assistance they need over the phone, which can negatively impact voluntary compliance.

Along with measuring FCR, the IRS should monitor the subjects of taxpayer complaints to understand other reasons a taxpayer may not have been satisfied with a call. While the IRS has procedures for responding to individual complaints,<sup>62</sup> it currently has no official system to track taxpayer complaints about telephone service.<sup>63</sup> Compiling complaints would allow the IRS to know whether "customer concerns are localized, specific to a given function, agency-wide, or systemic."<sup>64</sup>

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55 IRS response to TAS information request (Dec. 12, 2017). The IRS reports a 95 percent confidence level that the reported percentages are within +/- one percent confidence interval. However, for AM lines, less than one percent of all calls answered gets selected for the customer satisfaction survey, and just five percent of those selected participate in the survey. This limitation undercuts the value of administering such a measure, as those that did not respond to the survey could have very different opinions from the callers that did choose to complete the survey. In April 2017, the IRS eliminated customer satisfaction surveys for the Automated Under-reporter (AUR) and Compliance Center Exam (CCE) lines partially because of low response rates. Rather than eliminating satisfaction surveys, the IRS should consider using multiple other types of survey formats, such as mailed comment cards, online, or a callback number, to allow taxpayers to participate at their convenience.

56 See Literature Review: *Improving Telephone Service Through Better Quality Measures*, vol. 2, *infra*.

57 See Darren Baguley, *Contact Centre Benchmarking*, AUSTRALIAN INSTITUTE OF MANAGEMENT (June 1, 2008).

58 "A call with the IRS should resolve the taxpayer's issue or at least identify the specific steps the taxpayer must take to do so. It is incredibly frustrating for a call to conclude with the taxpayer no better off than before the call began, especially if the taxpayer has spent a lengthy period waiting just to speak to a telephone assistor." TAP Toll-Free Phone Lines Interview (Nov. 28, 2017).

59 International Finance Corp., *Measuring Call Center Performance: Global Best Practices 7* (June 2010).

60 Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*.

61 *Id.*

62 See IRM 21.1.3.16 (Oct. 1, 2014); IRM 5.19.5.3.11(11) (July 25, 2014).

63 IRS response to TAS information request (Nov. 29, 2017) (noting that complaints are only tracked through the e-Trak system for general correspondence, which is not intended as a searchable database).

64 Government Accounting Office (GAO), GAO-15-84, *Managing for Results: Selected Agencies Need to Take Additional Efforts to Improve Customer Service* 29 (Oct. 2014), <http://www.gao.gov/assets/670/666652.pdf>.

Understanding trends across repeat customer calls and behavioral patterns would allow the IRS to better anticipate customers' needs and preempt future calls.<sup>65</sup> Creating a taxpayer-focused approach to measuring telephone service would likely help the IRS improve taxpayer loyalty and voluntary compliance, thereby protecting taxpayers from more costly and adversarial compliance and enforcement actions down the road.

### IRS Telephone Assistors Need to Be Engaged With Ways to Improve Their Performance and Enhance Caller Satisfaction

TAS's review of relevant literature shows that keeping telephone assistors engaged in the service they provide is critical to improving call quality and caller satisfaction.<sup>66</sup> Unhappy telephone assistors make for unhappy callers.<sup>67</sup> Most telephone assistors are motivated by a desire to provide a service that satisfies a caller and helps resolve the problem.<sup>68</sup> While most IRS Customer Account Services (CAS) employees<sup>69</sup> recognize the importance of their work to organizational goals, many feel they don't have the knowledge or skills necessary to accomplish organizational goals.<sup>70</sup> Many of these employees are also dissatisfied with the training and resources available to help them get their job done.<sup>71</sup>

CAS employees reported particularly low levels of feeling personal empowerment with respect to work processes.<sup>72</sup> Many employees are concerned that their voices are not being heard at a leadership level, and feel their talents and training needs are not well assessed.<sup>73</sup> Telephone assistors are at the front lines of taking a relational approach to telephone service, and are key resources for improving taxpayer loyalty and detecting emerging service issues.<sup>74</sup> Therefore, the IRS needs to better listen and respond to its telephone assistors' concerns. The IRS should give telephone assistors a sense of ownership over their work by equipping them with the tools and issue-focused training to help resolve a caller's inquiry directly in as few steps as possible, thereby improving employee satisfaction and call quality.<sup>75</sup>

65 See also Matthew Dixon, Karen Freeman, & Nicholas Toman, *Stop Trying to Delight Your Customers*, HARVARD BUSINESS REVIEW (July–Aug. 2010), <https://hbr.org/2010/07/stop-trying-to-delight-your-customers> (“22 percent of repeat calls involve downstream issues related to the problem that prompted the original call, even if that problem itself was adequately addressed the first time around. Although companies are well equipped to anticipate and “forward-resolve” these issues, they rarely do so, generally because they’re overly focused on managing call time.”).

66 See Literature Review: *Improving Telephone Service Through Better Quality Measures*, vol. 2, *infra*.

67 Ian Jacobs et al., Forrester Research, *How to Measure and Improve the Contract Center Agent Experience* 1 (Apr. 16, 2015).

68 Audrey Gilmore, *Call Centre Management: Is Service Quality a Priority?*, 11 MANAGING SERVICE QUALITY 153-59 (2001).

69 The IRS uses the Federal Employee Viewpoint Survey as a key indicator of employees' perceptions of the agency and employee satisfaction; however, the IRS does not isolate information specific to telephone assistors. Responses from the IRS CAS employees includes IRS telephone assistors. TAS recommends that the IRS incorporate more satisfaction measures specific to telephone assistors in the future. See IRS response to TAS information request (Dec. 12, 2017).

70 IRS response to TAS information request (Dec. 12, 2017) (showing that while 81 percent agree that they know how their work relates to the agency's goals and priorities, 19 percent of CAS employees did not feel the workforce had the job-relevant knowledge and skills necessary to accomplish organizational goals).

71 IRS response to TAS information request (Dec. 12, 2017) (showing only 44 percent of CAS employees were satisfied with resources and 44 percent were satisfied with training). In FY 2017, the IRS spent on average of just \$87 on training per W&I employee, including CSRs. IRS response to TAS information request (Nov. 7, 2017).

72 IRS response to TAS information request (Dec. 12, 2017) (showing just 33 percent of CAS employees felt a feeling of personal empowerment).

73 IRS response to TAS information request (Dec. 12, 2017) (showing 45 percent of CAS employees feel their training needs are assessed and 49 percent agree that their talent is being used well in the workplace).

74 See, e.g., Scott Ferguson, IRWeb, *Customer Early Warning System Keeps Small Problems From Becoming Big Ones* (June 7, 2016), <http://irweb.irs.gov/AboutIRS/co/dcse/sehighlights/archive/50431.aspx> (“Listening to employees and monitoring customer touch points helps identify issues as they occur or begin to develop, instead of reacting later to a potentially larger issue.”). The IRS should make sure its employees are aware of and utilize more programs like the Customer Early Warning System (CEWS) to ensure its telephone assistors' voices are being heard and to identify ways to improve its telephone service.

75 Ian Jacobs et al., Forrester Research, *How to Measure and Improve the Contract Center Agent Experience* 7 (Apr. 16, 2015).

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While most IRS Customer Account Services employees recognize the importance of their work to organizational goals, many feel they don't have the knowledge or skills necessary to accomplish organizational goals.

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### The IRS Should Use New Technology and Adopt Industry Best Practices to Improve Taxpayers' Experience on Its Telephone Lines

To modernize call center operations, the IRS should develop a relationship-oriented approach and reduce the effort callers must expend to get their problems resolved. Despite recommendations from TAS and Taxpayer Advocacy Panel (TAP),<sup>76</sup> the IRS has not embraced current technology that would allow it to:

- Reduce the time a taxpayer spends waiting in a calling queue;
- Integrate and store taxpayer information across calls and channels; and
- Allow and improve ability to answer more complex tax law questions throughout the year.

These changes can help improve caller satisfaction and help empower telephone assistors to better respond to the needs of taxpayers.<sup>77</sup>

### *The IRS Should Use Callback Technology to Reduce the Amount of Time a Taxpayer Spends Idle on the Phone*

Implementing a callback function to its telephone service would allow the IRS to eliminate the burden caused by long wait times. Studies show that two of every three callers hang up if kept on hold for longer than two minutes.<sup>78</sup> However, taxpayers calling the IRS waited for 13 minutes on average for a telephone assistor to answer in FY 2017, while the average speed of answer on Consolidated ACS was over 30 minutes in FY 2017, indicating that those taxpayers who do get through to the IRS have a great need to speak with the IRS and are enormously patient.<sup>79</sup> In TAS's Service Priorities Project survey, taxpayers identified long hold times as one of the biggest reasons they were unable to resolve issues completely over the phone.<sup>80</sup>

There are several options modern technology offers to avoid long hold times that the IRS should consider:

- "Virtual Hold" technology allows taxpayers the option to have the next available customer service representative call them back, which results in *no wait time*.<sup>81</sup> TAS has previously recommended

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76 See National Taxpayer Advocate 2014 Annual Report to Congress 1-12 (Most Serious Problem: *Access to the IRS: Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*); TAP, *2016 Annual Report* 24.

77 The proposals in this section are not intended to be an exhaustive list of ways to modernize telephone service. There are many other resources, such as such as speech analytics tools, available for the IRS to consider as well. See Karolina Kiwak, SearchCRM, *Top Five Benefits of Speech Analytics Tools for Contact Centers* (Apr. 28, 2017), <http://searchcrm.techtarget.com/report/Top-five-benefits-of-speech-analytics-for-the-call-center>.

78 See, e.g., Taylor Jones, Arise, *Arise 2017 Customer Service Frustration Series: Phone Hold Times* (Feb. 2, 2017), <http://www.arise.com/resources/blog/arise-2017-customer-service-frustration-series-phone-hold-times>.

79 IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (Sept. 30, 2017).

80 See Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*.

81 Silky Sinha, *8 Benefits of Call Back Technology for Your Contact Center*, AMEYO (Aug. 4, 2015), <https://www.ameyo.com/blog/8-benefits-of-call-back-technology-for-your-contact-center>.



this feature as a prudent investment that would substantially reduce unsuccessful calls to the IRS and prevent taxpayers from wasting time while waiting to speak with a telephone assistor.<sup>82</sup>

- “Scheduled CallBack” is an additional feature that allows the taxpayer the flexibility of receiving a call from the IRS during a window he or she specifies. This option also provides a telephone assistor enough time to view the previous history and the necessary information about the taxpayer contained in IRS systems before calling back, which leads to fewer calls abandoned while a caller waits in the queue and higher first-contact resolution.<sup>83</sup>

More than limiting the inconvenience, adding a callback function would grant access to service for taxpayers who have limited monthly cell phone minutes for phone calls, and those who otherwise could not afford to spend the time required for a call to the IRS. While the IRS has identified customer callback as its top priority telephone technology upgrade, it must take action to actually implement this system.<sup>84</sup>

### *Using Taxpayer-Centric Routing and Information Retention Technology Would Allow the IRS to Address Taxpayer Concerns More Quickly and Directly*

The IRS should improve its call routing capabilities to allow a call to be directed to the appropriate department and telephone assistor who can resolve the taxpayer’s issue. When a taxpayer calls the IRS’s main line, he or she listens to a 30 second description of the availability of assistance on IRS.gov and then is presented with five routing options.<sup>85</sup> Taxpayers may be confused about which option is appropriate for their situation, or need assistance on multiple issues.<sup>86</sup> TAS has previously recommended that the IRS institute a system similar to a 311 system, where an initial operator would be able to ask questions to understand why a taxpayer is calling.<sup>87</sup> Then, the operator would match the taxpayer with the specific office within the IRS that handles his or her issue or case, which would improve FCR.<sup>88</sup> If a caller does have to be transferred, TAS recommends using expedited transitions between services to place the caller at the top of the queue for the appropriate telephone assistor.<sup>89</sup>

82 See *IRS Oversight: Hearing Before the H. Subcomm. of Financial Services and General Government Committee on Appropriations*, 115 Cong. 11 (2017) (statement of Nina E. Olson, National Taxpayer Advocate). TAP has also recommended this feature to the IRS in its annual report. See TAP, *2016 Annual Report* 24.

83 Silky Sinha, *8 Benefits of Call Back Technology for Your Contact Center*, AMEYO (Aug. 4, 2015), <https://www.ameyo.com/blog/8-benefits-of-call-back-technology-for-your-contact-center>.

84 While the IRS has included customer callback on its list of technology priorities, it is not as highly ranked as TAS would like. IRS response to TAS information request (Dec. 12, 2017).

85 This description is based off of a phone call made on December 10, 2017 by TAS to the IRS’s main line for individuals, 800-829-1040.

86 See National Taxpayer Advocate 2014 Annual Report to Congress 1-12 (Most Serious Problem: *Access to the IRS: Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*).

87 *Id.*; see also Accenture, *Transforming Customer Services to Support High Performance in New York City Government* 6 (2013) (discussing how New York City’s adoption of a 311 line has helped eliminate duplicative services, direct resources to areas of need, and achieve excellence in caller satisfaction).

88 See National Taxpayer Advocate 2014 Annual Report to Congress 1-12 (Most Serious Problem: *Access to the IRS: Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*) (noting a “persistent problem with requiring most taxpayer calls to be handled by a CSR who handles a range of issues” is that “the CSR speaking to the taxpayer may not have the expertise in the specific issue to assist the taxpayer.”).

89 If a caller is being transferred, one option recommended by taxpayers to ease the transition is to use a “warm transfer,” where the initial telephone assistor stays on the line to introduce the taxpayer and the situation to the appropriate telephone assistor. TAP Toll-Free Phone Lines Interview (Nov. 28, 2017).

In addition to ensuring the taxpayer is connected to the appropriate telephone assistor, the IRS should ensure that the taxpayer does not waste time repeating information once he or she has been connected. IRS telephone assistors should be able to access prior related contacts the taxpayer has had with the IRS over the phone or on other channels.<sup>90</sup> Information retention and sharing is essential to a successful omnichannel environment and allows taxpayers to avoid having to repeat sensitive information on multiple occasions.<sup>91</sup> Assistors should have access to “a unifying single database” retaining all of a taxpayer’s prior interactions with the IRS to better understand and address their needs.<sup>92</sup> In certain instances, the IRS should give taxpayers the option of having one employee assigned to resolve a taxpayer’s issue from start to finish.<sup>93</sup> While IRS telephone assistors are trained to handle many types of calls, taxpayers that have to make multiple calls to resolve an issue or were confused about information on the initial call should be able to choose between speaking with the first available assistor or waiting to speak with the same assistor who helped them initially.<sup>94</sup>

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**Information retention and sharing is essential to a successful omnichannel environment and allows taxpayers to avoid having to repeat sensitive information on multiple occasions. Assistors should have access to “a unifying single database” retaining all of a taxpayer’s prior interactions with the IRS to better understand and address their needs.**

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- 90 See Bank Administration Institute, *Evolution of Contact Centers in Banking: Engaging and Empowering Agents in an Omnichannel Operating Environment* 10 (2015), <https://www.avanade.com/~media/asset/brochure/contact-centers-in-banking-report.pdf> (“But, whether a request or transaction was begun online, in the branch, on an ATM or from their smartphone, customers still want an easy, seamless experience, without having to start over should they need assistance from the contact center.”).
- 91 The Northridge Group, *State of Customer Experience 2017* (2017), <https://www.northridgegroup.com/State-of-Customer-Experience-Report-2017>. TAP has also recommended this feature to the IRS in its annual report, noting that the benefits of information retention technology help to reduce the risk of identity theft. See TAP, 2016 Annual Report 24.
- 92 Voice Over Internet Protocol (Voip-info), *Call Center Statistics*, (July 26, 2012), <https://www.voip-info.org/wiki/view/Call+Center+Statistics>; see also National Taxpayer Advocate 2016 Annual Report to Congress 109–120 (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*) (“The age, number, and lack of integration across IRS case management 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. They also create a burden on taxpayers, who must contend with IRS customer service representatives who may not be able to access the records they need to assist taxpayers or must do so on multiple systems”).
- 93 South Africa’s Nedbank, for instance, instituted an “AskOnce” promise, which guarantees that the representative who picks up the phone will own the customer’s issue from start to finish. Matthew Dixon, Karen Freeman, & Nicholas Toman, *Stop Trying to Delight Your Customers*, HARVARD BUSINESS REVIEW (July–Aug. 2010), <https://hbr.org/2010/07/stop-trying-to-delight-your-customers>.
- 94 While the IRS has the capability to assign particular telephone assistors to a case, this feature is currently only available in very limited circumstances. IRS response to TAS information request (Nov. 29, 2017). This option should be made more widely available. See Most Serious Problem: *Identity Theft: As Tax-Related Identity Theft Schemes Evolve, the IRS Must Continually Assess and Modify Its Victim Assistance Procedures, infra* (noting the importance of having a single point of contact in identity theft cases).

### *IRS Telephone Assistors Should Answer Both “Basic” and “Complex” Tax Law Questions Throughout the Year*

Beginning in 2014, the IRS limited the scope of tax law questions it would answer over the phone. Currently, IRS telephone assistors can only answer “basic” tax law questions during filing season, and no tax law questions at all outside of filing season.<sup>95</sup> This limitation sharply curtails what had once been a valuable feature, as the IRS telephone lines had provided the “fastest and best experience” for taxpayers seeking to get answers to tax law questions.<sup>96</sup> Under the current approach, however, the roughly 16 million taxpayers who file returns later in the year are unable to get answers to any tax law questions from the IRS.<sup>97</sup>

The IRS’s inability to answer “complex” tax law questions over the telephone fails to meet the needs of taxpayers in today’s omnichannel service environment. As more people begin to access information through other channels, contact center calls are often necessary to build on basic information a caller may have already found, frequently resulting in more complicated and issue-oriented calls.<sup>98</sup> Thus, more “complex” tax law questions are the exact type of questions that taxpayers need assistance with when they call the IRS.<sup>99</sup> Therefore, the IRS should allow taxpayers to ask tax law questions, basic and complex, throughout the year and ensure that its telephone assistors have the resources and training necessary to answer them completely.<sup>100</sup>

## CONCLUSION

The National Taxpayer Advocate urges the IRS to evaluate and improve the overall quality of a taxpayer’s experience on the phone as a part of the omnichannel service environment. Decreasing demand for phone assistance by offering online alternatives is simply not enough. The IRS needs to embrace interactive, person-to-person communication with taxpayers. Telephone service provides taxpayers an invaluable avenue to seek information that they may be unable or uncomfortable finding on other channels.

To fulfill its mission to “provide America’s taxpayers with top quality service,” the IRS should commit to taking steps to improve the quality of telephone service, as well as telephone technology. The IRS needs to modernize the way it measures success to better account for factors that impact customer satisfaction. In addition, keeping telephone assistors engaged will help improve the quality of telephone calls. Finally, using callback technology and a knowledge database can help resolve taxpayers’ questions on first contact. Even in a reduced-resource environment, these changes should be prioritized as they

95 National Taxpayer Advocate FY 2018 Objectives Report to Congress.

96 See TIGTA, Ref. No. 2007-40-164, *The Internal Revenue Service Provides Helpful Tax Law Assistance but Still Has Problems With Tax Return Preparation Assistance* (Aug. 24, 2007).

97 National Taxpayer Advocate FY 2018 Objectives Report to Congress.

98 See Literature Review: *Improving Telephone Service Through Better Quality Measures*, vol. 2, *infra*.

99 See Research Study: *A Further Exploration of Taxpayers’ Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra* (showing tax law as the second most frequent service task on the IRS’s toll-free phone lines). “There is a difference in being able to read the law, and being able to understand and follow the law. Rather than just reading to taxpayers from information usually already available, IRS telephone assistors should work to engage with taxpayers and help them troubleshoot any issues they have.” TAP Toll-Free Phone Lines Interview (Nov. 28, 2017).

100 The National Taxpayer Advocate is concerned that in FY 2017, the IRS spent on average just \$87 on training per W&I employee, including CSRs, who are expected to be able to answer tax law questions on a broad variety of topics. IRS response to TAS information request (Nov. 7, 2017). See Most Serious Problem: *Employee Training: Changes to and Reductions in Employee Training Hinder the IRS’s Ability to Provide Top Quality Service to Taxpayers*, *infra*.

can ultimately save money by increasing voluntary compliance and reducing future work for the IRS.<sup>101</sup> These changes would allow the IRS to focus on ways to improve taxpayer satisfaction from telephone interaction in an omnichannel customer service environment.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Develop a comprehensive strategy for improving its telephone service to be included in its next Strategic Plan and in its Annual Appropriation Requests, with specific initiatives to increase taxpayer satisfaction.
2. Incorporate qualitative measures, such as First Contact Resolution rate, used by other government agencies and in the private sector to measure a caller's overall experience and satisfaction with a call.
3. Provide telephone assistors additional issue-focused training to help resolve a caller's inquiry directly in as few steps as possible.
4. Upgrade phone hardware technology to provide virtual hold and scheduled callback options to callers.
5. Institute a system similar to a 311 system where an operator can transfer a taxpayer to the specific office within the IRS that handles his or her issue or case.
6. Reinstate the capability for taxpayers to receive year-round tax law assistance over the telephone, including a second-tier of assistance for more complex tax law issues.

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<sup>101</sup> "The IRS needs to shift its mindset from one that is constrained by dwelling on what it could potentially do if it had more resources to one of creativity that focuses on what it can do to reach its goals with its existing resources." TAP Toll-Free Phone Lines Interview (Nov. 28, 2017).

MSP  
#3**ONLINE ACCOUNTS: The IRS's Focus on Online Service Delivery Does Not Adequately Take Into Account the Widely Divergent Needs and Preferences of the U.S. Taxpayer Population****RESPONSIBLE OFFICIALS**

Kenneth Corbin, Commissioner, Wage and Investment Operating Division  
Paul Mamo, Director, Office of Online Services

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

Since 2009, the National Taxpayer Advocate has advocated for and supports the IRS development of an online account application for taxpayers and their authorized representatives.<sup>2</sup> However, with approximately 41 million U.S. taxpayers without broadband at home and almost 14 million with no internet access at all at home, the IRS must continue to fully staff other service channels and it needs to upgrade its telephone technology to 21st century capabilities.<sup>3</sup> Taxpayers have a *right to quality service* and those taxpayers who want or need to interact with the IRS in a two-way conversation by telephone or face-to-face service should receive the same level of quality service as those who use the online self-help tools. The population of the United States is large and diverse in its taxpayer service needs, and a one-size-fits-all approach is not appropriate for a tax collection agency. Moreover, voluntary compliance and trust in the tax system are best promoted by person-to-person contact. In TAS's 2016 and 2017 survey on Taxpayers' Varying Abilities and Attitudes, approximately 50 percent disagreed with

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).

2 See National Taxpayer Advocate 2009 Annual Report to Congress 95-109 (Most Serious Problem: *The IRS Lacks a Servicewide e-Services Strategy*).

3 Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*; Most Serious Problem: *Telephones: The IRS Needs to Modernize the Way It Serves Taxpayers Over the Telephone, Which Should Become an Essential Part of an Omnichannel Customer Service Environment*, *supra*; Literature Review: *Improving Telephone Service Through Better Quality Measures*, vol 2, *infra*.

the statement “I feel secure sharing personal financial information over the Internet.”<sup>4</sup> Thus, a multi-faceted, omnichannel service strategy based on the needs and preferences of taxpayers is required.<sup>5</sup>

As the IRS focuses on providing self-service tools for taxpayers, the National Taxpayer Advocate has the following concerns:

- The IRS’s decision to prioritize online services over other service channels is resource-driven rather than based on research on taxpayer needs and preferences and the impact on compliance;
- Secure Access e-Authentication is a critical fraud prevention measure, but the 30 percent verification rate proves that it creates a barrier to entry for all taxpayer populations, not just the elderly and low income;<sup>6</sup>
- The low participation rates of the Taxpayer Digital Communications (TDC) pilot conducted by several IRS organizations illustrate the need to maintain and improve traditional service channels;
- The IRS should explore establishing a method for taxpayers to electronically submit documents or payments to the IRS which involves a less rigorous level of e-authentication; and
- The IRS has failed to make the policy decision to restrict third party access to current and future online applications.

## ANALYSIS OF PROBLEM

### Background

The IRS launched the online account application in Fall 2016.<sup>7</sup> The IRS adds additional features in increments. Currently, the application is limited to individual use and provides the following capabilities:<sup>8</sup>

- Details about current balance, with the balance broken down by year and tax type;
- Frequently asked questions about the account balance, with information on how to dispute a balance shown;
- Ability to view payments made within the past 18 months;
- Ability to make payments or apply for an installment agreement;
- Messages reminding the user of approaching filing and payment due dates;
- Ability to view a snapshot of tax record data for the current tax year; and

4 Research Study: *A Further Exploration of Taxpayers’ Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra* (95 percent confidence level).

5 Organisation for Economic Co-operation and Development (OECD), *Technologies for Better Tax Administration: A Practical Guide for Revenue Bodies* 26 (2016) (“While many individuals and businesses are shifting to working digitally across many of the interactions they have, there are groups with legitimate needs that may never operate digitally (including the elderly and those with limited access to broadband services due to their geographic location for instance). Additionally, there are industries that have less access to technology, or that resist or feel less confident interacting with the tax administration through digital channels, that will still require support.”).

6 IRS response to TAS information request (Nov. 22, 2017).

7 IRS News Release 2016-155, *IRS Launches New Online Tool to Assist Taxpayers with Basic Account Information* (Dec. 1, 2016); Luca Gattoni-Celli, *Olson Details IRS Online Account Requirements, Remains Skeptical*, 2016 TNT 96-5, *TAX NOTES TODAY*, (May 18, 2016).

8 IRS response to TAS fact check (Dec. 19, 2017); IRS response to TAS information request (Nov. 22, 2017); Meeting with IRS Office of Online Service on Online Account Project Status Overview (Nov. 7, 2017); TAS user testing of online account application (Nov. 3, 2017).

- Ability to view and download transcripts for the past four tax years (including return transcripts, account transcripts, wage and income transcripts, and record of account transcripts).<sup>9</sup>

The IRS plans to develop the following capabilities in future increments:<sup>10</sup>

- Verify identity on the online account — the application, ID Verify, will enable potential victims of identity theft to self-report tax return details to either verify their information or confirm that identity theft has occurred;<sup>11</sup>
- View more than 18 months of past payments; and<sup>12</sup>
- Access copies or images of correspondence and notices.<sup>13</sup>

In addition, during usability testing of the online account, users expressed an interest in the IRS adding the following features to the account:<sup>14</sup>

- The ability to file taxes directly with the IRS;<sup>15</sup>
- Live Chat;
- The ability to retrieve tax records, including third party information reports;<sup>16</sup> and
- Graphs of data to show how income and taxes have changed over time.

Further, the IRS Office of Online Services (OLS) is in the process of developing a prototype for the online account for third parties such as preparers (tentatively referred to as “Tax Pro”). The prototype version of Tax Pro shared with TAS in June 2017 included the following capabilities:<sup>17</sup>

- View a list of current clients for whom the practitioner holds a valid authorization;
- View a list of the most recent updates, upcoming deadlines and activity history;
- View a list of recent correspondences with the IRS, including document attachments;
- Add a client by submitting an online request to a client for an authorization such as a Power of Attorney (POA), Tax Information Authorization (TIA), or Reporting Agent Authorization (RAA); and
- Print a blank form or upload a signed form.

9 For a description of the different types of transcripts, see IRS, *Transcript Types and Ways to Order Them*, available at <https://www.irs.gov/individuals/tax-return-transcript-types-and-ways-to-order-them> (last visited Dec. 6, 2017).

10 IRS response to TAS information request (Nov. 22, 2017).

11 ID Verify will ultimately help the IRS determine whether to continue processing a flagged return. IRS response to TAS fact check (Dec. 19, 2017); Meeting with IRS Office of Online Service on Online Account Project Status Overview (Nov. 7, 2017).

12 TAS encourages the IRS to include at least two years of payments to assist the taxpayer in filing claims for refunds. See IRC § 6511.

13 As of December 19, 2017, the IRS has not approved nor made any decisions regarding timeframes or specific notices or correspondence that will be available on the application. This feature is currently on a list of potential future capacities. IRS response to TAS fact check (Dec. 19, 2017); IRS response to TAS information request (Nov. 22, 2017).

14 IRS response to TAS information request (Nov. 22, 2017) (Mediabarn conducted a series of user testing experiences in 2017 to test various prototypes of the online account).

15 The National Taxpayer Advocate has recommended that the IRS develop a platform to allow taxpayers to file directly with the agency at no cost. See, e.g., National Taxpayer Advocate 2004 Annual Report to Congress 471-77 (Key Legislative Recommendation: *Free Electronic Filing for All Taxpayers*).

16 The National Taxpayer Advocate has recommended in the past that the IRS provide a platform for taxpayers to view or download third party information reports. See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, at 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

17 IRS Office of Online Services email to TAS (June 21, 2017).

The IRS conducted focus groups on Tax Pro during the 2017 IRS Nationwide Tax Forums, during which tax professionals, not just limited to Circular 230 practitioners, tested the account and provided suggestions on how to make it more navigable, easy to understand, and recommended future capabilities. The results of the focus groups were generally positive. A few noteworthy recommended features include:<sup>18</sup>

- Providing an “action list” of upcoming items to complete;
- The capability to perform tax research within the account; and
- The capability to upload documents other than the authorization forms.

### **The IRS’s Decision to Prioritize Online Services Over Other Service Channels is Resource-driven Rather than Based on Research on Taxpayer Needs and Preferences and the Impact on Compliance**

Given the current budget environment, it is understandable that the IRS points taxpayers toward less costly self-service options. However, migration toward more online interaction between the IRS and taxpayers, at the expense of personalized services, will not save resources in the long term. The National Taxpayer Advocate has long advocated that the IRS develop the online account application, but only supports such development if it is only one component of a omnichannel service strategy.<sup>19</sup>

Digital interaction is not appropriate for certain populations, nor is it suitable for taxpayers with anything but simple and straightforward transactions and information needs. Once a taxpayer faces enforcement action, it is imperative that the IRS assist the taxpayer by learning the taxpayer’s particular facts and circumstances to help bring him or her into compliance and to educate the taxpayer on how to avoid making similar mistakes in the future. The IRS can only accomplish this through personalized services. Further, if taxpayers face too many obstacles in their attempted interactions with the IRS, their frustrations will mount and their willingness to voluntarily comply in the future may suffer. Thus, the IRS has developed a strategy that places too much emphasis on the online account, without adequately

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**The IRS has developed a strategy that places too much emphasis on the online account, without adequately addressing the service needs and preferences of taxpayers or the compliance consequences of their failing to have their needs met.**

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<sup>18</sup> IRS response to TAS information request (Nov. 22, 2017).

<sup>19</sup> See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, at 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*). An omnichannel environment is one in which the level of service, responsiveness, and quality of service received on any one channel is equally high across channels. In addition, a taxpayer could seamlessly transition from one channel to another. Most Serious Problem: *Telephones: The IRS Needs to Modernize the Way It Serves Taxpayers Over the Telephone, Which Should Become an Essential Part of an Omnichannel Customer Service Environment*, *supra*; Literature Review: *Improving Telephone Service Through Better Quality Measures*, vol 2, *infra*.



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Over the years TAS has conducted several important research studies and surveys of different taxpayer populations, which the IRS has completely ignored because the survey findings do not jive with the direction the IRS wishes to pursue.

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addressing the service needs and preferences of taxpayers or the compliance consequences of their failing to have their needs met.<sup>20</sup>

Accordingly, the IRS needs to incorporate research on taxpayer needs and preferences into its 2018–2022 IRS Strategic Plan. Over the years, TAS has conducted several important research studies and surveys of different taxpayer populations, which the IRS has completely ignored because the survey findings do not jive with the direction the IRS wishes to pursue.<sup>21</sup> Moreover, we can offer a plethora of suggestions based on the dozen National Taxpayer Advocate Public Forums on Taxpayer Needs and Preferences we hosted throughout the country in 2016.<sup>22</sup> During these Public Forums, TAS specifically solicited comments about needs and preferences for the IRS's online account application from the various panels of witnesses representative of each community visited.<sup>23</sup>

In 2016 and 2017, TAS conducted a nationwide survey of U.S. taxpayers about their needs, preferences, and experiences with IRS taxpayer service conducted entirely by telephone (landline and cell phone).<sup>24</sup> The findings of this survey confirm the need to maintain an omnichannel service strategy. For example,

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- 20 IRS response to TAS information request (Nov. 22, 2017). The IRS has contracted third parties to conduct usability testing for the individual online account and has been responsive to the user comments and suggestions regarding messaging, display, navigability, and features of the application. The IRS also conducted focus groups of the TaxPro prototype during the 2017 IRS Nationwide Tax Forums. It has also conducted online surveys of individual taxpayers which provide some evidence of how already-online taxpayers would like to interact with the IRS about some activities. However, it has not conducted comprehensive analysis of the online needs or taxpayer service needs of the U.S. taxpayer population, and it has ignored the significant work that the TAS has conducted in this regard. For a detailed discussion of the research, see National Taxpayer Advocate 2016 Annual Report to Congress 17-23, 123-24; National Taxpayer Advocate 2015 Annual Report to Congress 61-62.
- 21 For a description of TAS's research on taxpayers' service needs and preferences, see National Taxpayer Advocate 2016 Annual Report to Congress 17-23 (Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*); National Taxpayer Advocate 2016 Annual Report to Congress 121-37 (Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences is Critical as the IRS Develops an Online Account System*). See also, Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*; National Taxpayer Advocate 2015 Annual Report to Congress, vol. 2, 101-10 (Research Study: *Understanding the Hispanic Underserved Population*); National Taxpayer Advocate 2014 Annual Report to Congress, vol. 2, 1-26 (Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help From the Clinics*); National Taxpayer Advocate, *Characteristics of Low Income Taxpayers and Implications for Tax Administration*, Presentation to the Services & Enforcement Executive Steering Committee (Jan. 8, 2015).
- 22 For a more detailed discussion of the Public Forums, see National Taxpayer Advocate FY 2017 Objectives Report to Congress 1-52 (Preface: *National Taxpayer Advocate's Introductory Remarks, Including an Update on the National Taxpayer Advocate Public Forums on Taxpayer Needs and Preferences*).
- 23 For details on the National Taxpayer Advocate Public Forums on Taxpayer Service Needs and Preferences, including submitted written statements from panelists as well as full transcripts of the forums, see <https://taxpayeradvocate.irs.gov/public-forums> (last visited Apr. 20, 2017).
- 24 See Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*; See National Taxpayer Advocate 2016 Annual Report to Congress, vol. 2, at 1-30 (Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*).

survey results detailed below show that a significant percentage of taxpayers may not be able to access the internet or do not feel skilled at conducting research on the interest.

The survey has shown that approximately 41 million U.S. taxpayers have no broadband access at all in their homes.<sup>25</sup> Taxpayers with internet service connections slower than broadband will likely experience delays when attempting to access large files or complex web pages — including [irs.gov](http://irs.gov) which has over 135,000 web pages.<sup>26</sup> Vulnerable populations, including low income taxpayers, elderly taxpayers, and taxpayers with disabilities, are especially impacted by this issue, as illustrated in the chart below:

**FIGURE 1.3.1, No Broadband Access by Demographic Group**<sup>27</sup>

Taxpayer Population	Estimated Percentage
Not Low Income	21.8%
Low Income	35.5%
Senior	41.7%
Disabled	31.2%

In addition, almost 14 million U.S. taxpayers have no internet access at all at home, most significantly an issue in the vulnerable populations.<sup>28</sup>

As illustrated below, the vulnerable populations also feel less skilled conducting internet research.

**FIGURE 1.3.2, Percentage of Survey Respondents Who Disagreed with the Statement “I am skilled at doing research on the Internet.”**<sup>29</sup>

Taxpayer Population	Estimated Percentage
Not Low Income	7.0%
Low Income	14.1%
Senior	22.9%
Disabled	17.8%

Further, the study confirmed that the web is suitable for certain types of service needs. For example, the survey showed that taxpayers were more likely to be satisfied using the web channel to obtain a form than any of the other channels. In fact, 76 percent of respondents indicated that they used the web as the first channel to obtain a form or publication. In addition, approximately 42 percent of respondents

25 See Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra* (95 percent confidence level).

26 IRS response to TAS fact check (Dec. 19, 2017). Prior to the recent [irs.gov](http://irs.gov) launch, organizations across the agency conducted a content cleanup effort in to reduce redundant, inaccurate, or outdated content on the website. IRS.gov now has a total of over 140,000 web pages, static files (e.g., PDFs), and other content items.

27 See Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra* (95 percent confidence level).

28 See National Taxpayer Advocate 2016 Annual Report to Congress, vol. 2, 1-30 (Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*).

29 Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra* (95 percent confidence level).

used the web as their first channel (compared to 37 percent using the phone) to obtain information about an IRS notice or letter. The IRS should review the results of this survey to understand the service needs and preferences of taxpayers before they make any long term strategic decisions on taxpayer services.<sup>30</sup>

In addition to the above-noted research, the IRS, in collaboration with the TAS, should undertake a comprehensive study of taxpayer needs and preferences by taxpayer segment, using surveys (telephone, online, and mail), focus groups, town halls, public forums, and research studies. These initiatives should be designed to determine taxpayer needs and preferences, and not be biased by the IRS's own desired direction.

### Secure Access e-Authentication Is a Critical Fraud Prevention Measure, but the 30 Percent Verification Rate Proves it Creates a Barrier to Entry for All Taxpayer Populations, Not Just the Elderly and Low Income

To gain access to the online account application, taxpayers are required to pass a multi-factor e-authentication process, called Secure Access.<sup>31</sup> For calendar year 2017 through September 30 (before the IRS suspended Secure Access due to the Equifax breach, discussed below), only about 30 percent of the taxpayers who attempted to verify their identity through Secure Access in order to use the online account were able to do so.<sup>32</sup>

While it is crucial to protect the integrity of taxpayer data, Secure Access e-authentication creates a barrier to access during normal operation of the program. We are not suggesting that the IRS reduce its security protections. To the contrary, we believe protecting the security of taxpayer information is absolutely essential. The IRS must recognize that providing necessary security has implications for how many taxpayers will be able to access online accounts and how many will need to use other service channels, such as telephones or taxpayer assistance centers (TACs).

The IRS suspended Secure Access in mid-October until early December due to the data breach at Equifax, the company contracted by the IRS to verify taxpayers' identities for the program. This suspension impacted several online applications, including the online account, the TDC Secure Messaging system, Get Transcript, Identity Protection Personal Identification Number (IP PIN) issuance, and e-services for practitioners. For the online account program and TDC pilot, existing account holders were not impacted, but the suspension of Secure Access prevented new users from creating accounts.<sup>33</sup> This is clearly disruptive at best, but it may also drive taxpayers away from IRS online applications if they fear that their confidential information is in jeopardy of being hacked.

30 Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra* (95 percent confidence level).

31 For more details about the multi-factor e-authentication requirements, see National Taxpayer Advocate 2016 Annual Report to Congress 121-37 (Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical as the IRS Develops an Online Taxpayer Account System*).

32 IRS response to TAS fact check (Dec. 19, 2017); IRS response to TAS information request (Nov. 22, 2017). The verification rate drops to 27 percent when excluding those taxpayers who opted to receive an activation code by mail rather than by mobile phone. The mail option is particularly relevant to taxpayers who have pay-as-you-go mobile phones or a business/family plan mobile phone not associated with the taxpayer's name. See IRS, *Secure Access: How to Register for Certain Online Self-Help Tools*, <https://www.irs.gov/individuals/secure-access-how-to-register-for-certain-online-self-help-tools> (last visited Nov. 26, 2017).

33 Steven Overly, *IRS Temporarily Suspends Contract with Equifax*, POLITICO (Oct. 12, 2017).

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Before the Equifax data breach, taxpayers were already apprehensive about sharing their personal financial information over the internet. Specifically, in TAS's 2016 and 2017 survey on Taxpayers' Varying Abilities and Attitudes, approximately 50 percent disagreed with the statement "I feel secure sharing personal financial information over the Internet."

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Before the Equifax data breach, taxpayers were already apprehensive about sharing their personal financial information over the internet. Specifically, in TAS's 2016 and 2017 survey on Taxpayers' Varying Abilities and Attitudes, approximately 50 percent disagreed with the statement "I feel secure sharing personal financial information over the Internet."<sup>34</sup> This episode likely increased the apprehension found by the TAS survey. It also solidifies the need to fully staff other service channels, because if one service channel is unexpectedly suspended, the users of the suspended channel should have other options to communicate with the IRS.

### The Low Participation Rates of the TDC Pilot Conducted by Several IRS Organizations Illustrate the Need to Maintain and Improve Traditional Service Channels

Several organizations within the IRS, including Small Business/Self Employed (SB/SE) Exam, Large Business and International (LB&I), and TAS, conducted a pilot of the TDC Secure Messaging system beginning as early as December 2016.<sup>35</sup> The SB/SE and TAS pilots used the same e-authentication requirements as the online account, Secure Access.<sup>36</sup> TDC enables the participating IRS organizations to send and receive electronic webmail, along with certain digital documents (including uploaded scanned or photographed documents), to and from taxpayers through a secure portal. Taxpayers can communicate within the system using computers, smartphones or tablets.<sup>37</sup>

TAS's TDC pilot included unrepresented taxpayers with Earned Income Tax Credit (EITC) or levy cases. Fewer than ten taxpayers opened accounts out of the more than 700 taxpayers who were offered to participate in the pilot. Many pilot participants (both TAS case advocates and taxpayers) noted that the e-authentication requirements were the main reason for not opening an account. They also noted that it was simply easier to fax the information rather than scan and upload. Many taxpayers either deemed the process too burdensome or did not have the necessary information to pass Secure Access.<sup>38</sup>

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34 Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra* (95 percent confidence level).

35 SB/SE Exam began piloting TDC in December 2016 and TAS began the pilot in April 2017. Karen Shiller, SB/SE Commissioner, *Changing the Face of Taxpayer Communication in Exam* (May 2016). TAS is conducting the pilot in the following four offices: Dallas, Nashville, New Orleans, and Cleveland. The TAS pilot only includes unrepresented taxpayers involved in Earned Income Tax Credit (EITC) or levy cases. IRS SERP Alert 17A0048, *Secure Messaging Pilot for SBSE Correspondence Exam (TDC)* (Feb. 6, 2017); IRS SERP Alert 16A0336, *Secure Messaging Pilot for SBSE Correspondence Exam (TDC)* (Dec. 20, 2016); Luca Gattoni-Celli, *IRS Plans to Launch Secure Messaging Pilots for Exams*, TAS, 2017 TNT 24-5, *TAX NOTES TODAY* (Feb. 2, 2017). In August 2017, the Office of Appeals launched a 90-day pilot of a new web-based virtual conference option for taxpayers and their representatives. In late October, Appeals decided to extend the pilot through the end of February 2018. However initial results of the pilot were not available as of the date Appeals responded to the TAS fact check. IRS Office of Appeals response to TAS fact check (Dec. 12, 2017).

36 The LB&I TDC pilot did not include e-authentication requirements because alternate authentication was deemed reliable and less burdensome to the participants. LB&I response to TAS fact check (Dec. 15, 2017).

37 TAS Communications, Stakeholder Liaison, and Online Services *TAS Focus Group Report: Taxpayer Digital Communication (TDC) Pilot* (Nov. 2017).

38 *Id.*

The SB/SE Exam pilot includes taxpayers who claimed itemized deductions, claimed an education credit, and who were selected for a correspondence exam. The pilot uses TDC as an alternative communications channel for correspondence exams where examiners need to receive documents and other explanations from individual filers or their representatives to substantiate filing claims. Preliminary results from the pilot show almost 24 percent of the taxpayers who were sent an invitation to participate in the pilot attempted to create an account (2,194 attempts to create an account out of 9,149 invitations to participate in the pilot). Of the taxpayers who responded at all to the invitation to participate in the pilot, the rate was nearly 48 percent (2,194 attempts to create an account out of the 4,598 taxpayers who responded through any channel).<sup>39</sup> Of those attempts to create an account, less than half (971 out of 2,194) succeeded in opening an account.<sup>40</sup> The top reasons provided for not opening an account were as follows:<sup>41</sup>

- The program was perceived to be too much trouble;
- The taxpayer did not see the stuffer;
- The taxpayer thought the offer was a scam;
- The taxpayer could not pass e-authentication requirements;
- The taxpayer is “too old fashioned” to use the online service; and
- The taxpayer could not access the website.

LB&I’s pilot uses TDC to facilitate fee disputes with pharmaceutical companies resulting from their annual branded prescription drug compliance filings, required under the Affordable Care Act (ACA). Due to the nature of the pilot, the LB&I TDC pilot did not include e-authentication requirements because alternate manual authentication was deemed reliable and less burdensome to the participants.<sup>42</sup> Of the 115 offers to participate in the pilot, about 16 companies opened an account (with 56 total users).

The results of the TDC pilot provide useful information on the ability of taxpayers to participate in the IRS online applications with Secure Access e-authentication requirements. The initial results of the pilots show a low participation rate, which further supports the need for the IRS to maintain high levels of service on traditional service channels such as phone and in-person at the TACs.

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**TAS’s Taxpayer Digital Communication pilot included unrepresented taxpayers with Earned Income Tax Credit or Levy cases. Fewer than ten taxpayers opened accounts out of the more than 700 taxpayers who were offered to participate in the pilot.**

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39 IRS response to TAS fact check (Dec. 19, 2017); SB/SE response to TAS fact check (Dec. 18, 2017).

40 IRS response to TAS information request (Nov. 22, 2017).

41 The SB/SE Exam pilot involved attaching a stuffer to the first page of the initial contact letter. A week later, SB/SE Exam also mailed Letter 5919, reminding taxpayers secure messaging was an option. IRS response to TAS information request (Nov. 22, 2017).

42 IRS response to TAS fact check (Dec. 19, 2017); LB&I response to TAS fact check (Dec. 15, 2017); IRS response to TAS information request (Nov. 22, 2017).

### The IRS Should Explore Establishing a Method for Taxpayers to Electronically Submit Documents or Payments to the IRS Which Involves a Less Rigorous Level of E-authentication

During the TAS TDC pilot, participants raised concerns about the unnecessarily burdensome e-authentication requirements where the taxpayer merely wanted to electronically submit documents.<sup>43</sup> They raised a valid point — When confidential taxpayer information is only flowing *into* the IRS, there is little risk that the IRS will wrongly disclose information.

For example, when a taxpayer is submitting documentation for an audit or providing evidence of economic hardship for TAS, the taxpayer is not receiving information from the IRS. In such circumstances, it seems unnecessarily burdensome to require the user of the online application to pass the strict multi-factor requirements of Secure Access.<sup>44</sup> A taxpayer submitting documentation by mail or fax is not subject to authentication requirements, because the IRS does not disclose confidential tax return information in this one-way inbound communication.

While Secure Access is absolutely essential to protect taxpayer information on many online applications where the user can gain access to confidential tax return information, we do not believe the risk is as high when the taxpayer is submitting information to the IRS, but the IRS does not disclose information to the taxpayer. There is likely a lower risk that an identity thief would take the initiative to submit documents, or especially payments, to the IRS in the taxpayer's name. The IRS should evaluate the feasibility of creating a method to electronically submit documents or payments to the IRS with reduced e-authentication standards. The platform could be the digital equivalent to faxing or mailing documents to the IRS. It is our understanding that the IRS already tested a program with lower e-authentication requirements with the IRS ID.me authentication pilot. The pilot involved potential identity theft victims submitting confidential information online to verify their identity.<sup>45</sup> The third-party vendor performing the verification required significantly less information than the current Secure Access requirements. Unlike Secure Access, the pilot did not request loan account numbers or require the participant to have a text-enabled phone plan associated with the taxpayer's name or address.<sup>46</sup> While the verification rate for the pilot was only approximately 50 percent, it is still significantly higher than the verification rate experienced by Secure Access. We are not recommending that the IRS use the same e-authentication procedure as the ID.me authentication pilot, but we believe it is merely one example of a way the IRS could reduce the burden on taxpayers, especially when the flow of information is one-way, from the taxpayer to the IRS.

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**Since 2005, the National Taxpayer Advocate has recommended that the IRS restrict third party access to online account applications to only those practitioners subject to IRS oversight under Circular 230.**

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43 TAS Communications, Stakeholder Liaison, and Online Services, *TAS Focus Group Report: Taxpayer Digital Communication (TDC) Pilot* (Nov. 2017).

44 For a detailed description of the information required to pass Secure Access requirements, see IRS, *Secure Access: How to Register for Certain Online Self-Help Tools*, <https://www.irs.gov/individuals/secure-access-how-to-register-for-certain-online-self-help-tools> (last visited Dec. 5, 2017).

45 For information about the ID.me pilot, see IRS, *Identity Verification Service*, <https://www.irs.gov/identity-theft-fraud-scams/idverify> (last visited Dec. 20, 2017).

46 A3 Executive Governance Board, *Authentication, Authorization, and Access (A3): Presentation to the A3 EGB*, Slide 7 (Nov. 9, 2017); IRS, *Identity Verification Service*, <https://www.irs.gov/identity-theft-fraud-scams/idverify> (last visited Dec. 20, 2017).

### The IRS Has Failed to Make the Policy Decision to Restrict Third Party Access to Current and Future Online Applications

Before the IRS progresses too much further designing features for existing and future online applications, it must make critical policy decisions regarding third party access to these applications. Since 2005, the National Taxpayer Advocate has recommended that the IRS restrict third party access to online account applications to only those practitioners subject to IRS oversight under Circular 230.<sup>47</sup> Such practitioners include attorneys, certified public accountants, enrolled agents, enrolled actuaries, and enrolled retirement plan agents.<sup>48</sup> In addition, pursuant to Revenue Procedure 2014-42, preparers who have obtained the voluntary Annual Filing Season Program (AFSP) Record of Completion can represent taxpayers before the IRS during an examination of a tax return or claim for refund they prepared.<sup>49</sup> To receive the record of completion, the preparer must consent to be subject to the duties and restrictions relating to practice before the IRS in § 10.51 of Circular 230 for the entire period covered by the record of completion.<sup>50</sup> Therefore, preparers who have the voluntary record of completion are subject to Circular 230. Once the IRS strengthens the testing requirements in the AFSP, the IRS should expand online account access to those preparers who obtain the AFSP record of completion.<sup>51</sup> The IRS can monitor and enforce this requirement, because it has the preparer tax identification numbers (PTINs) for these individuals.

The IRS has not taken any definitive actions to support the restriction of third party access. In fact, when the IRS conducted focus group sessions on Tax Pro during each of the 2017 IRS Nationwide Tax Forums, it did not attempt to limit participation to only Circular 230 practitioners.<sup>52</sup> If the IRS does not make these policy decisions soon, online account development might progress to a point where it would be difficult to undo any launched capabilities that are inconsistent with this very important taxpayer protection. It could also wrongly create expectations of non-Circular 230 professionals if it invites these professionals to test the prototype of the application.

Without instituting safeguards on third party access to the system, the IRS could inadvertently perpetuate preparer misconduct. Uncredentialed preparers could gain access, interact with the IRS on the taxpayer's behalf, and potentially address notices, proposed adjustments, or even proposed correctable errors without the taxpayer's consent or knowledge.<sup>53</sup> Although the vast majority of return preparers are conscientious and ethical, the IRS has ample evidence and experience showing that there

47 See, e.g., National Taxpayer Advocate 2005 Annual Report to Congress 249-59 (Most Serious Problem: *Accessibility of E-Services For Tax Practitioners*).

48 31 U.S.C. § 10.3.

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

50 Rev. Proc. 2014-42, I.R.B. 2014-29 (July 14, 2014).

51 The National Taxpayer Advocate supports providing access to certain preparers, but only if they have satisfied robust minimum competency standards, which include a one-time "entrance" examination to ensure basic competency in return preparation and continuing education courses to ensure preparers keep up to date with the many frequent tax-law changes. The current voluntary Annual Filing Season Program does not satisfy this threshold. For a detailed description of these recommendations, see National Taxpayer Advocate 2016 Annual Report to Congress 121-37 (Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences is Critical as the IRS Develops an Online Taxpayer Account System*); National Taxpayer Advocate 2015 Annual Report to Congress 64-70 (Most Serious Problem: *Preparer Access to Online Accounts: Granting Uncredentialed Preparers Access to an Online Taxpayer Account System Could Create Security Risks and Harm Taxpayers*).

52 IRS response to TAS information request (Nov. 22, 2017).

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

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Without instituting safeguards on third party access to the system, the IRS could inadvertently perpetuate preparer misconduct. Uncredentialed preparers could gain access, interact with the IRS on the taxpayer's behalf, and potentially address notices, proposed adjustments, or even proposed correctable errors without the taxpayer's consent or knowledge.

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is a subset of return preparers who are negligent or commit refund fraud.<sup>54</sup> We received overwhelming support for this recommended restriction at the 2016 National Taxpayer Advocate Public Forums conducted around the country.<sup>55</sup>

## CONCLUSION

The National Taxpayer Advocate believes that the IRS online account application is an essential addition to a omnichannel service delivery approach. The application benefits those taxpayers and representatives who have the ability to access the program and who prefer this service channel. However, not all taxpayers have the ability to access the program due to various reasons, including lack of broadband access, inability to pass the strict multi-factor e-authentication requirements, or simply that their service need is complicated and they need to understand how the rules apply to their particular facts and circumstances. Accordingly, the IRS should continue to provide personalized services to taxpayers. Finally, the IRS should restrict third party access to such application to those practitioners who are subject to IRS oversight pursuant to Circular 230.

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54 The National Taxpayer Advocate's 2014 Annual Report to Congress: *Hearing Before the H.R. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 114th Cong. 18-20 (Apr. 15, 2015) (written testimony of Nina E. Olson, National Taxpayer Advocate); See National Taxpayer Advocate 2014 Annual Report to Congress 543-44; 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 Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined from Continuing its Efforts to Effectively Regulate Return Preparers*).

55 For details on the National Taxpayer Advocate Public Forums on Taxpayer Service Needs and Preferences, including submitted written statements from panelists as well as full transcripts of the forums, see <https://taxpayeradvocate.irs.gov/public-forums> (last visited Mar. 30, 2017).



## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Maintain an omnichannel approach to taxpayer service delivery to meet the needs and preferences of taxpayers and representatives who either cannot or prefer not to use the online account application for their particular interaction with the agency.
2. The Commissioner of Wage & Investment, the Director of Online Services, and the National Taxpayer Advocate should jointly undertake a collaborative and comprehensive study of taxpayer needs and preferences by taxpayer segment, using surveys (telephone, online, and mail), focus groups, town halls, public forums, and research studies (including TAS research studies and literature reviews). These initiatives should be designed to determine taxpayer needs and preferences, and not be biased by the IRS's own desired direction. This study should contain recommendations jointly agreed to by the principals for a comprehensive 21st century taxpayer service strategy.
3. Explore establishing a method for taxpayers to electronically submit documents or payments to the IRS which involves a less rigorous level of e-authentication.
4. Restrict third party access to those practitioners subject to Circular 230 oversight. Once the IRS strengthens the AFSP examination requirements, the IRS should permit ASFP Record of Completion holders to gain access to the application.
5. Upgrade phone technology to the 21st century, including call-backs.<sup>56</sup>

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<sup>56</sup> See Most Serious Problem: *Telephones: The IRS Needs to Modernize the Way It Serves Taxpayers Over the Telephone, Which Should Become an Essential Part of an Omnichannel Customer Service Environment*, *supra*.

**MSP  
#4****AUDIT RATES: The IRS Is Conducting Significant Types and Amounts of Compliance Activities That It Does Not Deem to Be Traditional Audits, Thereby Underreporting the Extent of Its Compliance Activity and Return on Investment, and Circumventing Taxpayer Protections****RESPONSIBLE OFFICIALS**

Kirsten Wielobob, Deputy Commissioner, Services and Enforcement

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Doug O'Donnell, Commissioner, Large Business and International Division

Sunita Lough, Commissioner, Tax Exempt and Government Entities Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

<sup>1</sup> See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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, Div. Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

## DEFINITION OF PROBLEM

The National Taxpayer Advocate has previously written about the issue of “real” vs “unreal” audits.<sup>2</sup> Under Internal Revenue Code (IRC) § 7602(a)(1), the IRS has the authority to examine any books, papers, records, or other data that may be relevant to ascertain the correctness of any return.<sup>3</sup> This type of examination can be referred to as a traditional or “real” audit. However, the IRS interprets this IRC provision narrowly and takes the position that a host of taxpayer compliance contacts through programs and procedures such as math error corrections, Automated Underreporter (AUR), identity and wage verification, and Automated Substitute for Return (ASFR) are not classified as “real” audits.<sup>4</sup> Yet these contacts, or “unreal” audits, where taxpayers must provide documentation or information to the IRS, comprise the majority of compliance contacts and eclipse “real” audit figures.<sup>5</sup> And to taxpayers, these “unreal” audits may feel very much like a “real” examination, in particular a correspondence examination.<sup>6</sup> This distinction between “real” and “unreal” audits has real-world consequences that impact taxpayer rights, including *the right to challenge the IRS’s position and be heard, the right to appeal an IRS decision in an independent forum, the right to finality, and the right to a fair and just tax system.*

2 See National Taxpayer Advocate 2016 Annual Report to Congress 27-29 (Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*); National Taxpayer Advocate 2011 Annual Report to Congress 24 (Introduction to Revenue Protection Issues: *As the IRS Relies More Heavily on Automation to Strengthen Enforcement, There is Increased Risk It Will Assume Taxpayers Are Cheating, Confuse Taxpayers About Their Rights, and Sidestep Longstanding Taxpayer Protections*); Nina Olson, *What’s an Audit, Anyway?*, NATIONAL TAXPAYER ADVOCATE BLOG (Jan. 25, 2012), <https://taxpayeradvocate.irs.gov/news/what’s-an-audit-anyway>. In its response to our standard request that the IRS verify the data cited in this discussion, the IRS objected to our use of the terms “real audits” and “unreal audits” and requested that we not use them. Its response stated:

An audit is defined per the Code as an examination of books and records, and is subject to limitations (*i.e.*, only one inspection of a taxpayer’s books shall be made each taxable year — unless there is evidence of fraud, malfeasance, etc. [See IRC §] 7605(b), Policy Statement P-4-3). Other contacts with a taxpayer (*e.g.*, to verify or adjust a discrepancy between the taxpayer’s return and third-party information returns) do not meet the definition of an inspection of the books and records within the meaning of [section] 7605(b) of the Code. Taxpayers may not always make such a distinction. However, the IRS must follow the law and properly distinguish an audit versus a contact. *The terms “real” and “unreal” are inaccurate, misleading and a mischaracterization of IRS’ interactions with taxpayers* [emphasis added].

The National Taxpayer Advocate disagrees and believes the use of the terms “real audits” and “unreal audits” are appropriate for purposes of this discussion. As the IRS notes, taxpayers generally do not make a distinction. Receipt of a notice stating that the IRS will increase the taxpayer’s liability unless the taxpayer responds and provides acceptable documentation to support his or her return position feels like an audit, regardless of whether it is technically an audit within the definition of IRC § 7605(b), a math-error adjustment, or a document-matching adjustment made by the IRS’s Automated Underreporter (AUR) program. Moreover, as this Most Serious Problem demonstrates, the National Taxpayer Advocate believes the IRS’s reporting of statistics, which focus heavily on the audit rate, understates the true level of IRS compliance activity, which includes “real” and “unreal” audits.

3 See Most Litigated Issue: *Summons Enforcement Under IRC §§ 7602, 7604, 7609, infra.*

4 See Rev. Proc. 2005-32, § 4.03, 2005-23 I.R.B. 1206.

5 See National Taxpayer Advocate 2016 Annual Report to Congress 27-28 (Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*). In addition to the “unreal” audits mentioned here, other IRS functions may conduct work that may be similar to an “unreal” audit. For example, in addition to “real” examinations, the Tax Exempt and Government Entities (TE/GE) Exempt Organizations function conducts compliance checks “to determine whether an organization (*i.e.*, taxpayer) is adhering to recordkeeping and information reporting requirements.” When TE/GE conducts a compliance check, the taxpayer is contacted and may be asked to submit information. Although the taxpayer is not required to respond to a compliance check, TE/GE may ultimately select the case (whether the taxpayer responds or not) for a “real” audit where appeal rights would be available. However, to the taxpayer, the pre-audit compliance contact may feel very similar to an audit in that the IRS is contacting them regarding information filed on a form or return. See IRS, *Tax Exempt and Government Entities FY 2018 Work Plan 8* (Sept. 28, 2017), [https://www.irs.gov/pub/irs-tege/tege\\_fy2018\\_work\\_plan.pdf](https://www.irs.gov/pub/irs-tege/tege_fy2018_work_plan.pdf); IRS, *Tax Exempt and Government Entities Business Performance Review FY 2017: Second Quarter 17*; See also IRS Pub. 4386, *Compliance Checks: Examination, Audit or Compliance Check?* (Apr. 2006); Internal Revenue Manual (IRM) 4.75.9.2.2, *Compliance Check Workstreams* (Aug. 9, 2016).

6 See, *e.g.*, *Effectively Representing Your Client Before the IRS: A Practical Manual for the Tax Practitioner with Sample Correspondence and Forms 3-9* (Keith Fogg ed., 2015) (noting that “to millions of taxpayers, receipt of a notice from one of the Service’s information-matching return programs feels very much like an examination or investigation”). A description of the three different types of IRS examinations is provided below.

The IRS’s “Future State” Initiative calls for the increased use of these types of “unreal” audit programs, which will undoubtedly impact many more taxpayers.<sup>7</sup> It is therefore crucial for the IRS to reevaluate and revise its current guidance about what constitutes an audit, through the lens of the Taxpayer Bill of Rights.

The National Taxpayer Advocate is concerned that the narrow definition of “real” audits:

- Causes the IRS to publicly report misleading information. For instance, the IRS only reports “real” audit statistics, which skews the audit rate and understates the IRS’s actual level of compliance contacts with taxpayers. It also causes the IRS to not completely and accurately report its return on investment (ROI) for compliance activities, as the IRS does not include all “unreal” audit programs in its ROI calculations;
- Limits a taxpayer’s ability to appeal to the IRS Office of Appeals (“Appeals”), as a taxpayer who disagrees with an “unreal” audit’s proposed assessment generally receives a statutory notice of deficiency, without the opportunity to seek an administrative review with Appeals to resolve the issue; and
- Circumvents statutory taxpayer protections from unnecessary audits as, under the IRS’s current position, taxpayers that are subjected to an “unreal” audit may face a “real” audit and other “unreal” audits at a later time.<sup>8</sup>

## ANALYSIS OF PROBLEM

### Background

#### *Traditional or “Real” Audits*

As noted above, under IRC § 7602(a)(1) the IRS has the authority to examine any books, papers, records, or other data that may be relevant to ascertain the correctness of any return.<sup>9</sup> The IRS conducts three types of traditional examinations or “real” audits: correspondence, field, and office.<sup>10</sup> A correspondence exam is conducted by mail for a single tax year and generally involves no more than a few issues that the IRS believes can be resolved by producing documents.<sup>11</sup> A field exam deals with more complex issues and involves a face-to-face meeting between the taxpayer and an IRS revenue agent, at the taxpayer’s home or place of business.<sup>12</sup> Finally, an office audit is conducted at a local IRS office

7 See, e.g., IRS, *Exploring the IRS Future State: Balancing Taxpayer Needs with IRS Budget and Resource Constraints*, adapted from ABA National Institute on Tax Controversy, Las Vegas, NV 16 (Dec. 9, 2016), [https://www.irs.gov/pub/newsroom/future\\_state\\_aba.pdf](https://www.irs.gov/pub/newsroom/future_state_aba.pdf) (noting that one of the focus areas of Small Business/Self Employed (SB/SE) and Wage & Investment (W&I) is issue identification and filing resolution to “maximize prerefund automatic issue identification and self-correction”).

8 See IRC §7605(b). This section provides “no taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer’s books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.”

9 See Most Litigated Issue: *Summons Enforcement Under IRC §§ 7602, 7604, 7609, infra*.

10 Part 4 of the IRM discusses the IRS’s examination process. For a good discussion of the different types of IRS examinations, see *Effectively Representing Your Client Before the IRS: A Practical Manual for the Tax Practitioner with Sample Correspondence and Forms 3-9, 10* (Keith Fogg ed., 2015). See also National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 71 (discussing the differences between field and correspondence audits).

11 See National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 71 (discussing the differences between field and correspondence audits).

12 See IRM 4.10.3.3.2, *Where to Conduct Interviews* (Feb. 26, 2016).

and generally involves issues that are more complex than those found in correspondence exams but less complex than field ones.<sup>13</sup>

Typically, in the “real” audit context, before issuing a statutory notice of deficiency, which enables a taxpayer to petition the Tax Court, the IRS will issue a 30-day letter to the taxpayer offering the opportunity to request an administrative appeal with IRS Appeals.<sup>14</sup> In addition, under IRC § 7605(b), taxpayers are protected from unnecessary examinations and the IRS is generally allowed to conduct only one inspection of a taxpayer’s books of account for each taxable year.<sup>15</sup>

### *Other Compliance Contacts or “Unreal” Audits*

The IRS also conducts a host of other compliance contacts with taxpayers, which can be categorized as “unreal” audits, and often solely rely on matching third-party documentation against the taxpayer’s return.<sup>16</sup> These contacts include:

- **Math or Clerical Error** – Congress has given the IRS authority to circumvent normal deficiency procedures in certain circumstances. IRC § 6213(b) authorizes the IRS to make a summary assessment of tax due where that addition is the result of a mathematical or clerical error on a return. To make this summary assessment, the IRS must explain the error to the taxpayer.<sup>17</sup> The taxpayer has 60 days from the date of the notice to request that the IRS abate the tax.<sup>18</sup> The IRS cannot begin to collect the tax due until the taxpayer has agreed to it or until the 60 days have passed.<sup>19</sup> If the taxpayer requests the tax be abated, the IRS must first use the deficiency procedures under IRC § 6212 to increase the tax shown on the return.<sup>20</sup> It is also the only way for the taxpayer to preserve the right to challenge the adjustment in the Tax Court — the only prepayment judicial forum.<sup>21</sup>

13 See IRM 4.10.3.3.2, *Where to Conduct Interviews* (Feb. 26, 2016).

14 See IRS Publication 3498-A, *The Examination Process (Audits by Mail)* (Jan. 2014), available at <http://www.irs.gov/pub/irs-pdf/p3498a.pdf>. For times for requesting appeals conferences, see IRM 4.19.13.14.2, *Transfer to Appeals* (Jan. 1, 2016).

15 IRC § 7605(b) provides “no taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer’s books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.” See also Treas. Reg. § 601.105(j) (limiting the IRS’s ability to reopen a case closed after examination to situations such those where there is evidence of fraud).

16 In the case of an information return that turned out to be inaccurate, courts have held that “the Commissioner would not be able to choose to rely solely upon the naked assertion that the taxpayer received a certain amount of unreported income for the tax period in question.” See *Portillo v. Comm’r*, 932 F.2d 1128 (5th Cir. 1991).

17 IRC § 6213(b)(1).

18 IRC § 6213(b)(2)(A).

19 IRC § 6213(b)(2)(B).

20 IRC § 6213(b)(2)(A).

21 IRC § 6213(b)(1). For a discussion of the National Taxpayer Advocate’s concerns regarding the IRS’s math error authority, see National Taxpayer Advocate 2015 Annual Report to Congress 329-39 (Legislative Recommendation: *Math Error Authority: Authorize the IRS to Summarily Assess Math and “Correctable” Errors Only in Appropriate Circumstances*); National Taxpayer Advocate 2014 Annual Report to Congress, 163-71 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 116-20 (*Math Errors Committed on Individual Tax Returns – A Review of Math Errors Issued on Claimed Dependents*). See also, Nina E. Olson, *Why Correctible Error Authority Raises Significant Taxpayer Rights Concerns – Part 1*, NATIONAL TAXPAYER ADVOCATE BLOG (Aug. 9, 2017), <https://taxpayeradvocate.irs.gov/news/why-correctible-authority-error-raises-significant-taxpayer-rights-concerns-part-1>; Nina Olson, *Correctible Error Authority Part 2: Why Correctible Error Authority Creates More Problems Than It Resolves*, NATIONAL TAXPAYER ADVOCATE BLOG (Aug. 16, 2017), <https://taxpayeradvocate.irs.gov/news/correctible-error-authority-part-2-why-correctible-error-authority-creates-more-problems-than-it-resolves>; Nathan J. Richman, *Expanding Math Error Authority Could Worsen Two Tax Systems Issues*, TAX NOTES TODAY (July 5, 2017).

- **Automated Underreporter (AUR)** – The IRS’s AUR program uses third party (*e.g.*, employers, banks, or brokers) documents submitted to the IRS. The IRS matches amounts reported on tax returns with the information returns.<sup>22</sup> This computer matching begins after the original return due date and is not a real-time process. The IRS will send the taxpayer a notice either notifying them of this adjustment or requesting additional information. If the taxpayer does not respond to these notices, the IRS will issue a statutory notice of deficiency.<sup>23</sup>
- **IRS Programs Used to Stop Identity Theft and Refund Fraud**<sup>24</sup> – The return integrity program, a process critical to the IRS’s strategy to address identity theft and detect and prevent improper fraudulent refunds, is complex and multifaceted.<sup>25</sup> The Return Integrity & Compliance Services (RICS) Return Integrity Operations (RIO) — a part of the Wage & Investment (W&I) Division — uses filters, rules, data mining models, and manual reviews to identify potentially false returns, usually through wages or withholding reported on the returns, to stop fraudulent refunds before the IRS issues them.<sup>26</sup> If one of these systems flags a return as potentially fraudulent, the return goes through the Taxpayer Protection Program (TPP), which verifies the identity of the taxpayer, and/or the Income Wage Verification (IWV) program, which verifies that the taxpayer’s wages and withholding are accurate, for further scrutiny.<sup>27</sup>
- **Automated Substitute for Return (ASFR)** – ASFR is an IRS program for enforcing filing compliance by taxpayers who have not filed individual tax returns, but have incurred a “significant” tax liability.<sup>28</sup> The program estimates the liability by computing tax, penalties, and interest based upon information reported to the IRS by third parties.<sup>29</sup> When a taxpayer with reported income is delinquent in filing a return, the IRS attempts to secure the return through correspondence. If the attempt is unsuccessful, the IRS is authorized by IRC § 6020(b) to

22 Some of the third-party forms used to match taxpayer data include Forms W-2 and Forms 1099 for miscellaneous, brokerage, interest, dividend, and cancellation of debt income.

23 IRM 4.19.2.2, *Overview* (Oct. 4, 2016).

24 For more information about these programs, see Most Serious Problem: *Fraud Detection: The IRS Has Made Improvements to Its Fraud Detection Systems, But a Significant Number of Legitimate Taxpayers Are Still Being Improperly Selected By These Systems, Resulting in Refund Delays*, *infra*; Most Serious Problem: *Identity Theft: As Tax-Related Identity Theft Schemes Evolve, the IRS Must Continually Assess and Modify Its Victim Assistance Procedures*, *infra*.

25 IRM 25.25.1.1, *Program Scope and Objectives* (Oct. 4, 2017).

26 IRM 25.25.6.1, *Program Scope and Objectives* (July 14, 2017). See also IRM 25.25.2.1(1), *Purpose and Program Goals* (Mar. 29, 2017). The IRS electronically screens tax returns using three independent systems: the Dependent Database (DDb), the Return Review Program (RRP), and the Electronic Fraud Detection System (EFDS).

27 See Most Serious Problem: *Fraud Detection: The IRS Has Made Improvements to Its Fraud Detection Systems, But a Significant Number of Legitimate Taxpayers Are Still Being Improperly Selected By These Systems, Resulting in Refund Delays*, *infra*; National Taxpayer Advocate 2016 Annual Report to Congress, 149-60, (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*). See also National Taxpayer Advocate 2015 Annual Report to Congress, 45-55, 180-87; National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 44-90; National Taxpayer Advocate 2013 Annual Report to Congress 75-83; National Taxpayer Advocate 2012 Annual Report to Congress 42-67, 95-110; National Taxpayer Advocate 2011 Annual Report to Congress 48-73; National Taxpayer Advocate 2009 Annual Report to Congress 307-17; National Taxpayer Advocate 2008 Annual Report to Congress 79-94; National Taxpayer Advocate 2007 Annual Report to Congress 96-115; National Taxpayer Advocate 2005 Annual Report to Congress 25-54, 180-91; National Taxpayer Advocate 2004 Annual Report to Congress 133-36; and National Taxpayer Advocate 2003 Annual Report to Congress 175-81.

28 IRM 5.18.1.2, *Automated Substitute for Return (ASFR) Program Overview* (Apr. 6, 2016). To meet ASFR processing criteria, the proposed tax liability must meet or exceed a predetermined dollar threshold established by the IRS for the ASFR program.

29 *Id.* The IRS can use information returns (*e.g.*, Forms W-2 and 1099) filed by employers, banks, and other third parties to report various types of payments to individuals. These payments include wages, interest, and dividends, as well as payments to self-employed taxpayers for services rendered. The IRS collects and maintains this information through the Information Return Program (IRP).

prepare a substitute return for the taxpayer.<sup>30</sup> However, due to resource constraints, the IRS has significantly reduced its usage of the ASFR program.<sup>31</sup>

Although “unreal” audits may feel much like “real” audits to taxpayers, they do not carry the same protections as “real” ones. In the “unreal” audit context, taxpayers generally do not have the opportunity to seek administrative review with Appeals prior to the IRS issuing a statutory notice of deficiency.<sup>32</sup> For math error notices, taxpayers must respond within 60 days and request an abatement of the tax or the IRS can summarily assess the tax without resorting to deficiency procedures.<sup>33</sup>

In addition, “unreal” audits do not carry the same IRC § 7605(b) protections against repeat examinations as “real” audits. Although Treasury regulations provide only one example of an inspection of a taxpayer’s books and records that is not an examination within the meaning of IRC §7605(b),<sup>34</sup> the IRS takes a more expansive view. In Revenue Procedure 2005-32, the IRS lists four broad categories of taxpayer contacts or other actions that it does not consider to be examinations and inspections.<sup>35</sup> Explicitly included in these categories are math error, AUR, and ASFR “unreal” audit contacts.<sup>36</sup> Therefore, a taxpayer subject to an “unreal” audit may be subject to a “real” audit at a later time.

The National Taxpayer Advocate has previously noted in the Affordable Care Act (ACA) context how there may be virtually no distinction between how the IRS conducts an “unreal” versus a “real” audit. For example, when the IRS notices information reported by the Marketplace regarding a taxpayer’s Advanced Premium Tax Credit (APTC) does not match information regarding the credit on the taxpayer’s return, or the APTC was not reconciled on Form 8962, *Premium Tax Credit (PTC)*, the IRS will delay processing of the return and issue Letter 12C requesting a corrected Form 8962, or Form 1095-A, *Health Insurance Marketplace Statement*, to support the credit and reconcile the APTC. Depending on the type of PTC discrepancy, the IRS refers the return either to Examination to work as a traditional audit or to the Automated Questionable Credit (AQC) program for a similar “audit” process. If referred to AQC, Letter 4800C, *Questionable Credit 30 Day Contact Letter*, which proposes an adjustment and requests Form 1095-A, will be sent to the taxpayer. The letter states, “This is not an audit. Your return may be examined in the future;” however, the AQC process and the documentation

30 IRC § 6020(b) provides: “(b) Execution of return by Secretary. — (1) Authority of Secretary to execute return. — If any person fails to make any return required by any internal revenue law or regulation made thereunder at the time prescribed therefor, or makes, willfully or otherwise, a false or fraudulent return, the Secretary shall make such return from his own knowledge and from such information as he can obtain through testimony or otherwise. (2) Status of returns. — Any return so made and subscribed by the Secretary shall be prima facie good and sufficient for all legal purposes.” IRM 5.18.1.1.2, Authority (Dec. 13, 2017).

31 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2017-30-078, *A Significantly Reduced Automated Substitute for Return Program Negatively Affected Collection and Filing Compliance* (Sept. 2017); The reduction in ASFR cases can be seen in Figures 1.4.1, 1.4.2, and 1.4.3 below. See also National Taxpayer Advocate 2015 Annual Report to Congress 188-95 (Most Serious Problem: *Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*).

32 As described below, in an AUR case, if a taxpayer makes a request for Appeals review with less than 365 days left in the period of limitations on assessment then this request will be denied. However, if there are more than 365 days left in the period of limitations on assessment, a taxpayer may request Appeals review an AUR case. However, it appears that taxpayers are not formally informed of this Appeals opportunity but would have to affirmatively make such a request. See IRM 4.19.3.21.1.8(1), *Appeals* (Aug. 22, 2017). This approach violates both the *right to be informed* and the *right to appeal an IRS decision in an independent forum*.

33 See IRC § 6213(b).

34 See Treas. Reg. § 301.7605-1(h) (providing that certain withholding agreements between the IRS and alien individuals are not examinations).

35 Rev. Proc. 2005-32, § 4.03, 2005-23 I.R.B. 1206.

36 See also IRS Chief Counsel Memorandum, *ASFR Questions Involving Subsequently Filed Delinquent Original Returns* (Mar. 29, 2005) (providing that IRS preparation of an ASFR is not considered an examination).

requirements imposed on the taxpayers under AQC are substantially similar to those in an examination. In fact, both the AQC and Exam request similar documentation for PTC verification.<sup>37</sup> Thus, there are situations where the IRS is essentially conducting a “real” audit under the guise of an “unreal” audit, thereby circumventing statutory protections against repeat examinations.

### **By Narrowly Defining “Real” Audits, the IRS Is Publicly Reporting Misleading Information Regarding Its Compliance Contacts With Taxpayers and Return on Investment**

#### *The IRS Does Not Include Unreal Audits in its Published Audit Rate Statistics*

The IRS’s classification system, which distinguishes between “real” and “unreal” audits, results in the IRS publicly reporting misleading information regarding the extent of its compliance contacts with taxpayers. The IRS, in its annually-released Data Book, publishes a variety of statistics regarding its enforcement efforts, including examinations.<sup>38</sup> These Data Book figures show a consistent decline in the IRS’s audit rate over the last several years, which has been noted by the press and others.<sup>39</sup> However, the IRS’s audit rate figures only take into account “real” audits. Other compliance contacts, or “unreal” audits, are not included in the IRS’s audit calculations.<sup>40</sup>

As shown in the Figures 1.4.1, 1.4.2, and 1.4.3, TAS performed an analysis of both “real” and “unreal” IRS audits of individuals for fiscal years (FYs) 2014 through 2016.

37 National Taxpayer Advocate 2015 Annual Report to Congress 173-76 (Most Serious Problem: *Affordable Care Act (ACA) – Individuals: The IRS Is Compromising Taxpayer Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions*); Automated Questionable Credit (AQC) requests “documentation proving premium payments, copies of insurance enrollment forms, invoices, or statements from the insurance providers that include the names of those covered by the benefits.” Exam requests “copies of insurance enrollment forms, invoices, or statements from your insurance providers.”

38 See, e.g., IRS Data Book 2016.

39 See, e.g., Kevin McCoy, *Your Odds of Facing an IRS Audit Are 1-in-143*, U.S.A. TODAY, (Mar. 6, 2017) <https://www.usatoday.com/story/money/2017/03/06/your-odds-facing-irs-audit-1-143/98808612/> (noting that IRS audit rates fell to a 14-year low in 2016); TIGTA, Ref. No. 2017-30-072, *Trends in Compliance Activities Through Fiscal Year 2016* 51 (Sept. 2017) (showing a decline in the audit rate for individual and business tax returns between fiscal years 2012 and 2016); See also IRS, *Prepared Remarks of John A. Koskinen Before the National Press Club* (Apr. 5, 2017) (Then Commissioner Koskinen noted the decline in the IRS’s audit rate and stated, “Last year, we audited about 1 million people. That may sound like a lot, but it’s less than one percent of individual returns filed. It’s also the lowest number of audits in more than a decade.”), <https://www.irs.gov/newsroom/prepared-remarks-of-john-a-koskinen-before-the-national-press-club-washington-dc-april-5-2017>.

40 See TIGTA, Ref. No. 2017-30-072, *Trends in Compliance Activities Through Fiscal Year 2016* 18 (Sept. 2017) (noting that “In addition to correspondence and face-to-face examinations, the IRS also uses several computer-matching and automated error-checking programs to verify the accuracy of tax returns. These routines often identify and recommend adjustments to tax liabilities. However, these adjustments are not included in the traditional examination coverage calculations and are not reported separately as enforcement efforts.”). In its Data Book, the IRS does provide some limited information regarding its AUR, ASFR, and math error programs. However, as noted, these programs are not included in the IRS’s audit rate calculations. See IRS Data Book 2016 at 35.



**FIGURE 1.4.1, Real vs. Unreal Audits: FY 2014 Occurrences Compared to Returns Filed in Calendar Year 2013<sup>41</sup>**

Adjusted Gross Income Category	FY 2014 Exams	Exam (Audit) Coverage Rate %	FY 2014 ASFR	FY 2014 AUR	FY 2014 Math Error	FY 2014 Taxpayer Protection Program	FY 2014 Wage Verification	Combined	Calendar Year 2013 Returns	Combined Coverage Rate %
No adjusted gross income	263,615	10.4%	190,941	13,559	33,549	127,291	251,440	837,579	2,534,533	33.0%
\$1 under \$25,000	458,310	0.8%		954,859	759,140	376,372	601,495	2,995,755	55,591,101	5.4%
\$25,000 under \$50,000	162,455	0.5%		1,109,790	505,006	88,941	200,301	2,017,617	33,478,934	6.0%
\$50,000 under \$75,000	92,650	0.5%		569,566	291,884	41,692	69,748	1,044,793	18,918,026	5.5%
\$75,000 under \$100,000	58,286	0.5%		359,315	181,699	22,884	34,423	645,930	12,052,040	5.4%
<b>Subtotal - under \$100,000</b>	<b>1,035,316</b>	<b>0.8%</b>	<b>190,941</b>	<b>3,007,089</b>	<b>1,771,278</b>	<b>657,180</b>	<b>1,157,407</b>	<b>7,541,674</b>	<b>122,574,634</b>	<b>6.2%</b>
\$100,000 under \$200,000	92,649	0.6%		603,650	238,184	29,927	52,980	1,003,331	15,449,869	6.5%
\$200,000 under \$500,000	64,930	1.6%		206,282	47,485	11,962	44,701	369,257	4,147,849	8.9%
\$500,000 under \$1,000,000	22,439	3.2%		38,965	6,562	3,087	26,054	95,399	697,262	13.7%
\$1,000,000 under \$5,000,000	18,937	5.5%		18,429	3,270	1,389	26,662	67,428	345,656	19.5%
\$5,000,000 under \$10,000,000	2,477	9.2%		1,129	321	112	3,945	7,834	26,832	29.2%
\$10,000,000 or more	2,505	14.2%		568	339	59	3,228	6,560	17,590	37.3%
<b>Total</b>	<b>1,239,253</b>	<b>0.9%</b>	<b>190,941</b>	<b>3,876,112</b>	<b>2,067,439</b>	<b>703,716</b>	<b>1,314,977</b>	<b>9,091,483</b>	<b>143,259,692</b>	<b>6.3%</b>

<sup>41</sup> Data from the Automated Information Management System (AIMS), Individual Returns Transaction File (IRTF), Individual Master File (IMF), and Notice Delivery System from the Compliance Data Warehouse (CDW). The number of audits represent tax returns for which the IRS closed its audit in FY 2014. The statistics for returns secured through Automated Substitute for Return (ASFR) are from the IRS fiscal year (FY) 2014 Collection Activity Report No. 5000-139 (Oct. 9, 2014). Because ASFR returns are not filed by the taxpayer, no adjusted gross income (AGI) is associated with the return; however, these returns actually have a AGI (but unrecorded). Therefore, the combined coverage rate percentage for the no AGI category is somewhat overstated. 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 2014. The combined coverage rate removes duplicates, so that a tax return is only counted once even if affected by two or more of these compliance programs in FY 2014. The coverage rate is computed by dividing by the number of individual income tax returns filed in each AGI category for Calendar Year 2013.

**FIGURE 1.4.2, Real vs. Unreal Audits: FY 2015 Occurrences Compared to Returns Filed in Calendar Year 2014<sup>42</sup>**

Adjusted Gross Income Category	FY 2015 Exams	Exam (Audit) Coverage Rate %	FY 2015 ASFR	FY 2015 AUR	FY 2015 Math Error	FY 2015 Taxpayer Protection Program	FY 2015 Wage Verification	Combined	Calendar Year 2014 Returns	Combined Coverage Rate %
No adjusted gross income	257,217	10.5%	184,776	12,597	29,633	120,729	94,276	564,475	2,455,720	23.0%
\$1 under \$25,000	476,122	0.9%		936,516	705,570	1,019,482	467,285	3,202,112	55,345,582	5.8%
\$25,000 under \$50,000	150,849	0.4%		1,110,611	508,272	360,772	166,826	2,132,672	33,654,191	6.3%
\$50,000 under \$75,000	82,524	0.4%		563,110	272,084	161,619	71,445	1,070,202	19,114,016	5.6%
\$75,000 under \$100,000	54,557	0.4%		354,911	168,328	92,758	46,955	666,242	12,302,459	5.4%
<b>Subtotal - under \$100,000</b>	<b>1,021,269</b>	<b>0.8%</b>	<b>184,776</b>	<b>2,977,745</b>	<b>1,683,887</b>	<b>1,755,360</b>	<b>846,787</b>	<b>7,635,703</b>	<b>122,871,968</b>	<b>6.2%</b>
\$100,000 under \$200,000	91,018	0.6%		608,617	230,602	137,675	91,753	1,054,229	16,272,703	6.5%
\$200,000 under \$500,000	58,988	1.3%		213,372	52,063	65,329	74,213	407,059	4,503,701	9.0%
\$500,000 under \$1,000,000	22,842	3.2%		34,544	7,912	19,472	36,434	102,819	708,224	14.5%
\$1,000,000 under \$5,000,000	22,201	7.1%		12,656	3,262	10,652	31,173	65,478	311,420	21.0%
\$5,000,000 under \$10,000,000	3,457	16.4%		663	297	994	3,931	7,914	21,104	37.5%
\$10,000,000 or more	3,744	29.3%		338	288	620	2,743	6,007	12,766	47.1%
<b>Total</b>	<b>1,223,519</b>	<b>0.8%</b>	<b>184,776</b>	<b>3,847,935</b>	<b>1,978,311</b>	<b>1,990,102</b>	<b>1,087,034</b>	<b>9,279,209</b>	<b>144,701,886</b>	<b>6.4%</b>

42 Data from AIMS, IRTF, IMF, and Notice Delivery System from CDW. The number of audits represent tax returns for which the IRS closed its audit in FY 2015. The statistics for returns secured through ASFR are from the IRS FY 2015 Collection Activity Report No. 5000-139. Because ASFR returns are not filed by the taxpayer, no AGI is associated with the return; however, these returns actually have a AGI (but unrecorded). Therefore, the combined coverage rate percentage for the no AGI category is somewhat overstated. The number of taxpayers receiving an 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 tax return is only counted once even if affected by two or more of these compliance programs in FY 2015. The coverage rate is computed by dividing by the number of individual income tax returns filed in each AGI category for Calendar Year 2014.

**FIGURE 1.4.3, Real vs. Unreal Audits: FY 2016 Occurrences Compared to Returns Filed in Calendar Year 2015<sup>43</sup>**

Adjusted Gross Income Category	FY 2016 Exams	Exam (Audit) Coverage Rate %	FY 2016 ASFR	FY 2016 AUR	FY 2016 Math Error	FY 2016 Taxpayer Protection Program	FY 2016 Wage Verification	Combined	Calendar Year 2015 Returns	Combined Coverage %
No adjusted gross income	151,639	6.3%	50,722	12,210	32,606	123,151	60,811	402,349	2,392,293	16.8%
\$1 under \$25,000	409,246	0.8%		771,410	681,795	1,182,997	313,754	3,157,201	54,347,216	5.8%
\$25,000 under \$50,000	156,209	0.5%		961,431	483,641	425,734	106,362	2,056,907	33,929,692	6.1%
\$50,000 under \$75,000	74,014	0.4%		498,649	257,347	184,367	45,817	1,023,476	19,389,871	5.3%
\$75,000 under \$100,000	60,343	0.5%		317,359	160,690	113,611	32,126	657,091	12,566,667	5.2%
<b>Subtotal - under \$100,000</b>	<b>851,451</b>	<b>0.7%</b>	<b>50,722</b>	<b>2,561,059</b>	<b>1,616,079</b>	<b>2,029,860</b>	<b>558,870</b>	<b>7,297,024</b>	<b>122,625,739</b>	<b>6.0%</b>
\$100,000 under \$200,000	99,155	0.6%		570,898	227,269	200,413	76,680	1,112,913	17,258,123	6.4%
\$200,000 under \$500,000	46,596	0.9%		208,363	53,183	110,113	78,921	451,177	4,985,176	9.1%
\$500,000 under \$1,000,000	15,258	1.9%		32,577	6,517	32,940	42,058	112,373	801,738	14.0%
\$1,000,000 under \$5,000,000	15,529	4.2%		12,327	3,000	20,069	37,899	76,985	365,701	21.1%
\$5,000,000 under \$10,000,000	2,518	9.6%		603	289	1,943	5,049	9,032	26,111	34.6%
\$10,000,000 or more	2,849	17.4%		318	297	1,471	3,554	7,470	16,390	45.6%
<b>Total</b>	<b>1,033,356</b>	<b>0.7%</b>	<b>50,722</b>	<b>3,386,145</b>	<b>1,906,634</b>	<b>2,396,809</b>	<b>803,031</b>	<b>9,066,974</b>	<b>146,078,978</b>	<b>6.2%</b>

<sup>43</sup> Data from AIMS, IRTF, IMF, and Notice Delivery System from CDW. The number of audits represent tax returns for which the IRS closed its audit in FY 2016. The statistics for returns secured through ASFR are from the IRS FY 2016 Collection Activity Report No. 5000-139 (Oct. 3, 2016). Because ASFR returns are not filed by the taxpayer, no AGI is associated with the return; however, these returns actually have a .AGI (but unrecorded). Therefore, the combined coverage rate percentage for the no AGI category is somewhat overstated. The number of taxpayers receiving an AUR contact are those who received a CP 2000 or CP 2501 notice from the IRS in FY 2016. The combined coverage rate removes duplicates, so that a tax return is only counted once even if affected by two or more of these compliance programs in FY 2016. The coverage rate is computed by dividing by the number of individual income tax returns filed in each AGI category for Calendar Year 2015.

As these figures show, the IRS's counting of only "real" audits in its public audit rate skews this rate and grossly understates the extent of its taxpayer compliance contacts. For example, in FY 2014, the IRS conducted "real" audits of over 1.2 million tax returns (an audit rate of 0.9 percent). However, the IRS conducted "unreal" audits of almost 8.2 million additional tax returns through its math error, AUR, identity and wage verification, and ASFR programs. When combining the IRS's "unreal" audits with its "real" ones, the coverage rate rose to 6.3 percent.

In FY 2015, the IRS conducted slightly fewer "real" audits than in FY 2014 and its reported audit rate declined to 0.8 percent. However, the IRS conducted over 900,000 more "unreal" audits than the prior year, with the total number of "unreal" audits reaching almost 9.1 million. Therefore, the IRS's combined coverage rate rose to 6.4 percent. In FY 2016, the IRS conducted fewer "real" audits than in FY 2015 and its audit rate slightly dipped to 0.7 percent. But again, the IRS conducted approximately 8.5 million "unreal" audits and the combined coverage rate was still over six percent. Thus, by reporting only its "real" audit activity, the IRS is masking the true extent of its compliance activities, which touch millions more tax returns each year. In addition, if the IRS would report the full extent of its compliance contacts with taxpayers, it might serve as a deterrent for those taxpayers who are noncompliant (or are considering noncompliance) due to the IRS's low "real" audit rate. Finally, a more accurate portrayal of the IRS's compliance activities would provide better information as to the level of resources needed for customer service, because audits, "real" or "unreal", often generate calls to the IRS.

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In fiscal year 2014, the IRS conducted "real" audits of over 1.2 million tax returns (an audit rate of 0.9 percent). However, the IRS conducted "unreal" audits of almost 8.2 million additional tax returns through its math error, Automated Underreporter, identity and wage verification, and Automated Substitute for Return programs. When combining the IRS's "unreal" audits with its "real" ones, the coverage rate rose to 6.3 percent.

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### *The IRS Does Not Calculate Its Return on Investment (ROI) for Certain "Unreal" Audit Categories*

In addition to underreporting the extent of its actual compliance contacts with taxpayers, the IRS is also not fully transparent in reporting its ROI for all its "unreal" compliance contacts. The IRS provides annual ROI information to Congress regarding its major enforcement efforts as part of the budget process.<sup>44</sup> As expected, the IRS provides ROI information for its "real" audit activities (*i.e.*, correspondence, field, and office examinations).<sup>45</sup> The IRS also reports ROI for the "unreal" audit

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44 See Department of the Treasury Internal Revenue Service, *Congressional Justification for Appropriations and Annual Performance Report and Plan FY 2018*, [http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY\\_2018/IRS\\_FY\\_2018\\_CJ.pdf](http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY_2018/IRS_FY_2018_CJ.pdf). As noted in this report and as a matter of basic definition, return on investment (ROI) is calculated by dividing revenue by cost.

45 IRS response to TAS research request (Oct. 20, 2017); Department of the Treasury Internal Revenue Service, *Congressional Justification for Appropriations and Annual Performance Report and Plan FY 2018* 61, [http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY\\_2018/IRS\\_FY\\_2018\\_CJ.pdf](http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY_2018/IRS_FY_2018_CJ.pdf).

categories of ASFR and AUR.<sup>46</sup> However, it does not report ROI for the “unreal” audit categories of math error, identity theft, and wage verification.<sup>47</sup> Therefore, the IRS is not providing a complete and accurate picture of its actual ROI for all compliance contacts with taxpayers.

### “Unreal” Audits Have an Adverse Impact on Taxpayer Rights and Circumvent Statutory Protections That Are Present During “Real” Audits

#### “Unreal” Audits Foreclose Taxpayer Appeal Rights

As noted above, a hallmark of the “real” audit process is an opportunity for taxpayers to generally seek impartial Appeals review of an IRS proposed adjustment prior to receiving a statutory notice of deficiency.<sup>48</sup> Appeals can take a fresh look at a taxpayer’s case and consider settling it based on hazards of litigation, something that is not typically considered during an IRS examination.<sup>49</sup>

To a taxpayer, “unreal” audits may look and feel similar to IRS correspondence examinations in that they are conducted by mail, may cover limited issues, and ask a taxpayer to respond or produce documents. However, unlike “real” audits, taxpayers do not have an opportunity to request Appeals review of an “unreal” audit case and have their documentation considered by an impartial third party prior to receiving a statutory notice of deficiency. The impact of no or limited appeal rights in “unreal audits” is as follows:

- The issue of appeal rights is most pronounced in math error cases, where the onus is on the taxpayer to respond to an IRS notice and request an abatement within 60 days.<sup>50</sup> If the taxpayer does not request an abatement within this time frame, he faces an IRS summary assessment and will not receive a statutory notice of deficiency, thereby losing the opportunity to go to Tax Court. The taxpayer’s only recourse would be to pay the tax, file a refund claim with the IRS, and litigate in federal refund forums. A taxpayer does not have the opportunity to seek Appeals review in math error cases. However, if the issue in the math error notice arose during a “real”

46 IRS response to TAS research request (Oct. 20, 2017). ASFR is included in the ROI for the IRS’s collection program while AUR ROI is reported as a separate category. Department of the Treasury Internal Revenue Service, *Congressional Justification for Appropriations and Annual Performance Report and Plan FY 2018* 61, [http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY\\_2018/IRS\\_FY\\_2018\\_CJ.pdf](http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY_2018/IRS_FY_2018_CJ.pdf). The IRS classifies the revenue from its examination, ASFR, and AUR programs as “revenue protected.” IRS response to TAS research request (Oct. 20, 2017).

47 IRS response to TAS research request (Oct. 20, 2017). The IRS classifies the revenue from these three programs as “revenue protected.” It should be noted that a case from an “unreal” audit program in which ROI is not calculated (e.g., math error) could figure into an ROI calculation if it turns into a formal or “real” audit.

48 See IRS Publication 3498-A, *The Examination Process (Audits by Mail)* (Jan. 2014), <http://www.irs.gov/pub/irs-pdf/p3498a.pdf>. For times for requesting appeals conferences, see IRM 4.19.13.14.2, *Transfer to Appeals* (Jan. 1, 2016).

49 See IRM 8.6.4.1, *Fair and Impartial Settlements per Appeals Mission* (Oct. 26, 2007) (noting “A fair and impartial resolution is one which reflects on an issue-by-issue basis the probable result in event of litigation, or one which reflects mutual concessions for the purpose of settlement based on relative strength of the opposing positions where there is substantial uncertainty of the result in event of litigation.”).

50 For a discussion of the National Taxpayer Advocate’s concerns regarding the IRS’s math error authority, see National Taxpayer Advocate 2015 Annual Report to Congress 329-39 (Legislative Recommendation: *Math Error Authority: Authorize the IRS to Summarily Assess Math and “Correctable” Errors Only in Appropriate Circumstances*); National Taxpayer Advocate 2014 Annual Report to Congress, 163-71 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 116-20 (*Math Errors Committed on Individual Tax Returns – A Review of Math Errors Issued on Claimed Dependents*). See also, Nina E. Olson, *Why Correctible Error Authority Raises Significant Taxpayer Rights Concerns – Part 1*, NATIONAL TAXPAYER ADVOCATE BLOG (Aug. 9, 2017), <https://taxpayeradvocate.irs.gov/news/why-correctible-authority-error-raises-significant-taxpayer-rights-concerns-part-1>; Nina E. Olson, *Correctible Error Authority Part 2: Why Correctible Error Authority Creates More Problems Than It Resolves*, NATIONAL TAXPAYER ADVOCATE BLOG (Aug. 16, 2017), <https://taxpayeradvocate.irs.gov/news/correctible-error-authority-part-2-why-correctible-error-authority-creates-more-problems-than-it-resolves>; Nathan J. Richman, *Expanding Math Error Authority Could Worsen Two Tax Systems Issues*, TAX NOTES TODAY (July 5, 2017).

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The IRS plans, as part of its “Future State” Initiative, to enhance its use of these “unreal” audits, meaning that more and more taxpayers will be subject to these audit-like contacts where taxpayer rights are diminished or curtailed altogether.

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audit, the taxpayer would generally receive a 30-day letter offering an opportunity to go to Appeals prior to petitioning the Tax Court.

- In an AUR case, the IRS may have received an erroneous Form W-2 or 1099 that triggered an AUR notice. In a “real” audit, a taxpayer would be able to challenge an erroneous form during the exam or in Appeals prior to the IRS issuing a statutory notice of deficiency. However, in an AUR case, taxpayers’ opportunity to request Appeals review prior to the issuance of a statutory notice of deficiency is limited.<sup>51</sup>
- In wage and identity verification program cases, which occur in a pre-refund environment, a taxpayer may have his refund held while the IRS conducts authentication and verification. Although the taxpayer may receive a notice notifying her of the hold, she might not hear anything from the IRS for weeks or months. The taxpayer may not be able to reach an IRS customer service representative (CSR) regarding the issue, and even if she does reach a CSR, the CSR does not have access to the appropriate IRS databases.<sup>52</sup> Although the IRS’s position is that taxpayer contacts from these programs are not “real” audits, they are compliance touches that feel like “real” audits to taxpayers and have real-world consequences such as a lack of Appeal rights or refund holds without adequate information as to when the refund may be released.
- A taxpayer in an ASFR case may have third-party documentation that would reduce his tax liability. In the “real” audit context, this information would be considered in the examination and the taxpayer could seek Appeals review of the examination. However, although taxpayers may be able to request IRS reconsideration of an ASFR determination through the audit reconsideration process, it appears that they cannot seek formal Appeals review of an ASFR determination prior to the IRS issuing a statutory notice of deficiency.<sup>53</sup>

The lack of the opportunity to seek Appeals review in the “unreal” audit context directly and profoundly impacts taxpayer rights, including the *right to challenge the IRS’s position and be heard*, the *right to appeal an IRS decision in an independent forum*, the *right to finality*, and the *right to a fair and just tax system*. The taxpayer rights issues are particularly glaring because, as shown in Figures 1.4.1, 1.4.2, and 1.4.3 above, “unreal” audits disproportionately impact low and middle-income taxpayers, who are least

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51 In an AUR case, if a taxpayer makes a request for Appeals review with less than 365 days left in the period of limitations on assessment then this request will be denied. However, if there are more than 365 days left in the period of limitations on assessment, a taxpayer may request Appeals review an AUR case. However, it appears that taxpayers are not formally informed of this Appeals opportunity but would have to affirmatively make such a request. See IRM 4.19.3.21.1.8(1), *Appeals* (Aug. 22, 2017).

52 The National Taxpayer Advocate has raised concerns that the IRS’s filters are too broad and unnecessarily identify legitimate returns as potentially fraudulent. See National Taxpayer Advocate 2016 Annual Report to Congress, 149-60 (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*).

53 See IRM 4.13.5, *Exam SFR Reconsiderations* (Dec. 16, 2015). For the National Taxpayer Advocate’s concerns about the ASFR program, see National Taxpayer Advocate 2015 Annual Report to Congress 188-95 (Most Serious Problem: *Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*).

able to afford representation to challenge the IRS. Further, the IRS plans, as part of its “Future State” Initiative, to enhance its use of these “unreal” audits, meaning that more and more taxpayers will be subject to these audit-like contacts where taxpayer rights are diminished or curtailed altogether.<sup>54</sup>

### *“Unreal” Audits Circumvent Statutory Taxpayer Protections*

As noted above, “unreal” audits do not carry the same IRC § 7605(b) protections against repeat examinations as “real” audits. The IRS takes a broad view of taxpayer compliance contacts or other actions that it does not consider to be examinations and inspections.<sup>55</sup> As discussed, explicitly included in these categories are math error, AUR, and ASFR “unreal” audit contacts.<sup>56</sup> Therefore, the IRS can circumvent statutory protections against repeat audits by conducting an “unreal” audit and then subsequently performing a “real” audit.

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**If the IRS were to change its position set forth in Revenue Procedure 2005-32 to consider certain “unreal” audits to be “real” audits, it would protect taxpayers from multiple reviews of the same return, force the IRS to identify *all* issues relating to that return that require some sort of documentation, and address those issues as early as possible in one proceeding.**

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The National Taxpayer Advocate understands the need of the IRS to conduct “unreal” audits for limited issues. However, to taxpayers, these “unreal” audits may feel like a “real” IRS correspondence examination. If the IRS were to change its position set forth in Revenue Procedure 2005-32 to consider certain “unreal” audits to be “real” audits, it would protect taxpayers from multiple reviews of the same return, force the IRS to identify *all* issues relating to that return that require some sort of documentation, and address those issues as early as possible in one proceeding.

The National Taxpayer Advocate recognizes that there are limited circumstances (such as a basic math error correction) where an IRS compliance contact does not constitute a “real” audit. For example, in true math error situations where the IRS has identified errors such as switching digits, transferring information incorrectly from one schedule to the other, or forgetting to include a schedule, the IRS should not be required to hold a return for months while it conducts a thorough review before it issues a refund to ensure it did not miss any other errors on the return. However, as a general matter and contrary to the IRS’s position, the National Taxpayer Advocate believes that for purposes of IRC § 7602, an audit generally includes both pre-refund and post-refund examinations of returns that,

54 See, e.g., IRS, *Exploring the IRS Future State: Balancing Taxpayer Needs with IRS Budget and Resource Constraints*, adapted from ABA National Institute on Tax Controversy, Las Vegas, NV 16 (Dec. 9, 2016), [https://www.irs.gov/pub/newsroom/future\\_state\\_aba.pdf](https://www.irs.gov/pub/newsroom/future_state_aba.pdf) (noting that one of the focus areas of SB/SE and W&I is issue identification and filing resolution to “maximize prerefund automatic issue identification and self-correction”).

55 Rev. Proc. 2005-32, § 4.03, 2005-23 I.R.B. 1206.

56 *Id.* See also IRS Chief Counsel Memorandum, *ASFR Questions Involving Subsequently Filed Delinquent Original Returns* (Mar. 29, 2005) (providing that IRS preparation of an ASFR is not considered an examination). Identity and wage verification programs are not explicitly mentioned in the revenue procedure and did not exist in the form that they do today at the time that the revenue procedure was released. However, like the other “unreal” audit programs mentioned in the revenue procedure, the IRS would presumably not consider these programs to be examinations and inspections.

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...there are “unreal” audit situations that clearly look like an audit, walk like an audit, quack like an audit, and should be considered a “real” audit.

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like correspondence examinations, require the taxpayer to provide some level of documentation. This definition recognizes that certain “unreal” audits bear a close resemblance to “real” ones and would afford taxpayers appropriate rights and protections. As illustrated by the ACA example above, there are “unreal” audit situations that clearly look like an audit, walk like an audit, quack like an audit, and should be considered a “real” audit.

## CONCLUSION

The IRS conducts the overwhelming majority of its compliance contacts with taxpayers through “unreal” audits, and this practice is expected to only increase with the IRS’s “Future State” Initiative.<sup>57</sup> By not including “unreal” audits in its audit rate calculations, the IRS is publicly reporting incomplete and misleading information concerning the extent of its compliance touches with taxpayers and not providing a full picture of its return on investment. More accurate reporting of this information might benefit the IRS in deterring noncompliance and provide useful data regarding resource allocation. In addition, “unreal” audits adversely impact taxpayer Appeal rights and statutory protections that exist for “real” audits. Because of the prevalence of “unreal” audits, the IRS should revisit its classification approach and provide taxpayers with additional opportunities for Appeals review of “unreal” audit cases and increased protections against repeat reviews of cases.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. In collaboration with the National Taxpayer Advocate, conduct a comprehensive review of its audit definition under Revenue Procedure 2005-32 to reflect IRS compliance activity today, and the application of the Taxpayer Bill of Rights.
2. Include “unreal” audits in its audit rate and ROI calculations to properly reflect the actual compliance activity that it conducts.
3. Grant taxpayers the opportunity to seek Appeals review in certain “unreal” audit cases, such as in certain math error and AUR cases where Appeal rights do not already exist.
4. Where practicable, address all issues in a “real” audit rather than conducting an “unreal” audit and then subsequently conducting a “real” audit.

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<sup>57</sup> See, e.g., IRS, *Exploring the IRS Future State: Balancing Taxpayer Needs with IRS Budget and Resource Constraints*, adapted from ABA National Institute on Tax Controversy, Las Vegas, NV 16 (Dec. 9, 2016), [https://www.irs.gov/pub/newsroom/future\\_state\\_aba.pdf](https://www.irs.gov/pub/newsroom/future_state_aba.pdf) (noting that one of the focus areas of SB/SE and W&I is issue identification and filing resolution to “maximize prerefund automatic issue identification and self-correction”).



## MSP #5 EXEMPT ORGANIZATIONS: Form 1023-EZ, Adopted to Reduce Form 1023 Processing Times, Increasingly Results in Tax Exempt Status for Unqualified Organizations, While Form 1023 Processing Times Increase

### RESPONSIBLE OFFICIAL

Sunita Lough, Commissioner, Tax Exempt and Government Entities Division

### TAXPAYER RIGHTS IMPACTED<sup>1</sup>

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

### DEFINITION OF PROBLEM

The IRS introduced Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, in July 2014.<sup>2</sup> The form was adopted in large part to reduce inventory backlogs for processing Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*.<sup>3</sup> By mid-2015, the volume of Form 1023-EZ applications exceeded Form 1023 applications.<sup>4</sup> In July 2016, the Form 1023-EZ user fee was reduced from \$400 to \$275, further fueling the shift from the use of Form 1023 to Form 1023-EZ.<sup>5</sup> Virtually all Form 1023-EZ applications are approved.<sup>6</sup>

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).
- 2 Organizations with total assets in excess of \$250,000 and those expecting annual gross receipts to exceed \$50,000 are not eligible to use Form 1023-EZ. Rev. Proc. 2017-5, § 6.05, 2017-1 I.R.B. 230 (Jan. 3, 2017).
- 3 See, e.g., National Taxpayer Advocate 2015 Objectives Report to Congress 47 (Area of Focus: *Despite Improvements, TAS Remains Concerned About IRS Treatment of Taxpayers Applying for Exempt Status*).
- 4 *Form 1023-EZ Update Report 2*, [https://www.irs.gov/pub/irs-tege/form\\_1023ez\\_update\\_report\\_final.pdf](https://www.irs.gov/pub/irs-tege/form_1023ez_update_report_final.pdf), referenced in *Tax Exempt and Government Entities FY 2017 Work Plan 2* (Sept. 28, 2016, as amended Mar. 8, 2017).
- 5 Rev. Proc. 2016-32, § 3, 2016-22 I.R.B. 1019 (May 31, 2016). For the third quarter of fiscal year (FY) 2017, of 65,059 Form 1023 and Form 1023-EZ applications, 41,806, or 64 percent, were submitted on Form 1023-EZ. Tax Exempt and Government Entities (TE/GE) FY 2017 Third Qtr. Business Performance Review (BPR) at 16 (Oct. 2017).
- 6 See *Form 1023-EZ Update Report 4*, [https://www.irs.gov/pub/irs-tege/form\\_1023ez\\_update\\_report\\_final.pdf](https://www.irs.gov/pub/irs-tege/form_1023ez_update_report_final.pdf), referenced in *Tax Exempt and Government Entities FY 2017 Work Plan 2* (Sept. 28, 2016, as amended Mar. 8, 2017), noting the 94 percent approval rate of Form 1023-EZ applications.

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This year's TAS study of a representative sample of approved Form 1023-EZ applicants from 20 states that post articles of incorporation online, similar to the studies TAS carried out in 2015 and 2016, found that 42 percent of approved organizations do not meet the organizational test. When organizations from four additional states that now post articles of incorporation online are included, the rate rises to 46 percent.

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As the IRS is aware, it erroneously approves Form 1023-EZ applications:

- A 2015 TAS study of organizations in 20 states that post articles of incorporation online showed that 37 percent of approved entities did not meet the organizational test for qualification as an Internal Revenue Code (IRC) § 501(c)(3) organization;<sup>7</sup>
- A similar study TAS carried out in 2016 found that 26 percent of approved organizations did not meet the organizational test;<sup>8</sup> and
- The IRS's own 2016 analysis showed that Form 1023-EZ applications failed a pre-determination review more than 25 percent of the time.<sup>9</sup>

The problem of erroneous approvals has persisted. This year's TAS study of a representative sample of approved Form 1023-EZ applicants from 20 states that post articles of incorporation online, similar to the studies TAS carried out in 2015 and 2016, found that 42 percent of approved organizations do not meet the organizational test. When organizations from four additional states that now post articles of incorporation online are included, the rate rises to 46 percent. The organizations in this year's sample included four churches, two limited liability corporations, and a school. These organizations are not eligible to file Form 1023-EZ.<sup>10</sup>

The time needed to process Form 1023, which was nearly a year prior to the adoption of Form 1023-EZ, decreased to 96 days in fiscal year (FY) 2016.<sup>11</sup> However, the time needed to process Form 1023 has begun to rise, and was 113 days for FY 2017. Thus, the adoption of Form 1023-EZ may have been only a short-term "solution" to the problem of long processing times for Form 1023 — a solution that comes with a high cost to the integrity of the U.S. tax exempt sector.

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7 The study was of a representative sample of corporations that had obtained exempt status on the basis of a Form 1023-EZ and were organized in one of 20 states that make articles of incorporation available online at no cost. National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 1-31 (*Study of Taxpayers That Obtained Recognition As IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*). The "organizational test" generally requires an applicant's organizing document to contain adequate purpose and dissolution clauses. See Treas. Reg. §§ 1.501(c)(3)-1(b)(1)(i)(a), (b); 1.501(c)(3)-1(b)(4); 1.501(c)(3)-1(b)(2).

8 National Taxpayer Advocate 2016 Annual Report to Congress 254 (Most Serious Problem: *Form 1023-EZ: The IRS's Reliance on Form 1023-EZ Causes It to Erroneously Grant Internal Revenue Code § 501(c)(3) Status to Unqualified Organizations*).

9 *Id.*

10 See Rev. Proc. 2016-5, § 3.06, 2016-30 I.R.B. 188 (Jan. 4, 2016); Rev. Proc. 2017-5, § 6.05(2), 2017 I.R.B. 230 (Jan. 3, 2017), discussed below.

11 TE/GE response to TAS information request (Aug. 31, 2017).

## ANALYSIS OF PROBLEM

### Background

In 2015, TAS studied a representative sample of corporations in 20 states that make articles of incorporation viewable online at no cost whose Form 1023-EZ application was approved.<sup>12</sup> A review of the corporations' articles of incorporation revealed that 37 percent did not meet the organizational test.<sup>13</sup> Even though they had received a favorable determination from the IRS granting them tax-exempt status and making contributions to them eligible for a tax deduction by the donor, they did not qualify for IRC § 501(c)(3) status as a matter of law.<sup>14</sup> TAS conducted a similar study in 2016, using the same data collection instrument as for the 2015 study, and concluded that 26 percent of organizations in the representative sample did not meet the organizational test.<sup>15</sup> The results of the 2015 and 2016 studies are statistically valid at the 95 percent confidence level with a margin of error no greater than +/-5 percent.

At the conclusion of the 2015 study, TAS shared with Tax Exempt and Government Entities (TE/GE) the Employer Identification Numbers of taxpayers whose articles of incorporation, according to TAS, did not meet the organizational test. TE/GE did not agree with TAS's conclusions in every case, but conceded that there was an "organizational test non-compliance rate" of 17 percent.<sup>16</sup>

### The IRS Continues to Approve Form 1023-EZ Applications at an Unacceptably High Rate

In 2017, TAS again studied a representative sample of corporations in 20 states that make articles of incorporation viewable online at no cost whose Form 1023-EZ application was approved.<sup>17</sup> The four

12 In all 20 states, the articles are viewable at no charge to the public, except for Texas, which charges \$1 per search. Because TAS used the IRS's account with the Texas Secretary of State to access the database, TAS did not incur this charge.

13 An applicant seeking to qualify as an organization described in IRC § 501(c)(3) must demonstrate that it meets an "organizational test" and an "operational test." Treas. Reg. § 1.501(c)(3)-1(a)(1). The "organizational test" requires an applicant's "organizing document" to establish that it is "organized and operated exclusively" for one of eight enumerated exempt purposes. IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(1)(i). Treas. Reg. § 1.501(c)(3)-1(b)(4) provides that "[a]n organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes..." and notes "an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders."

14 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 1-31 (*Study of Taxpayers That Obtained Recognition As IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*).

15 National Taxpayer Advocate 2016 Annual Report to Congress 256-57 (*Most Serious Problem: Form 1023-EZ: The IRS's Reliance on Form 1023-EZ Causes It to Erroneously Grant Internal Revenue Code § 501(c)(3) Status to Unqualified Organizations*).

16 *Id.* at 256.

17 This year's study considered Form 1023-EZ applications approved between July 1, 2016 and June 30, 2017. Organizations were in the following 20 states: Alaska, Colorado, Florida, Idaho, Indiana, Iowa, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Mississippi, Missouri, New Hampshire, North Carolina, Ohio, Oregon, Rhode Island, South Dakota, and Texas. As in the previous studies, our findings are dependent upon the State posting the information accurately on the website.

states in the 2015 and 2016 studies that have adopted the *cy pres* doctrine remained the same in the 2017 study.<sup>18</sup>

TE/GE now releases to the public a data file that includes information for approved Form 1023-EZ applications beginning in mid-2014, when Form 1023-EZ was introduced.<sup>19</sup> Out of these organizations, TAS Research identified a representative, random sample of 337 organizations from the same 20 states as in the 2015 and 2016 random samples for further analysis. Like the results of the 2015 and 2016 studies, the results of the 2017 study are statistically valid at the 95 percent confidence level with a margin of error no greater than +/-5 percent.<sup>20</sup>

Out of the 337 organizations in the sample, 143 organizations, or 42 percent, do not meet the organizational test and therefore do not qualify as IRC § 501(c)(3) organizations as a matter of law. Figure 1.5.1 shows the rate at which TE/GE's Exempt Organization (EO) function erroneously approved Form 1023-EZ applications over the past three years for organizations in the 20 states that were included in each TAS study. It also shows that when organizations from four additional states are included, as described below, the rate rises to 46 percent.<sup>21</sup>

In addition to selecting a valid sample of 337 organizations from the 20 states that were included in the 2015 and 2016 studies, this year we expanded the sample to include 58 representative cases from four more states that now make articles of incorporation available online at no charge.<sup>22</sup> Of the combined 395 organizations, 182, or 46 percent, did not meet the organizational test. This is due to the fact that two-thirds of organizations in the four new states (39 out of 58) failed to meet the test. One of the 58 organizations was a church and therefore not eligible to use Form 1023-EZ. Further research is needed to ascertain the reason for the higher rate of erroneous approvals for organizations from the four additional states, compared to the original 20 states.

18 In states that have adopted the *cy pres* doctrine, a nonprofit corporation's articles need not include a specific dissolution provision because by operation of state law the organization's assets would be distributed upon dissolution for one or more exempt purposes, or to the federal government, or to a state or local government, for a public purpose. As in the 2015 and 2016 studies, the states in the 2017 study that have adopted the *cy pres* doctrine are Massachusetts, Missouri, Ohio, and Texas. However, we reviewed dissolution clauses of all the organizations in our sample, because if the creating document contains a dissolution provision that is defective, state law or court action would not cure the defect. See Elizabeth Ardoin, *2004 EO CPE Text Organizational Test – IRC 501(c)(3) 12, Q.11*, <https://www.irs.gov/pub/irs-tege/eotopicd04.pdf>.

19 The data file is available at <https://www.irs.gov/charities-non-profits/exempt-organizations-form-1023ez-approvals>. The data is based on information provided by applicants on Forms 1023-EZ that were approved by the IRS.

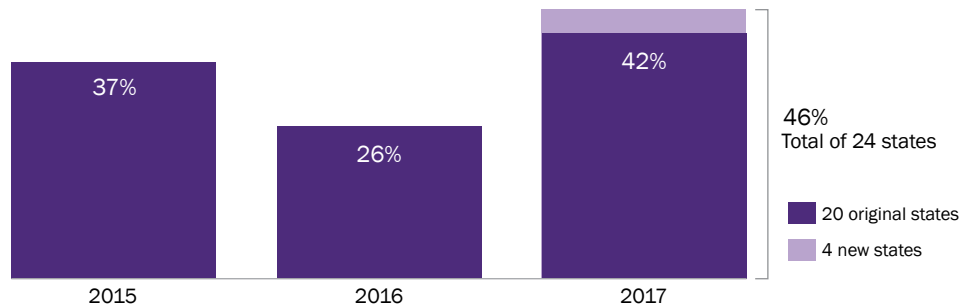
20 Study findings can be projected to the population of 20,106 organizations from the original 20 states in our study.

21 The data reflects the result of the 2015-2017 TAS studies. The Form 1023-EZ applications of organizations in the 2015 TAS study were approved between July 1, 2014 and March 27, 2015. The Form 1023-EZ applications of organizations in the 2016 study were approved between July 1, 2015 and June 30, 2016. The Form 1023-EZ applications of organizations in the 2017 study were approved between July 1, 2016 and June 30, 2017.

22 The additional four states are Arizona, Georgia, Virginia, and Vermont. None of these states have adopted the doctrine of *cy pres*. See Rev. Proc. 82-2, 1982-1 C.B. 367.

FIGURE 1.5.1

## Erroneous Approval Rate Found in Review of Form 1023-EZ Applications



Another cause for concern is the absence of some organizations' articles of incorporation on databases of states that post articles of incorporation online. Of organizations in the same 20 states as in the 2015 and 2016 studies, the initial sample size was 350. However, articles of incorporation for 13 organizations in the sample (four percent) were not found on the official site for the state in which, according to the application, the organization was formed. We excluded these organizations from our sample, resulting in a sample size of 337. Of organizations in the additional four states that made articles of incorporation available online at no cost in 2017, the initial sample size was 60. However, articles of incorporation for two of the organizations, or three percent, were not found on the official site for the state in which, according to the application, the organization was formed, and we excluded these organizations from this sample, resulting in a sample size of 58. The lack of availability of articles of incorporation raises concerns about the very existence of these entities and about the motives of the applicants who attested, under penalty of perjury, that articles of incorporation had been filed.

An example of an inadequate purpose clause we encountered in this year's study was one organization's statement, in its entirety: "Establishment and operation of a farmer's market." The IRS has opined that a farmer's market whose primary purpose and activity was the conduct of a regular business of a kind ordinarily carried on for profit did not qualify for exempt status under IRC § 501(c)(3).<sup>23</sup> A different organization in the sample has no purpose clause at all, and its entire dissolution clause provides: "No assets will be acquired during the course of business. Plan to apply for exemption status with the IRS." Yet another organization's dissolution clause provides: "The assets of this non-profit will be distributed evenly amongst the families of the team [team name]. The team will have authority to donate said assets to another non-profit organization within the [named city] Metro area." Still another organization, on the date it filed its Form 1023-EZ as well as on the date it was given a favorable determination ruling, had been involuntarily dissolved by the state in which it was incorporated. It was still in that status on December 1, 2017, when we last consulted the state website. None of these organizations are described in IRC § 501(c)(3). All of them are holding themselves out as having IRC § 501(c)(3) status, supported by determination letters from the IRS.

23 See Non Docketed Service Advice Review 19990219, 1999 WL 33949267 (July 30, 2017). See also the IRS letter ruling denying IRC § 501(c)(3) status to an organization operated for the purpose of facilitating sales for the benefit of vendors at its farmers' market, reported at 2017 TNT 227-22 (Nov. 28, 2017). An organizing document that expressly empowers the organization to engage in activities which are not in furtherance of one or more exempt purposes (other than as an insubstantial part of its activities) does not meet the organizational test. Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)(b).

Some organizations in our sample would not likely qualify for exempt status even if they met the organizational test.<sup>24</sup> For example, one organization's website solicits donations for research about a specific illness that affects the organizer's child.<sup>25</sup> The only indication that contributions could be used other than for the benefit of the organizer's child is the statement that other named, well-known IRC § 501(c)(3) organizations "will benefit from all proceeds raised." Thus, serious questions of inurement are presented by this organization's website.

Evidently interested in learning more about its use of Form 1023-EZ, TE/GE plans to engage an independent consultant, MITRE, to "conduct an independent assessment of the efficacy of Form 1023-EZ."<sup>26</sup> The focus of the MITRE study is "measuring and evaluating EO's current pre- and post-determination sampling practices and to identify applications in need of closer inspection prior to making a determination."<sup>27</sup> TE/GE intends to measure the efficacy of Form 1023-EZ sampling practices primarily by comparing Form 1023-EZ determinations and subsequent compliance by Form 1023-EZ filers with corresponding data for Form 1023 filers.<sup>28</sup> Investigating how to improve procedures for reviewing *every* application for IRC § 501(c)(3) status — before conferring that status — does not appear to be the primary purpose of the project.

### The Adoption of Form 1023-EZ Alleviated Form 1023 Processing Backlogs, But the Improvement May Be Temporary

Prior to the introduction of Form 1023-EZ, the increased number of applications for exempt status and the decrease in the number of EO employees who handle them was a recurring theme in the National Taxpayer Advocate's Annual Reports to Congress.<sup>29</sup> By the first half of FY 2014, average cycle time (the number of days that elapse between the date the application was received and the date it was closed) for all approved applications was 315 days.<sup>30</sup> TE/GE's announced goal was to process all applications

24 As noted above, to qualify for IRC § 501(c)(3) status, an organization must also satisfy the "operational test" which is met if: the organization engages primarily in activities which accomplish one or more of the eight exempt purposes specified in IRC § 501(c)(3); no more than an insubstantial part of its activities is not in furtherance of an exempt purpose; and it is operated to further public rather than private interests. See Treas. Reg. § 1.501(c)(3)-1(c)(1), (d)(1)(ii). We did not attempt to develop a conclusion about whether organizations in our sample met the operational test. However, an EO Determinations employee reviewing a Form 1023-EZ application would consult relevant information such as the organization's website in making a determination as to exempt status. See Internal Revenue Manual 7.20.9.4.6, *Pre-determination Review and Tax Examiner Referral Cases (Specialist)* (June 27, 2016).

25 The organization's articles of incorporation do not contain any purpose clause and thus the organization does not meet the requirements for IRC § 501(c)(3) status on that basis alone.

26 TE/GE FY 2017 Third Qtr. BPR 5 (Oct. 2017).

27 TE/GE response to TAS fact check request (Dec. 8, 2017).

28 TE/GE explains, "The scope of the work will include quantifying the accuracy and precision of current 1023-EZ sampling practices, comparing the 1023-EZ data with the 1023 data to look for variances or other anomalies. MITRE will review our pre-determination sampling methodology and compare determination results, subsequent Form 990 filings, and audit results for entities using the 1023-EZ against those of organizations that submitted full 1023 filings before the EZ was created. MITRE will also stratify the 1023-EZ population to determine whether the sampling strategy can be made more efficient. It will also investigate models for identifying entities that are potentially non-compliant."

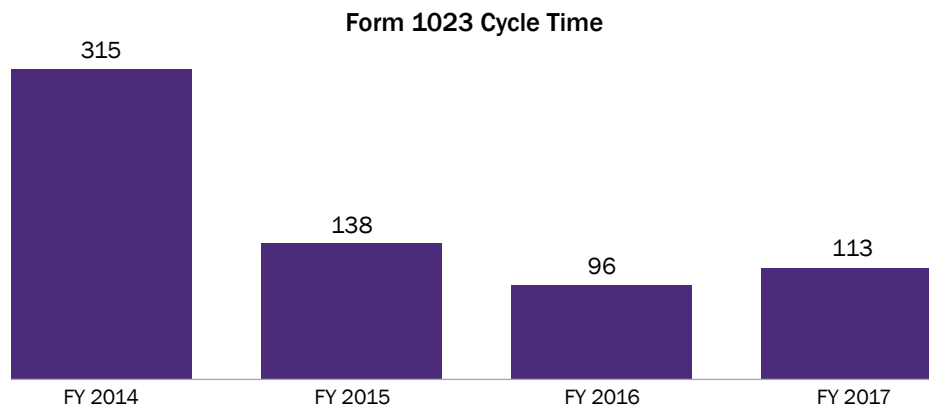
29 National Taxpayer Advocate 2013 Annual Report to Congress 165 (Most Serious Problem: *The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*); National Taxpayer Advocate 2012 Annual Report to Congress 192 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*); National Taxpayer Advocate 2011 Annual Report to Congress 442 (Most Serious Problem: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*); National Taxpayer Advocate 2007 Annual Report to Congress 210 (Most Serious Problem: *Determination Letter Process*); National Taxpayer Advocate 2004 Annual Report to Congress 193, 203 (Most Serious Problem: *Application and Filing Burdens on Small Tax-Exempt Organizations*).

30 National Taxpayer Advocate 2015 Objectives Report to Congress 47-48 (Area of Focus: *Despite Improvements, TAS Remains Concerned About IRS Treatment of Taxpayers Applying for Exempt Status*). Virtually all applications were for exempt status under IRC § 501(c)(3) rather than under another subsection such as (c)(4).

within six months.<sup>31</sup> By the end of FY 2015, Form 1023 cycle time had been reduced to 138 days. At the beginning of FY 2016, TE/GE realigned more than 20 percent of the EO Determinations specialists who evaluated Form 1023 applications to the EO Examination function.<sup>32</sup> By the end of FY 2016, Form 1023 cycle time was 96 days but for FY 2017 increased to 113 days.<sup>33</sup>

Figure 1.5.2 shows the average cycle time for Form 1023 applications in recent years.

**FIGURE 1.5.2**



Cycle time for Form 1023-EZ has always hovered at around 14 days.<sup>34</sup> This cycle time is achievable because it takes only a little more than 30 minutes of direct time on average to evaluate a Form 1023-EZ application.<sup>35</sup> Thirty minutes or so may be sufficient to ascertain whether an applicant checked the appropriate boxes on Form 1023-EZ, signed the form, and paid the user fee, but it is difficult to

31 Jeff Carlson, *IRS Making Progress in Improving 501(c)(3) Application Process, Says Koskinen*, CCH News (Apr. 8, 2014), reporting on Commissioner Koskinen's testimony before the House Appropriations Committee Subcommittee on Financial Services and General Government on the FY 2015 IRS budget at <http://tst-news.cchgroup.com.php56-7.ord1-1.websitetestlink.com/2014/04/08/irs-making-progress-in-improving-501c3-application-process-says-koskinen/>.

32 TE/GE response to TAS information request (Aug. 31, 2017), noting that in FY 2015, there were 134 full-time equivalent EO Determinations specialists, who evaluate applications submitted on Form 1023; Form 1024, *Application for Recognition of Exemption Under Section 501(a) or for Determination Under Section 120*; Form 8940, *Request for Miscellaneous Determination*; and Form 1028, *Application for Recognition of Exemption*; and other letter applications (other than Form 1023-EZ). In FY 2016, TE/GE realigned 31 one full-time equivalent EO Determinations specialists to EO Exam. As of the third quarter of FY 2017, there were 75 full-time Determinations specialists evaluating these applications.

33 TE/GE response to TAS information request (Oct. 20, 2017). The response also noted that EO Determinations "has no plans to reassign any FTEs [full-time equivalent employees] to other areas of EO or other TE/GE functions. However, EO Determinations does anticipate a reduction of case working revenue agents within the Determinations' function due to attrition (retirements, competitive selections for other positions, etc.)." The response also notes that the EO Rulings and Agreements function "plans to solicit 20 Grade 11 revenue agents from EO Examinations to assist with processing EO Determinations cases for a NTE [not to exceed] one year period."

34 TE/GE response to TAS information request (Oct. 20, 2017). The number of full-time equivalent employees who process Form 1023-EZ applications has been stable, at approximately 29. TE/GE responses to TAS information request (Aug. 31, 2017 and Oct. 20, 2017).

35 TE/GE FY 2017 Third Qtr. BPR, at 16 (Oct. 2017), reporting that determination hours per case for Form 1023-EZ applications averaged 36 minutes in FY 2017. In contrast, it took 2.6 hours on average to evaluate a Form 1023 application in FY 2017. When a Form 1023-EZ application is selected for review as part of TE/GE's pre-determination process, the review takes an average of 2.6 hours. TE/GE response to TAS fact check request (Dec. 8, 2017), noting that this estimate includes only time directly attributable to the case by the Revenue Agent. As of June 30, 2017, audits of Form 1023-EZ filers were taking on average 14.6 hours. TE/GE FY 2017 Third Qtr. BPR, at 30 (Oct. 2017) (describing audits of cases assigned project code 8004).

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By the end of FY 2015, Form 1023 cycle time, which had been 315 days in the first half of 2014, had been reduced to 138 days and by the end of FY 2016, cycle time was 96 days; the FY 2017 cycle time for Form 1023 increased to 113 days.

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understand how an actual determination as to exempt status can be made in that amount of time. The National Taxpayer Advocate has always maintained that Form 1023-EZ should solicit additional information sufficient to allow the IRS to make a reasoned determination and at the same time drive compliant behavior when organizations are forming.<sup>36</sup>

In response to the National Taxpayer Advocate's September 26, 2016 Taxpayer Advocate Directive (TAD), the IRS agreed to revise Form 1023-EZ to require applicants to submit a brief narrative statement of their actual or planned activities.<sup>37</sup> This welcomed change may reduce the rate at which TE/GE erroneously approves Form 1023-EZ applications. The Deputy Commissioner for Services and Enforcement rescinded that portion of the TAD in which the National Taxpayer Advocate ordered the IRS to also require submission of organizing documents (unless the documents are already retrievable from a state online database) and summary financial information such as past and projected revenues and expenses.

## CONCLUSION

As the National Taxpayer Advocate has always maintained, Form 1023-EZ does not elicit enough information from applicants to allow the IRS to determine whether they qualify for IRC § 501(c)(3) status, yet approval of a Form 1023-EZ application is virtually guaranteed. Consequently, the IRS continues to erroneously approve Form 1023-EZ applications at an unacceptably high rate. The damage to the integrity of the tax-exempt sector caused by recognizing organizations as exempt under IRC § 501(c)(3) when they do not meet the basic requirements for that status outweighs the benefit of reduced Form 1023 cycle time. Moreover, because Form 1023 cycle time has now begun to rise, any such benefit may have been temporary.

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<sup>36</sup> See, e.g., National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 35, 64 (Area of Focus: *Despite Improvements, TAS Remains Concerned About IRS Treatment of Taxpayers Applying for Exempt Status*) referencing the desirability of requiring from applicants seeking IRC § 501(c)(3) status: (1) the articles of incorporation (2) the bylaws (3) a narrative statement and (4) attestations of core requirements such as having a conflicts of interest policy — all of which drive better practices and behavior at the outset of the entity's existence.

<sup>37</sup> Memorandum from the Deputy Commissioner for Services and Enforcement to the National Taxpayer Advocate (Oct. 25, 2016) sustaining in part National Taxpayer Advocate TAD 2016-1, *Revise Form 1023-EZ to Require Additional Information from Applicants, Require Review of Such Additional Information Before Making a Determination, and Explain Your Conclusions With Respect to Each of 149 Organizations Identified by TAS* (Oct. 5, 2016). See also T.D. 9819, 82 Fed. Reg. 29730-01 (June 30, 2017), final Treasury regulations that permit the IRS to adopt Form 1023-EZ and note in the preamble that the regulations are sufficiently flexible to allow revision of Form 1023-EZ to require filers to submit information regarding their proposed activities.



## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Require Form 1023-EZ applicants, other than corporations in states that make articles of incorporation publicly available online at no cost, to submit their organizing documents.
2. Require Form 1023-EZ applicants to submit summary financial information such as past and projected revenues and expenses.
3. Revise Form 1023-EZ to include a question about whether the organization has a conflicts of interest policy.
4. Accept electronically Form 1023-EZ supporting documents, such as articles of incorporation.
5. Make a determination about qualification as an IRC § 501(c)(3) organization only after reviewing a Form 1023-EZ applicant's narrative statement of actual or planned activities, organizing documents, and any other supporting documents.
6. Make the primary purpose of the contract with MITRE to investigate how to improve procedures for reviewing every application for IRC § 501(c)(3) status, before conferring that status.

**MSP  
#6****PASSPORT DENIAL AND REVOCATION: The IRS's Plans for Certifying Seriously Delinquent Tax Debts Will Lead to Taxpayers Being Deprived of a Passport Without Regard to Taxpayer Rights****RESPONSIBLE OFFICIALS:**

Mary Beth Murphy, Commissioner, Small Business/Self Employed Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

In 2015, Congress passed the Fixing America's Surface Transportation (FAST) Act, which requires the Department of State to deny an individual's passport application and allows the Department of State to revoke or limit an individual's passport if the IRS has certified the individual as having a seriously delinquent tax debt.<sup>2</sup> Although the IRS does not plan to implement the passport certification program until early 2018, the proposed IRS procedures and policies raise concerns about how the program will harm taxpayers and infringe upon their rights. Currently, an estimated 270,000 taxpayers meet the criteria for a seriously delinquent tax debt and do not meet one of the statutory exceptions or discretionary exclusions to certification.<sup>3</sup> The IRS expects to certify 2,700 taxpayers when it initially implements the program in early 2018, and continue with certifications throughout the year in phases based on taxpayer response rates.<sup>4</sup> At this time, the IRS will not be sending recommendations or requests to the Department of State to revoke taxpayers' passports; although, the Department of State will revoke passports in accordance with its longstanding procedures.<sup>5</sup> Nonetheless, taxpayers will be harmed when their passport applications are denied. The National Taxpayer Advocate is concerned that:

- The IRS's failure to provide adequate notice prior to certifying a taxpayer's seriously delinquent tax debt infringes on taxpayer rights and constitutional due process protections;
- The IRS's refusal to exclude taxpayers who already have open TAS cases or who are pursuing other administrative rights frustrates the purpose of the law and jeopardizes taxpayer rights;
- Taxpayers may be unable to resolve their tax debts and have their certifications reversed within the 90-day holding period for passport applications; and

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).

2 Pub. L. No. 114-94, Div. C, Title XXXII, § 32101, 129 Stat. 1312, 1729-32 (2015) (codified as IRC § 7345) (hereinafter FAST Act).

3 These numbers reflect the number of taxpayers who meet certification criteria and do not qualify for an exception as of October 2017. Small Business/Self Employed Division (SB/SE) response to TAS's information request (Oct. 18, 2017).

4 SB/SE response to TAS information request (Oct. 18, 2017).

5 SB/SE response to TAS Fact Check (Dec. 18, 2017).

- Notices to taxpayers leave out important information related to taxpayer rights.

## ANALYSIS OF PROBLEM

### Background

Prior to passing the FAST Act, Congress had introduced multiple bills to deny passport applications or revoke passports for taxpayers with a seriously delinquent tax debt.<sup>6</sup> Congress was concerned about challenges the IRS faced in collecting unpaid tax debt and the significant amount of unpaid federal tax debt owed by passport holders, and it believed it could increase tax compliance by linking passport issuance with paying a tax debt.<sup>7</sup> Under the FAST Act, a seriously delinquent tax debt is an “unpaid, legally enforceable federal tax liability of an individual,” which:

- Has been assessed;
- Is greater than \$50,000 (adjusted for inflation);<sup>8</sup> and
- Meets either of the following criteria: (1) a notice of lien has been filed under Internal Revenue Code (IRC) § 6323 and the Collection Due Process (CDP) hearing rights under IRC § 6320 have been exhausted or lapsed; or (2) a levy has been made under IRC § 6331.<sup>9</sup>

There are statutory exceptions, which include a debt:

- That is being timely paid through an installment agreement (IA) or offer in compromise (OIC);
- For which collection is suspended because the taxpayer requested a CDP hearing or a CDP hearing is pending; or
- For which collection is suspended because the taxpayer has requested relief from joint liability (known as innocent spouse relief).<sup>10</sup>

In addition, the IRS has created discretionary exclusions in its Internal Revenue Manual (IRM) for debts that:

- Are determined to be in currently not collectible (CNC) status due to hardship;<sup>11</sup>

6 See e.g., S. 2132, 112th Cong. § 305 (2012); H.R. 3146, 113th Cong. § 4 (2013); S. 1269, 114th Cong. § 1001 (2015).

7 S. REP. No. 114-45, at 57 (2015). In 2011, the Government Accountability Office found that during fiscal year (FY) 2008, over 224,000 passports (over one percent of the 16 million passports issued during FY 2008) were issued to persons owing over \$5.8 billion in unpaid federal taxes. Government Accountability Office (GAO), GAO 11-272, *Federal Tax Collection: Potential for Using Passport Issuance to Increase Collection of Unpaid Taxes* (Mar. 2011), <http://www.gao.gov/new.items/d11272.pdf>.

8 At the time of drafting this discussion, TAS was not aware of any inflation adjustment to the \$50,000 amount. On January 8, 2017, the IRS published its Internal Revenue Manual (IRM) related to the passport program, which announced that this amount would be increased to \$51,000 as of January 1, 2018. IRM 5.19.1.5.19.2, *Seriously Delinquent Tax Debt* (Jan. 8, 2018). Because of the late timing of this announcement, this discussion and the data cited within use \$50,000 as the relevant amount.

9 FAST Act § 32101(a) (codified as IRC § 7345(b), 32101(f)). Generally, the IRS must notify the taxpayer of the right to a collection due process (CDP) hearing 30 days prior to issuing the first levy for the taxable period. IRC § 6330(a)(1). However, the Code provides exceptions, such as for levies where the collection of tax is in jeopardy or levies of a taxpayer’s state income tax refund. In these cases, the CDP hearing shall occur within a reasonable time after the levy. IRC § 6330(f).

10 FAST Act § 32101(a) (codified as IRC § 7345(b)(2)).

11 Currently not collectible (CNC) status removes taxpayer accounts from active collection inventory. IRM 5.19.17.2, *Currently not Collectible (CNC) Procedures* (Oct. 5, 2017). The IRS places taxpayer accounts into CNC Hardship status when “collection of the liability would create a hardship for taxpayers by leaving them unable to meet necessary living expenses.” IRM 5.19.1.1.6.5.2, *Hardship CNC Closing Codes* (Mar. 1, 2016).

- Result from identity theft;
- Belong to a taxpayer in a disaster zone;
- Belong to taxpayer in bankruptcy;
- Belong to a deceased taxpayer;
- Are included in a pending OIC or pending IA; and
- For which there is a pending claim and the resulting adjustment is expected to result in no balance due.<sup>12</sup>

The law delays certification for taxpayers in a combat zone<sup>13</sup> and provides an exception allowing the Department of State to issue a passport in emergency circumstances or for humanitarian reasons.<sup>14</sup> If a certification is found to be erroneous, the debt is fully satisfied, it becomes legally unenforceable, or it ceases to be a seriously delinquent tax debt due to a statutory exception, the IRS must reverse the certification and notify the Department of State and the taxpayer.<sup>15</sup> The IRS will systemically send certifications and decertifications to the Department of State on a weekly basis, with decertifications required by law to generally be sent within 30 days of a taxpayer meeting the criteria.<sup>16</sup>

### The IRS's failure to provide adequate notice prior to certifying the taxpayer's seriously delinquent tax debt infringes on taxpayer rights and constitutional due process protections

Under the statute, the IRS must notify the taxpayer of a certification or decertification around the same time as it transmits it to the Department of State.<sup>17</sup> The IRS also must include in its CDP hearing notices, information about the certification of seriously delinquent tax debts and the denial, revocation, or limitation of passports.<sup>18</sup> The IRS's failure to provide any additional notice beyond these requirements impairs the taxpayer's *right to be informed* and *right to challenge the IRS's position and be heard* because taxpayers may not learn the IRS has certified their tax debts until after certification.

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**The IRS does not send a stand-alone notice prior to certification and there is no holding period — once the IRS sends the certification notice to the taxpayer, passport denial can occur at any time because the certification is sent to the Department of State at that same time. Thus, the IRS does not provide a meaningful opportunity to contest the certification before it occurs.**

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12 IRM 5.19.1.5.19.4, *Discretionary Certification Exclusions* (Jan. 8, 2018).

13 FAST Act § 32101(d) (codified at IRC § 7508(a)).

14 FAST Act § 32101(e)(1)(B).

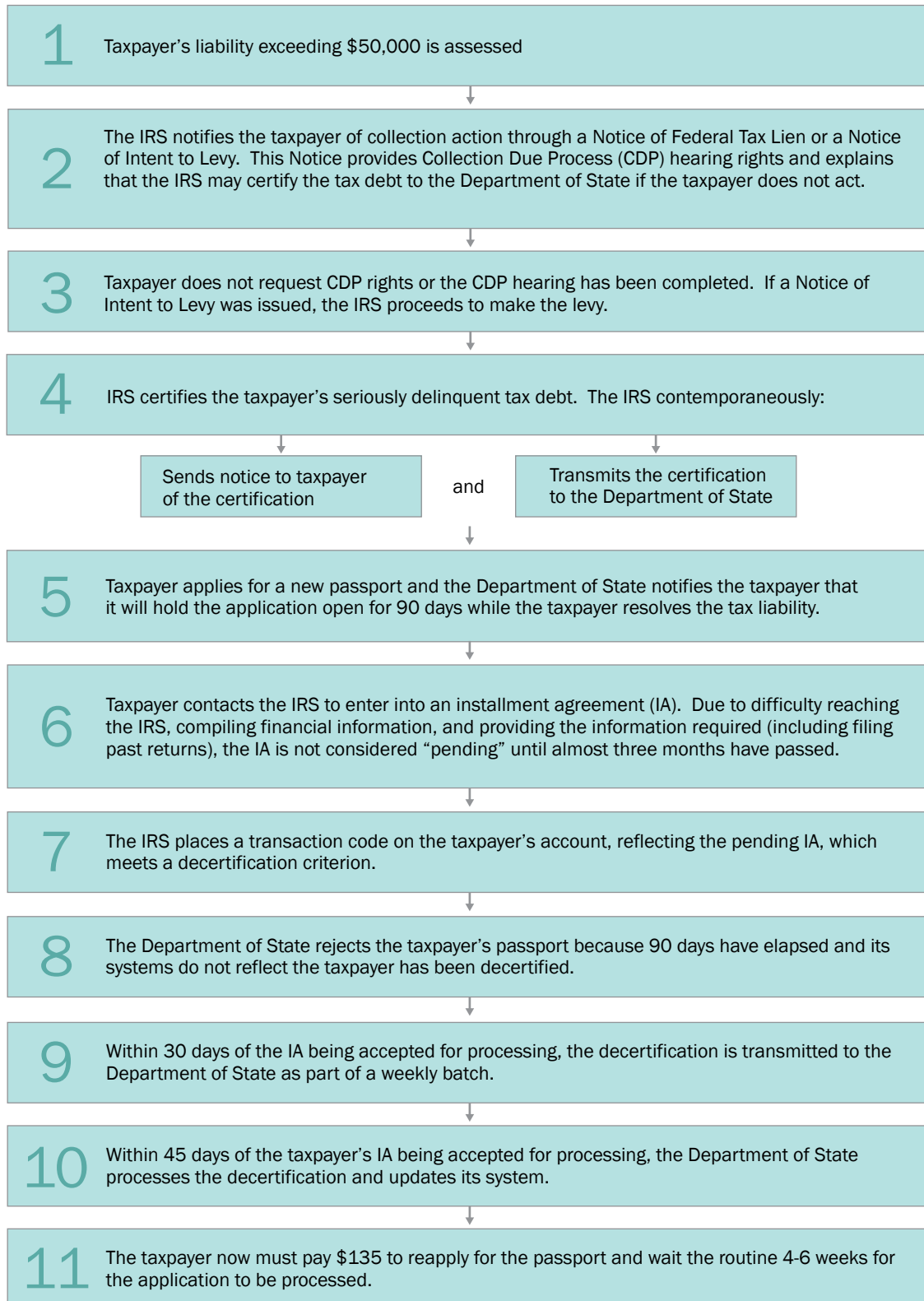
15 FAST Act § 32101(a) (codified at IRC § 7345(c)).

16 FAST Act § 32101(a) (codified at IRC § 7345(c)(2)). An erroneous certification requires the decertification notice to be sent to the Department of State as soon as practicable. *Id.* See IRM 5.19.1.5.19.8, *Certification Process* (Jan. 8, 2018); IRM 5.19.1.5.19.9, *Reversal of Certification* (Jan. 8, 2018).

17 The statute requires “contemporaneous notice.” The notice must explain the taxpayer’s right to bring suit in U.S. Tax Court or a U.S. district court to determine whether the certification was erroneous or whether the IRS has failed to reverse it. FAST Act § 32101(a) (codified as IRC § 7435(d)).

18 FAST Act § 32101(b) (codified as IRC §§ 6320(a)(3)(E), 6331(d)(4)(E)).

### Example of How Passport Certification Process Will Work



This lack of notice may violate the Due Process Clause of the Constitution, which protects the right to travel internationally.<sup>19</sup> In the context of passport denial for unpaid child support,<sup>20</sup> the Court of Appeals for the Second Circuit has found that statute meets due process requirements because it provides for notice and an opportunity to be heard prior to the state agency certifying the unpaid child support to the federal government.<sup>21</sup> In the unpaid child support cases, a Pre-offset Notice (PON) must be issued for all new cases within the U.S. Passport Denial Program. There is then a 30-day holding period after the notice to the taxpayer and before the Department of State is notified and passport denial can occur. The primary focus of the PON is on the pending consequences of not resolving the unpaid amount, including passport denial.<sup>22</sup> In contrast, the IRS does not send a stand-alone notice prior to certification and there is no holding period — once the IRS sends the certification notice to the taxpayer, passport denial can occur at any time because the certification is sent to the Department of State at that same time.<sup>23</sup> Thus, the IRS does not provide a meaningful opportunity to contest the certification before it occurs.

The passport language in the CDP notice may not constitute effective notice because it is buried within four or more pages of other information and is delivered at a time when the taxpayer is focusing on resolution of the debt and claiming CDP rights.<sup>24</sup> Additionally, over three-quarters of the individual taxpayers potentially eligible to be certified did not receive the benefit of the passport language in the CDP notice at all because they received their CDP notices prior to the IRS including it.<sup>25</sup> Despite TAS's request, the IRS has no intention of giving these taxpayers additional, advanced notice. Finally, the IRS's approach to providing notice ignores behavioral research<sup>26</sup> and creates extra work for the IRS, who must process the certification and then reverse it when the taxpayer resolves the liability or meets an exclusion criterion. A stand-alone notice, focussing specifically on the harm that will occur, issued 30 days prior to certification (90 days for taxpayers outside the United States) would protect taxpayer rights and motivate taxpayers to resolve their tax debts quickly, which is the purpose of the statute.

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- 19 See e.g., *Kent v. Dulles*, 357 U.S. 116 (1958). Article 13 of the Universal Declaration of Human Rights states “Everyone has the right to leave any country, including his own, and to return to his country.” United Nations, Universal Declaration of Human Rights, GA Res. 217A (III), UN Doc A/810 (1948).
- 20 The Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996 requires the Department of State to deny a passport application and allows it to revoke or limit a passport if the person owes delinquent child support exceeding \$5,000 (subsequently lowered to \$2,500). Pub. L. No. 104-193, 110 Stat. 2252 (codified as 42 U.S.C. § 652(k)(1)).
- 21 *Weinstein v. Albright*, 261 F.3d 127 (2nd Cir. 2001), *aff'g* 2000 WL 1154310 (S.D.N.Y. 2000).
- 22 See Federal Parent Locator Service, *Federal Offset Program Technical Guide*, Appendix I-17 (Dec. 10, 2012), [https://www.acf.hhs.gov/sites/default/files/ocse/fop\\_user\\_guide.pdf](https://www.acf.hhs.gov/sites/default/files/ocse/fop_user_guide.pdf).
- 23 As discussed below, once a certified taxpayer applies for a passport, the Department of State will hold the passport application open for a “holding period” of 90 days. However, this is different from the holding period in the child support context because the taxpayer is unable to receive a new or renewed passport during this time, at least until the tax debt is resolved. The holding period in the child support context provides time for the person to resolve the debt beforehand and if the person does so, there is never a period when the person cannot receive a new or renewed passport.
- 24 The CDP letter spans at least four pages and includes other information such as how to request a CDP hearing, other actions the IRS may take (such as a lien or levy), and interest and penalty charges. IRS, Letter 1058, *Notice of Intent to Levy and Notice of Your Right to a Hearing* (Jan. 2017).
- 25 These taxpayers owe over \$50,000 in unpaid assessments and received a CDP notice by December 31, 2016, which was not undeliverable, unclaimed, or refused, and did not receive a subsequent CDP notice in 2017. Some of the total number of taxpayers with tax debts of more than \$50,000 will meet statutory or discretionary exclusion criteria.
- 26 By applying behavioral insights, such as the concept of salience, the IRS could increase taxpayers' attention to the passport notices by ensuring the communications are novel (not buried within another notice) and are sent at the time when they are relevant to the taxpayer — shortly before the certification will occur and the taxpayer can still act to avoid certification. See National Taxpayer Advocate 2016 Annual Report to Congress 50-63 (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*).

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Over three-quarters of the individual taxpayers potentially eligible to be certified did not receive the benefit of the passport language in the Collection Due Process (CDP) notice at all because they received their CDP notices prior to the IRS including it.

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**The IRS's refusal to exclude taxpayers who are experiencing significant hardship and have already open TAS cases, or who are exercising administrative rights frustrates the purpose of the law and jeopardizes taxpayer rights**

The passport certification program was intended to assist the IRS with difficult to collect, unpaid tax debts.<sup>27</sup> For taxpayers who are actively working with the IRS to resolve their debts, it is unclear what purpose is served by certifying their tax debts. In the context of private debt collection, the IRS has agreed to not refer open TAS cases to private collection agencies.<sup>28</sup> The National Taxpayer Advocate has repeatedly raised to the then-Commissioner of Internal Revenue and the Commissioner of the Small Business/Self Employed Operating Division the need to exclude already open TAS cases from the inventory of taxpayers whose debts the IRS will certify as seriously delinquent. The IRS has significant discretion to provide certification exclusions.<sup>29</sup> Taxpayers are excluded from certification if they receive CNC hardship status, but taxpayers with similar circumstances who come to TAS because they experience a significant hardship and have been unable to obtain a collection alternative or otherwise resolve their debt on their own would be certified.<sup>30</sup>

Despite this disparate treatment among similarly situated taxpayers, the IRS stated one of its reasons for not excluding TAS cases was to avoid disparate treatment among taxpayers with seriously delinquent tax debts.<sup>31</sup> The IRS also stated that excluding a taxpayer who did not meet an exception would defeat the purpose of the statute. This response is ludicrous, given the IRS itself has created non-statutory exceptions that somehow have not “defeated the purpose of the statute.”<sup>32</sup> Moreover, TAS accepts cases only from taxpayers who are suffering or are about to suffer a significant hardship, as defined in the Internal Revenue Code and Treasury Regulations,<sup>33</sup> and only keeps cases open if taxpayers are working to achieve a resolution.<sup>34</sup> Once a case is closed, taxpayers would be certified if they did not meet an exclusion. In fiscal year 2017, TAS closed approximately 2,700 balance due cases where the taxpayer owed more than \$50,000 and received full or partial relief.

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27 “The Committee is aware that the amount of unpaid Federal tax debts continues to present a challenge to the IRS. The Committee is also aware that a significant amount of unpaid Federal tax debt is owed by persons to whom passports have been issued... The Committee believes that tax compliance will increase if issuance of a passport is linked to payment of one’s tax debts.” S. REP. No. 114-45, at 57 (2015).

28 National Taxpayer Advocate FY 2018 Objectives Report to Congress, vol. 2, 97.

29 The statute states: “If the Secretary receives certification by the Commissioner of Internal Revenue that an individual has a seriously delinquent tax debt...” FAST Act § 32101(a) (codified as IRC § 7345(a)).

30 IRM 5.16.1.2.9, *Hardship* (Aug. 25, 2014) provides a definition of “hardship” for CNC status. Treas. Reg. § 301.7811(a)(4)(2) provides the definition of a “significant hardship” for the purposes of issuing a Taxpayer Assistance Order (TAO).

31 Email from SB/SE Commissioner to National Taxpayer Advocate (Sept. 20, 2017) (on file with TAS).

32 See IRM 5.19.1.5.19.4, *Discretionary Certification Exclusions* (Jan. 8, 2018).

33 IRC § 7811(a)(2); Treas. Reg. § 301.7811(a)(4)(ii).

34 IRM 13.1.21.1.3.19, *No or Partial Reply from Taxpayer* (Feb. 2, 2011).

The IRS also considered the following factors in deciding not to exclude TAS cases:

- “Only” 10 percent of open TAS cases met passport certification criteria;
- Only taxpayers who are in the process of applying for or renewing a passport would be affected;
- TAS can expedite decertification if it identifies a case meeting exclusion criteria;
- If TAS and the IRS come to a resolution that meets one of the exclusion criteria, the taxpayer will be systemically decertified; and
- The Department of State applies a 90-day holding period before a passport application is denied.<sup>35</sup>

As of October 1, 2017, there were approximately 800 TAS cases where the taxpayer had an aggregate, unpaid, assessed tax liability of more than \$50,000, and the taxpayer did not qualify for either a statutory exception or a discretionary exclusion as defined in the IRM.<sup>36</sup> The IRS is incorrect that only taxpayers currently seeking a passport or renewal are affected because the statute also provides the Department of State with the authority to revoke passports,<sup>37</sup> and there may be situations where taxpayers need a new passport in the future before they can resolve their tax debts. Certifying a taxpayer already trying to resolve their tax debt, only to require TAS to request and the IRS to process a manual expedited decertification, makes little sense from a resource and taxpayer rights perspective. As discussed below, the expedited decertification procedures and 90-day holding period may not provide relief.

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**As of October 1, 2017, there were approximately 800 TAS cases where the taxpayer had an aggregate, unpaid, assessed tax liability of more than \$50,000, and the taxpayer did not qualify for either a statutory exception or a discretionary exclusion as defined in the Internal Revenue Manual.**

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Although the statute only references administrative rights provided as part of a CDP hearing, the legislative history makes clear Congress intended to “permit revocation of a passport only after the IRS has followed its examination and collection procedures under current law and the taxpayer’s administrative and judicial rights have been exhausted or lapsed.”<sup>38</sup> One of a taxpayer’s administrative rights and rights under the Taxpayer Bill of Rights (TBOR) is to seek assistance from TAS. When one reads IRC § 7811<sup>39</sup> in harmony with the FAST Act, it is clear taxpayers who are already seeking assistance from TAS should be excluded. Similarly, there are other administrative remedies that

35 Email from SB/SE Commissioner to National Taxpayer Advocate (Sept. 20, 2017) (on file with TAS).

36 IRC § 7345(b)(2). IRM 5.19.1.5.19.4, *Discretionary Certification Exclusions* (Jan. 8, 2018). This analysis does not include as an exclusion any taxpayer who has an offer in settlement. Taxpayers in ZIP codes that were declared disaster areas were determined from analyzing the zip codes where the disaster declaration lasts past October 1, 2017, as defined by the following website: <http://www.icce.irs.gov/fema/>.

37 FAST Act § 32101(e)(2). *But see* SB/SE response to TAS information request (Oct. 18, 2017) (stating the IRS will not be making requests to the Department of State to revoke taxpayers’ passports).

38 H.R. REP. No. 114-357, at 531-32 (2015).

39 IRC § 7811 authorizes the National Taxpayer Advocate to issue a TAO when a taxpayer is suffering or is about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered.



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**Certifying a taxpayer already trying to resolve their tax debt, only to require TAS to request and the IRS to process, a manual expedited decertification, makes little sense from a resource and taxpayer rights perspective.**

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should be excluded. Notably, Congress specified “examination and collection procedures *under the law* [emphasis added]” but did not make the same specification for other administrative rights, which include: Equivalent Hearings,<sup>40</sup> Collection Appeals Program (CAP) procedures,<sup>41</sup> and the Post Appeals Mediation program.<sup>42</sup> As noted earlier, the IRS has wide discretion to establish administrative exclusions to certification. Refusing to exclude taxpayers working with TAS or exercising established administrative rights does not achieve the purpose of the law and violates taxpayer rights.

### **Taxpayers may be unable to resolve their tax problems and have their passport applications approved during the 90-day holding period for keeping passport applications open**

The Department of State will hold passport applications of certified taxpayers open for 90 days before denying them to allow the taxpayers to resolve their tax debts. However, the IRS errs by designing its policies and procedures under the assumption that the 90-day period will provide relief to most taxpayers. The IRS cites the 90-day period as a reason for not excluding open TAS cases, but this argument ignores the reality of TAS casework — it tends to be complex, cannot be resolved through normal IRS channels, and often takes additional time. Notwithstanding that TAS works cases expeditiously and holds its employees accountable for taking timely actions,<sup>43</sup> the average TAS collection case stays open for 88 days, from receipt to completion of all actions necessary to resolve the taxpayer’s problem.<sup>44</sup> When you combine this time with the up to 30 days required for transmitting the decertification, the 90-day holding period will be unhelpful for many taxpayers with TAS cases.

Taxpayers trying to resolve their tax debts on their own may be unable to do so within the 90-day period because during the 2017 filing season, the level of service on the IRS’s Balance Due phone line was only 40 percent and the average hold time was 47 minutes.<sup>45</sup> Furthermore, the Department of State passport hold letter advises “it may take an additional 45 days after you resolve your debt with the IRS

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40 Equivalent Hearings (EHs) hold the same purpose as CDP hearings — to provide the taxpayer with the opportunity 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. IRM 5.19.8.4.3, *Equivalent Hearing (EH) Requests and timeliness of EH Requests* (Nov. 1, 2007). See generally IRC § 6330(c)(2).

41 The Collection Appeals Program (CAP) is an administrative program that allows a taxpayer to appeal certain collection actions or proposed collection actions and is available in a wider set of circumstances than a CDP hearing. IRM 8.24.1, *Collection Appeals Program and Jeopardy Levy Appeals, Collection Appeals Program (CAP)* (Dec. 2, 2014).

42 IRC § 7123 requires the IRS to establish procedures for nonbinding mediation on any issue unresolved after appeals procedures or an unsuccessful attempt to enter into a closing agreement or OIC.

43 TAS evaluates employee performance by looking at factors such as “substantive actions to move case towards resolution,” “initial actions taken timely,” and “follow-up actions timely.” TAS Case Quality Attributes (FY 2017).

44 TAS Report, *TAS Relief Rate by Primary Core Issue Code (PCIC) by Business Operating Division (BOD), FY 2017: October 10 through September 12* (Oct. 1, 2017).

45 See IRS, Joint Operations Center, *Snapshot Reports: Product Line Detail: Installment Agreement/Balance Due* (week ending April 22, 2017). See Most Serious Problem: *Telephones: The IRS Needs to Modernize the Way It Serves Taxpayers Over the Telephone, Which Should Become an Essential Part of an Omnichannel Customer Service Environment*, *supra*.

for the information to be cleared from our system.”<sup>46</sup> The IRS’s expedited decertification procedures may not provide relief for taxpayers close to the end of the 90-day period. After the taxpayer has met the expedited decertification criteria, the account has been correctly marked, and an IRS employee has received supervisory approval to submit the request form to the Collection Policy Passport Analyst, it can still take up to an additional ten days for the decertification to reach the Department of State.<sup>47</sup> Once the Department of State rejects the passport application, the applicant forfeits the application and processing fees (\$135 for new adult applicants) and must reapply.<sup>48</sup>

### Notices to taxpayers leave out important information related to their rights

Although the IRS provided draft versions of Notice CP 508C, *Passport Denied or Revoked Due to Serious Tax Delinquency*, to TAS for review, it rejected TAS’s suggestions and proceeded to publish the notice without negotiating TAS’s recommendations. Notice CP 508C provides only two options for taxpayers to prevent Department of State from denying, revoking, or limiting a taxpayer’s passport: full payment of the liability or alternate payment arrangements, such as an IA or OIC. The notice lacks any language about other situations where tax debts may be excluded from the program, such as if the taxpayer is a victim of identity theft or qualifies for CNC hardship. In response to TAS’s recommendation to include this information, the IRS stated that the information was not appropriate for the notice, it was included on irs.gov, and it is not included on the notice of levy or any other collection action letters.<sup>49</sup> Because the CP 508C is the only stand-alone notice the taxpayer receives regarding passport certification, it is the most appropriate place for informing the taxpayer about exceptions to certification. While including this information on irs.gov is helpful, failing to include it on the passport certification notice is inconsistent with the TBOR, which states taxpayers “are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence.”<sup>50</sup> The fact that the information does not appear in any other collection notices makes it even more crucial for the information to appear on the CP 508C.

The CP 508C notice also fails to inform taxpayers that if they have emergency or humanitarian reasons for needing to travel, the Department of State can make an exception and they should contact the Department of State directly. The IRS rejected TAS’s recommendation to add such language because the statute places the responsibility on the Department of State to administer this exception and Department of State sends out its own notice when denying a passport application.<sup>51</sup> The fact that the Department of State administers this exception provides an argument for including this information: without explaining this exception and directing taxpayers to the Department of State, the IRS is inviting additional calls from taxpayers who believe the IRS may be able to help in these situations. In the age of limited resources, the IRS could save itself work by adding a single sentence to this notice. Additionally, the Department of State letter does not include any information about the emergency and humanitarian exception and could mislead a taxpayer experiencing an emergency to believe they must

46 Dept of State, Letter 695 – Debts, Clearance Holds, 06 - IRS – Seriously Delinquent Tax Debt (May 20, 2015).

47 To meet the criteria for expedited decertification, the taxpayer must have a pending application for passport or renewal, and either be traveling outside the United States within 45 days or reside outside the United States with an urgent need for a passport. IRM 5.19.1.5.19.9.1, *Expedited Decertification* (Jan. 8, 2018).

48 Dept of State, Letter 696, Denial – Not Entitled to U.S. Passport, 05- Denial – IRS (July 2016); Dept of State, United States Passport Fees, [https://travel.state.gov/content/dam/passports/FeeChart/PassportFeesChart\\_TSG\\_January 2017.pdf](https://travel.state.gov/content/dam/passports/FeeChart/PassportFeesChart_TSG_January 2017.pdf) (Jan. 2017).

49 TAS, Internal Management Document 5164, IRS response (Aug. 4, 2017).

50 IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

51 TAS, Internal Management Document 5164, IRS response (Aug. 4, 2017).

work with the IRS.<sup>52</sup> Another shortcoming of the Department of State letter is the lack of information about TAS. If a taxpayer has been trying to work with the IRS unsuccessfully, or is suffering from a significant hardship, the taxpayer should be directed to TAS, not the IRS. Although TAS did not have the opportunity to provide comments or suggestions on the Department of State passport denial letters, we will independently approach the Department of State to advocate for the rights of taxpayers subject to IRS's certification.

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**Taxpayers have a constitutional right to travel, and the IRS risks abridging this right by declining to adopt additional taxpayer protections, such as stand-alone pre-certification notices that provide taxpayers with the *right to challenge the IRS's position and be heard*.**

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## CONCLUSION

When the IRS begins implementing the passport certification program in early 2018, taxpayers will be harmed from the moment they need to apply for a passport and are denied due to the IRS's certification. The statute itself provides some taxpayer protections, such as requirements for including passport language in CDP notices and exceptions for taxpayers who are actively paying as part of an IA or OIC. However, taxpayers have a constitutional right to travel, and the IRS risks abridging this right by declining to adopt additional taxpayer protections, such as stand-alone pre-certification notices that provide taxpayers with the *right to challenge the IRS's position and be heard*. Despite the broad discretion provided by Congress, the IRS has refused to exclude taxpayers suffering a significant hardship and actively working with TAS, and those pursuing administrative remedies not specifically listed in the statute. By going after taxpayers who are already actively trying to resolve their tax problems, the IRS fails to follow the spirit of the law and infringes on a taxpayer's *right to challenge the IRS's position and be heard* and *right to a fair and just tax system*.

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52 The letter states "Neither this passport agency nor the Department of State has information concerning your seriously delinquent tax debt. You may contact the IRS at..." and "If you have urgent travel, you should contact the IRS at the number listed above immediately." Dept of State, Letter 695 – Debts, Clearance Holds, 06 - IRS – Seriously Delinquent Tax Debt (May 20, 2015).

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Provide a stand-alone notice to all taxpayers 30 days (90 days for taxpayers outside the United States) prior to certifying their seriously delinquent tax debts that discusses the specific harm that will occur and outlines all options available to taxpayers to avoid or reverse certification.
2. Exercise its discretionary authority to exclude from passport certification any taxpayers who already have an open case with TAS at the time the IRS would otherwise certify their seriously delinquent tax debts.
3. Exercise its discretionary authority to exclude from passport certification any taxpayers who have requested certain alternative administrative remedies, including an Equivalent Hearing, a Collection Appeals Program (CAP) Appeal, or Post Appeals Mediation, and delay certification for these taxpayers until they receive a final determination from these programs.
4. Revise its procedures for expedited decertification to transmit the decertification to the Department of State within two business days after the Collection Passport Policy Analyst receives the approved request form.
5. Update Notice 508C to include information about all ways in which a taxpayer can become eligible for decertification and advise taxpayers to contact the Department of State if they have an emergency or humanitarian need to travel.

MSP  
#7**EMPLOYEE TRAINING: Changes to and Reductions in Employee Training Hinder the IRS's Ability to Provide Top Quality Service to Taxpayers****RESPONSIBLE OFFICIALS**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed  
 Kenneth Corbin, Commissioner, Wage and Investment  
 Donna Hansberry, Chief, Appeals  
 Don Fort, Chief, Criminal Investigations  
 Sunita B. Lough, Commissioner, Tax Exempt and Government Entities  
 Douglas W. O'Donnell, Commissioner, Large Business and International

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

The IRS is charged with administering the Internal Revenue Code (IRC), a massive document encompassing approximately four million words.<sup>2</sup> The IRC is a living document as Congress continually enacts new laws; over one change to the tax code per day on average,<sup>3</sup> requiring employees to be up to date on the latest changes in order to assist taxpayers and fulfill the IRS mission to “[p]rovide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.”<sup>4</sup> However, the IRS has reduced its employee

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).

2 To determine the number of words in the IRC, TAS downloaded Title 26 of the U.S. Code (i.e., the Internal Revenue Code) 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 November 14, 2017. 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.

3 Unpublished data provided by Wolters Kluwer Tax & Accounting to TAS (Dec. 8, 2016). This analysis shows nearly 5,900 changes to the tax code since 2001. Wolters Kluwer notes there is some subjectivity in computing these numbers because the counts are tied to how legislation is written. In general, an “Act Finding List” lists every Act section (or portion thereof) in a given Public Law and the corresponding amendment(s) it makes to the IRC. For example, assume an Act adds three new sections to the IRC. If the Act contains three sections that each adds one Code section, Wolters Kluwer would count three Code changes. But if the Act contains one section that adds a new Part to the IRC and that Part, in turn, contains the same three new Code sections, Wolters Kluwer would count one Code change.

4 IRS, *The Agency, its Mission and Statutory Authority*, <https://www.irs.gov/uac/the-agency-its-mission-and-statutory-authority>.

training budget by nearly 75 percent since fiscal year (FY) 2009.<sup>5</sup> Not only has the budget for training drastically declined, but the way in which employees receive that training has shifted from in-person, face-to-face training to virtual training. The National Taxpayer Advocate is particularly concerned that:

- In FY 2017, the IRS spent \$489 (about three percent of its budget) per employee on training compared to about \$1,450 per employee in FY 2009.<sup>6</sup>
- Wage and Investment (W&I), with the most employees of any operating division, spends only \$87 per employee per year for training.<sup>7</sup>
- Face-to-face training has been replaced by virtual training.<sup>8</sup>
- The IRS provides only 19 hours of training per employee in at least one key job series, which includes nearly five hours of mandatory briefings, leaving only 14 hours of substantive training.<sup>9</sup>
- The number of courses available to employees in key job series declined.<sup>10</sup>

IRS employees cannot be expected to provide competent advice and adequate service to taxpayers who present myriad issues when they do not receive training timely or effectively. The downstream consequences to the IRS and taxpayers, including rework, misleading or incomplete advice, improper compliance actions, and distrust in the IRS serve to further degrade the relationship between the IRS and taxpayers and violate the taxpayer *rights to be informed, to quality service, and to a fair and just tax system*. Employees must receive timely, comprehensive, and effective training in order to protect taxpayer rights and provide top quality service to taxpayers. In light of current tax reform legislation, the National Taxpayer Advocate is concerned with how the IRS will effectively and efficiently train employees on the new tax laws in addition to providing regular substantive training given the budget and hours currently dedicated to training.

5 IRS response to TAS information request (Nov. 22, 2013 and Nov. 7, 2017); IRS response to TAS fact check (Dec. 15, 2017). While the budget for training has increased by approximately \$17 million since a low point of approximately \$22.6 million in fiscal year (FY) 2013, the reduction from previous years of over \$113 million spent on training is drastic.

6 IRS response to TAS information request (Nov. 22, 2013 and Nov. 7, 2017). IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/> (last visited Nov. 15, 2017). The IRS had 105,783 employees as of the last week of FY 2009 and spent \$153,155,686 on training. Per employee, the IRS spent \$1,448 in FY 2009 and only \$489 in FY 2017. IRS response to TAS information request (Nov. 22, 2013 and Dec. 7, 2017). IRS response to TAS fact check (Dec. 15, 2017).

7 IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/> (last visited Nov. 17, 2017). IRS response to TAS information request (Nov. 7, 2017).

8 In FY 2009, the IRS offered 314 face-to-face trainings for the Office of Appeals 0592 job series. In FY 2017, only 13 face-to-face trainings were available to these employees, a reduction of nearly 96 percent. IRS response to TAS information request (Nov. 22, 2013 and Nov. 7, 2017).

9 IRS response to TAS information request (Nov. 7, 2017). For example, employees in the Tax Exempt and Government Entities (TE/GE) 0592 job series received 18.75 hours of training per employee, not even three full work days of training in an entire year. The IRS-wide position description for the Tax Examining Technician details that these employees must possess extensive knowledge of individual and business tax law, forms, regulations, collection techniques, notices, and many other IRS documents. IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/> (last visited Nov. 17, 2017). IRS, *Standard Position Description GGS-0592-07* (June 18, 2003). All IRS employees in FY 2017 were required to take a series of briefings accounting for at least 4.83 hours of training. Those courses were: Information Systems Security Refresher, Unauthorized Access (UNAX) Awareness, Facilities Management and Security Services Physical Security Briefing, Notification and Federal Employee Antidiscrimination and Retaliation Act of 2002 (No FEAR Act) Briefing Refresher, Records Management Awareness, Privacy, and Information Protection & Disclosure Refresher.

10 For instance, employees in the Office of Appeals 0592 job series had 213 course options in FY 2013 compared to 153 course options in FY 2017. IRS response to TAS information request (Nov. 22, 2013 and Nov. 7, 2017). It is important to note that many of the course offerings are mandatory briefings on topics such as physical safety and other required non-tax law substantive courses such as time entry instruction or voicemail tutorials.

## ANALYSIS OF THE PROBLEM

### Background

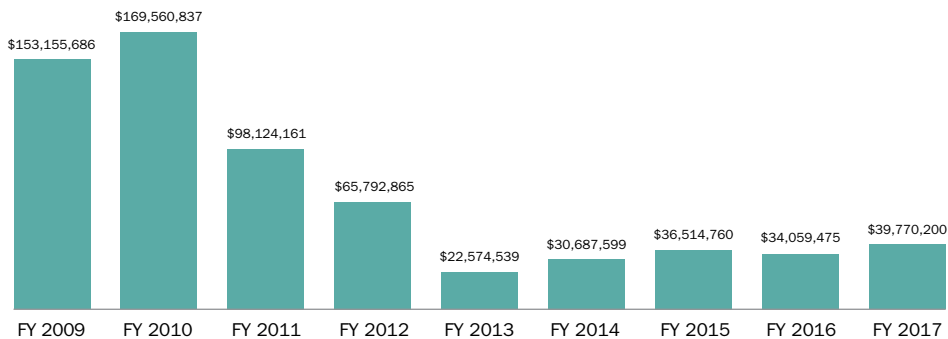
In FY 2017, the IRS allocated \$39.8 million of its over \$11 billion budget to training its employees, or just over 0.3 percent of the total budget.<sup>11</sup> Taking actual dollars appropriated to the IRS, the IRS budget has declined just under \$300 million in raw dollars since FY 2009 or about 2.5 percent, while at the same time, it has cut its training budget by nearly 75 percent.<sup>12</sup> The IRS has faced many years of reduced budgets, including additional cuts due to sequestration in FY 2013.<sup>13</sup>

### Cuts to Training Far Exceed Cuts to the Overall IRS Budget

Sequestration resulted in an eight year low of spending on training in FY 2013, with only \$22.6 million spent on training for all employees.<sup>14</sup> However, despite a restoration of spending on training of slightly over \$17 million by the end of FY 2017, budgets across the IRS divisions for training have increased unevenly.<sup>15</sup>

FIGURE 1.7.1<sup>16</sup>

IRS Training Budget by Fiscal Year



Taking actual dollars appropriated to the IRS, the IRS budget has declined just under \$300 million in raw dollars since fiscal year 2009 or about 2.5 percent, while at the same time, it has cut its training budget by nearly 75 percent.

11 IRS response to TAS fact check (Dec. 7, 2017). Department of Treasury, *2017 Treasury Operating Plan* 32.

12 *Id.* at 1 and 32.

13 Budget Control Act of 2011, Pub. L. No. 112-25.

14 IRS response to TAS information request (Nov. 22, 2013).

15 IRS response to TAS fact check (Dec. 7, 2017).

16 *Id.*

### *The IRS Has Slashed the Wage & Investment Division (W&I) Training Budget*

The W&I mission is to “provide Wage and Investment customers top quality service by helping them understand and comply with applicable tax laws and to protect the public interest by applying the tax law with integrity and fairness to all.”<sup>17</sup> Being the largest of the IRS operating divisions, W&I serves over 123 million<sup>18</sup> individual taxpayers and boasts nearly 35,000 employees or about 43 percent of all IRS employees.<sup>19</sup> Yet, between the low point of FY 2013 IRS spending on training and the end of FY 2017, the training budget for W&I actually decreased by nearly \$1 million, a decrease of over 24 percent.<sup>20</sup> W&I is spending only \$87 per employee per year for training, which is more than 81 percent less than the IRS spends on average per employee.<sup>21</sup>

W&I employees are the face and the voice of the IRS. W&I maintains the Taxpayer Assistance Centers (TACs)<sup>22</sup> and provides many of the employees answering the IRS main toll-free line.<sup>23</sup> An individual taxpayer needing to resolve an IRS issue, ask a question, make a payment, request a form, or complete many other routine tasks is most likely to speak to a W&I employee, yet the IRS is spending almost nothing to provide training to these customer-facing employees.

The National Taxpayer Advocate and her staff attend many industry gatherings, speak at conferences and events, and hear directly from taxpayers and practitioners.<sup>24</sup> A common concern expressed by taxpayers and practitioners alike is that they are not receiving accurate advice or resolving their issues when they contact the IRS. When W&I is only able to spend \$87 per employee per year for training, it is not surprising that taxpayers are unable to rely on the advice received or be confident in the answer provided by the IRS. The National Taxpayer Advocate frequently hears that employees rely on scripts to answer taxpayer questions. If the issue is beyond the scope of the script, the taxpayer cannot be assisted by that employee. A lack of training undermines the taxpayers’ *right to be informed* and the *right to quality service* and erodes trust and confidence in the IRS and prevents employees from having the tools to effectively do their jobs.

17 IRS, *Mission*, <http://www.irs.gov/pub/irs-news/ir-98-59.pdf> (last visited Nov. 15, 2017).

18 *Id.*

19 IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/> (last visited Nov. 17, 2017).

20 IRS response to TAS information request (Nov. 22, 2013 and Nov. 7, 2017).

21 IRS response to TAS information request (Nov. 7, 2017).

22 For a more detailed discussion of Taxpayer Assistance Centers (TACs), see Most Serious Problem: *Taxpayer Assistance Centers (TACs): Cuts to IRS Walk-In Sites Have Left the IRS With a Substantially Reduced Community Presence and Have Impaired the Ability of Taxpayers to Receive In-Person Assistance*, *infra*.

23 For a more detailed discussion of the IRS telephone service, see Most Serious Problem: *Telephones: The IRS Needs to Modernize the Way It Serves Taxpayers Over the Telephone, Which Should Become an Essential Part of an Omnichannel Customer Service Environment*, *infra*.

24 One method that anyone can use to report a systemic IRS issue to TAS is through the Systemic Advocacy Management System (SAMS). <https://www.irs.gov/advocate/systemic-advocacy-management-system-sams>. For example, the National Taxpayer Advocate recently met with attorney from the Southeast Regional Bar Association at their liaison meeting. Several attorneys in attendance related issues with completing tasks at TACs (Oct. 20, 2017). The tasks in question, making payments and filing a return do not require appointments, yet these practitioners were turned away for not having appointments. For a more detailed discussion of TACs, see Most Serious Problem: *Taxpayer Assistance Centers (TACs): Cuts to IRS Walk-In Sites Have Left the IRS With a Substantially Reduced Community Presence and Have Impaired the Ability of Taxpayers to Receive In-Person Assistance*, *infra*. See also <https://taxpayeradvocate.irs.gov/news/nta-blog-taxpayer-assistance-center-service-continues-to-decline-impairing-taxpayers-ability-to-receive-in-person-assistance?>



### *Training Dollars Vary Wildly by Operating Division*

Many IRS operating divisions handle extremely difficult, technical cases and require specialized training to address the issues presented by these cases. As a result, spending in highly technical job series and divisions will necessarily cost more money in order to provide appropriate training. For example, the Criminal Investigation division spent about \$2,000 per employee in FY 2017.<sup>25</sup> However, it is baffling that W&I employees received only \$87 worth of training per employee while these employees deal directly with over 123 million taxpayers, and Agency Wide Shared Services employees, who provide payroll, facilities, physical security, travel, credit card, cross-functional administrative and procurement support to the operating divisions, received over \$479 of training per employee.<sup>26</sup> In other words, employees who assist taxpayers directly in key taxpayer service functions receive 80 percent less training dollars per employee than employees who manage internal administrative functions such as payroll.

### **Employees in Key Job Series Receive Very Little Training**

TAS identified key job series in the IRS operating divisions, by division, where employees need technical knowledge and work directly with taxpayers or on taxpayer cases.<sup>27</sup> Within these categories of employees and across the operating divisions, training hours delivered to the employees varies widely. In the Tax Exempt and Government Entities (TE/GE) Division job series 0592, Tax Examining Technician, the employees received an average of 19 hours of training per employee, while W&I employees in the same job series received almost 65 hours of training per employee.<sup>28</sup>

The IRS-wide position description for the Tax Examining Technician details that these employees must possess extensive knowledge of individual and business tax law, forms, regulations, collection techniques, notices, and many other IRS documents.<sup>29</sup>

Additional duties include:

- Responding to taxpayer inquiries regarding tax return preparation, including schedules and documentations;
- Analyzing and resolving tax processing problems, including adjusting accounts, issuing manual refunds and computing tax, penalties and interest; and
- Recommending lien and/or levy action.<sup>30</sup>

After backing out required courses such as ethics, unauthorized account access and physical safety briefing, TE/GE Tax Examining Technicians receive only 14 hours per employee of training per year.<sup>31</sup>

25 IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/> (last visited Nov. 17, 2017); IRS response to TAS information request (Nov. 7, 2017).

26 *Id.*

27 TAS looked at training made available to tax examining technicians, revenue agents, revenue officers, customer service specialists, bankruptcy specialists, and tax analysts.

28 IRS response to TAS information request (Nov. 7, 2017). IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/> (last visited Nov. 17, 2017). Wage and Investment (W&I) hired over 1,000 new employees in this job series in FY 2017, while TE/GE had no new hires in FY 2017. As a result, W&I employees may have received, on average, more training per employee due to the length of the new hire training courses. However, it is important to note that W&I had over 4,700 existing employees in this job series compared to TE/GE's slightly over 100 employees. IRS response to TAS fact check (Dec. 15, 2017).

29 IRS, *Standard Position Description GGS-0592-07* (June 18, 2003).

30 *Id.*

31 IRS response to TAS information request (Nov. 7, 2017). IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/> (last visited Nov. 17, 2017).

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In other words, employees who assist taxpayers directly in key taxpayer service functions receive 80 percent less training dollars per employee than employees who manage internal administrative functions such as payroll.

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How can an employee responsible for the duties detailed in the position description possibly be informed of all changes to the law, forms, regulations, notices, etc., in only 14 hours of training per year?

### In-person Training Continues to Decrease in Certain Key Job Series

In FY 2013, the IRS cut most in-person training in response to sequestration. While hours of in-person training have increased in certain key job series, several have been cut even further from the low FY 2013 levels.<sup>32</sup> Revenue Agents in Small Business/Self-Employed (SB/SE) and TE/GE received even less in-person training in FY 2017 than in FY 2013. SB/SE Revenue Agents received almost 36 hours of in-person training per employee in FY 2013, while in FY 2017 they received only 21 hours of in-person training.<sup>33</sup> TE/GE Revenue Agents received nearly 27 hours of in-person training per employee in FY 2013 while in FY 2017 those same employees received less than seven hours of in-person training.<sup>34</sup> While the National Taxpayer Advocate understands that costs associated with in-person training are expensive, learning directly with other employees and exchanging ideas and strategies face-to-face helps employees learn from each other. Moreover, in-person training is highly effective in promoting problem solving, and it enables instructors to identify areas in need of clarification and additional instruction.

### The IRS Can Use Many Strategies to Deliver In-Person Training

Training can be delivered to employees via many vehicles. However, all training methods are not equally effective. Training, particularly in critical job skills, must be provided in the most effective manner possible to allow employees to gain and practice the skills necessary to do their jobs. Skills that involve communicating directly with the taxpayer and eliciting the information necessary to reach the right answer for that taxpayer are critical to any job series that involves taxpayer communication.

For example, TAS recently conducted an in-person training on these skills at the Congressional Affairs Program Conference for Local Taxpayer Advocates (LTAs), who were then able to take what they learned back to their office and train their case advocates and other employees in this critical skill.<sup>35</sup> Similarly, in preparation for case assignments to Private Collection Agencies (PCAs), in January 2017, TAS delivered in-person training to PCA managers which included a 45-minute video of the National Taxpayer Advocate explaining how the Taxpayer Bill of Rights applies to PCA employees and

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32 The IRS believes it is more appropriate to focus on the change in total training hours, including virtual training, as compared with solely in-person training. We disagree. Virtual training is not as effective as in-person for many purposes. For example, in-person training allows groups of employees to discuss cases and consider alternative scenarios in ways that cannot be replicated through online training. Moreover, even focusing on total training, hours per employee have generally dropped significantly. With respect to Revenue Agents in TE/GE, for example, the IRS reports that the number of training hours per employee has declined from 80.39 hours per employee in FY 2013 to 43.48 hours per employee in FY 2017, a reduction of almost 46 percent. IRS response to TAS fact check (Dec. 15, 2017).

33 IRS response to TAS information request (Nov. 22, 2013 and Nov. 7, 2017).

34 *Id.*

35 See also *Case Advocacy, infra*. Currently TAS is developing TAS Employer Shared Responsibility Payment training that will kick off with train-the-trainer sessions in January 2018 and continue with training all TAS employees in January as part of Filing Season Readiness training.

activities.<sup>36</sup> We also delivered PCA training to all LTAs in March 2017, and created a dedicated mailbox for case advocates to send any questions they have about the program, committing to provide answers to their questions within 24 hours.

Having “train the trainer” courses in-person can be an effective way to teach critical job skills. This methodology permits the trainer to go back and provide the training to employees in their local area, thus limiting the number of employees who need to travel for training.

Further, the IRS should make use of training provided by other entities, such as the American Bar Association or the American Institute of Certified Public Accountants, state and local Bar and Certified Public Accountant (CPA) associations, and educational institutions. Employees could be encouraged to seek out opportunities for training from outside groups and be granted permission to attend on a rotating basis in their local commuting areas. TAS obtained an opinion from the IRS Office of Chief Counsel that TAS employees can accept waived admission fees to attend outside continuing professional education courses; the IRS should pursue the same.

Additionally, TAS makes use of outside experts in presenting training to TAS employees. Recently TAS filmed training related to the Annual Report to Congress Most Litigated Issues (MLI) section, focusing on issues that TAS employees may encounter in their case work. The National Taxpayer Advocate, her attorney-advisors, and practitioners from Low Income Taxpayer Clinics (LITCs) delivered these trainings. The perspective from practitioners can be invaluable in adding real-world experience to training and driving home how the work IRS employees do impacts taxpayers. LITCs in particular can provide information on how IRS practices are born out in the low income taxpayer community, a particularly vulnerable population. This training is available to all IRS employees through a video link. In fact, one Appeals manager reached out to TAS inquiring how his employees can access the MLI training and was provided the link.

### The IRS’s Failure to Provide Adequate Training to Employees Impacts Taxpayer Rights and Causes Downstream Consequences

Taxpayers have the *right to be informed* and *to quality service*.<sup>37</sup> If the IRS does not provide timely and comprehensive training to its employees, taxpayers cannot expect to receive quality service and may be misinformed.<sup>38</sup> Taxpayers need to be able to trust that they can contact the IRS and receive the right answer from any employee. Anything less erodes trust and confidence in an agency that already struggles in both areas. Failure to train employees comprehensively can also result in rework or further taxpayer contacts, causing additional costs to the IRS. It may also result in costs to taxpayers who may feel the need to turn to paid tax assistance in order to receive appropriate guidance. Or, a taxpayer may become frustrated and give up which could have dire consequences in the form of liens or levies for that taxpayer.

36 See also Case Advocacy, *infra*. Despite TAS’s offer to deliver this training to all Private Collection Agencies (PCA) employees, the IRS refused to impose this training requirement.

37 See TBOR, [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).

38 For a discussion of the TBOR, see Most Serious Problem: *Taxpayer Rights: The IRS Does Not Effectively Evaluate and Measure Its Adherence to the Taxpayer’s Right to a Fair and Just Tax System*, *infra*.

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**That \$200 in interest paid to the taxpayers whose Earned Income Tax Credit (EITC) claims were originally denied is more than the IRS is spending, on average, to train an employee in Wage & Investment who handles EITC issues.**

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In some scenarios, because of a wrong answer from an IRS employee or an improper collection action, taxpayers may pursue litigation to arrive at the correct determination or to seek damages from the IRS.<sup>39</sup> Such litigation is time-consuming and costly to both parties, and strains judicial resources.

For example, a TAS study on Earned Income Tax Credit (EITC) cases, where the taxpayer petitioned the Tax Court for review of the IRS's determination to disallow all or part of the claimed EITC, found that the IRS paid on average \$200 in interest to the taxpayers on the delayed refund in about one third of the sample cases.<sup>40</sup> That \$200 in interest paid to the taxpayers whose EITC claims were originally denied is more than the IRS is spending, on average, to train an employee in W&I who handles EITC issues.<sup>41</sup> Further, prior to getting to the stage of potential litigation, taxpayers in the majority of these cases attempted to resolve the issue, calling the IRS five times on average (one taxpayer actually called 15 times).<sup>42</sup> The downstream cost of resolving or litigating the case is far beyond the cost of training to ensure that employees reach the correct answer early in the process.

## CONCLUSION

Reductions in training and the lack of in-person training causes taxpayer burden and undermines taxpayer rights. Technological advances and innovative approaches to training used by TAS demonstrate that in-person training can be accomplished in a variety of ways. Face-to-face and interactive training should become a priority, using “train-the-trainer” methodology, video presentations combined with in-person question and answer sessions, and mailboxes for follow-up. The IRS should encourage its employees to attend in-person courses and trainings offered by third parties, such as Bar and CPA associations, colleges and universities in the local commuting areas. Meeting with other employees, other business operating divisions, and, especially, taxpayer representatives and tax experts in local communities will provide employees with different, diverse perspectives on their job duties, increase competence, and allow them to learn from each other to better understand taxpayer issues.

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39 See, e.g., IRC §§ 7432, 7433. For example, a taxpayer may bring a civil action for damages against the United States in a district court if an IRS employee negligently fails to release a lien or disregards any IRC provision or regulation associated with collection of taxes.

40 See National Taxpayer Advocate 2012 Annual Report to Congress 72-104 (Research Study: *Study of Tax Court Cases in Which the IRS Conceded the Taxpayer Was Entitled to Earned Income Tax Credit (EITC)*).

41 IRS response to TAS information request (Nov. 7, 2017). IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/> (last visited Nov. 17, 2017).

42 See National Taxpayer Advocate 2012 Annual Report to Congress 72-104 (Research Study: *Study of Tax Court Cases in Which the IRS Conceded the Taxpayer Was Entitled to Earned Income Tax Credit (EITC)*).

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Increase “train the trainer” in-person trainings to allow more effective delivery of training to field offices.
2. Increase training hours per employee, particularly in mission critical job series.
3. Encourage employees to identify outside training relevant to their jobs and allow the employees to attend such trainings.
4. Include outside experts in training to leverage knowledge gained from working with taxpayers who are impacted by IRS actions.

**MSP  
#8****TAXPAYER RIGHTS: The IRS Does Not Effectively Evaluate and Measure Its Adherence to the Taxpayer’s Right to a Fair and Just Tax System****RESPONSIBLE OFFICIALS**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division  
 Kenneth Corbin, Commissioner, Wage & Investment Division  
 Donna Hansberry, Chief, Appeals  
 Douglas O’Donnell, Commissioner, Large Business & International  
 Sunita Lough, Commissioner, Tax Exempt / Government Entities Division  
 John D. Fort, Chief, Criminal Investigation

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

For many years, the National Taxpayer Advocate urged the IRS to adopt a Taxpayer Bill of Rights (TBOR) and Congress to codify the TBOR.<sup>2</sup> In 2014, the IRS officially adopted the TBOR, and in late 2015, Congress followed suit by adding the list of fundamental rights to the Internal Revenue Code (IRC or Code).<sup>3</sup> IRC § 7803(a)(3) now states: “In discharging his duties, the Commissioner shall ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title, including— .” This section then lists the ten fundamental rights proposed by the National Taxpayer Advocate. The statutory language of IRC § 7803(a)(3) shows Congress’s intent not just to articulate and group taxpayer rights in categories, but to ensure the IRS is held accountable for putting those rights into practice.

The IRS has recently taken some positive steps to revise its policies, procedures, and materials to support the TBOR. For example, the IRS updated an introductory section in the examination part of its Internal Revenue Manual (IRM) to provide excellent explanations of various actions employees can take related to taxpayer rights.<sup>4</sup> Despite these improvements, the IRS has not yet adequately incorporated the TBOR into its measures or quality review criteria, thus making it difficult to evaluate the extent to which IRS employees are considering a taxpayer’s *right to a fair and just tax system* in their day to day work. The IRS’s description of the *right to a fair and just tax system* states:

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).
- 2 See, e.g., National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration: Recommendations to Raise Taxpayer and Employee Awareness of Taxpayer Rights* (2013), <https://taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Toward-a-More-Perfect-Tax-System-A-Taxpayer-Bill-of-Rights-as-a-Framework-for-Effective-Tax-Administration.pdf>.
- 3 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 4 IRM 4.10.1.2, *Taxpayer Rights* (Aug. 24, 2017).

Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers have the right to receive assistance from the TAS if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.<sup>5</sup>

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The statutory language of IRC § 7803(a)(3) shows Congress’s intent not just to articulate and group taxpayer rights in categories, but to ensure the IRS is held accountable for putting those rights into practice.

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The IRS is not fully complying with the statutory mandate in IRC § 7803(a)(3) regarding the *right to a fair and just tax system* for the following reasons:

- Critical Job Elements (CJEs) do not evaluate employees on whether they consider a taxpayer’s individual facts and circumstances;
- Quality attributes do not measure whether an office or group of employees’ actions are appropriate in light of the taxpayer’s facts and circumstances as part of the quality review process; and
- The IRS’s guidelines for creating performance commitments for managers as well as its fiscal year (FY) 2014-2017 Strategic Plan do not require or encourage managers or employees to protect taxpayer rights.

## ANALYSIS

### Background

#### *Why it Is Important for the IRS to Evaluate Employees, Measure Quality, and Establish Goals*

The criteria used to evaluate employee performance and measure overall case quality and results are key drivers of employee behavior. If the IRS wants employees to act in accord with the TBOR, it must measure to what extent employees take appropriate actions on taxpayer cases. As one behavioral economist has noted, “Human beings adjust behavior based on the metrics they’re held against. Anything you measure will impel a person to optimize his score on that metric. What you measure is what you’ll get. Period.”<sup>6</sup> In a study of 335 airline pilots across 40,000 flights, economists found two ways to effectively drive intended behavior (in this case, reducing carbon emissions): (1) inform the pilots that their performance was being monitored, and (2) give them personalized performance targets.<sup>7</sup> In that study, the economists tied most of the gains simply to the awareness of being monitored.

5 IRS, Publication 1, *Your Rights as a Taxpayer* (Sept. 2017), <https://www.irs.gov/pub/irs-pdf/p1.pdf>.

6 Dan Ariely, *You are What You Measure*, HARV. BUS. REV. (June 2010), <https://hbr.org/2010/06/column-you-are-what-you-measure>.

7 Robert Metcalfe, Greer Gosnell, and John List, *Virgin Atlantic Tested 3 Ways to Change Employee Behavior*, HARV. BUS. REV. (Aug. 1, 2016), <https://hbr.org/2016/08/virgin-atlantic-tested-3-ways-to-change-employee-behavior>.

Research shows that beyond just evaluating employee performance and measuring how that performance achieves quality, it is important for managers to provide positive feedback regarding what employees are doing well, or else risk that employees will stop performing the positive action if it is not acknowledged.<sup>8</sup> In the case of IRS employees, if managers do not evaluate employees and discuss with them how they have taken actions to support the taxpayer's *right to a fair and just tax system* by considering the taxpayer's facts and circumstances, employees may stop taking these actions.

Performance management, which is informed by both program evaluation and performance measurement, is part of the movement known as New Public Management (NPM), which has changed the way governmental agencies are managed.<sup>9</sup> NPM principles include: "stating clear program and policy objectives, measuring and reporting program and policy outcomes, and holding managers, executives, and politicians accountable for achieving expected results."<sup>10</sup> The five stages of performance management are relevant to the IRS and its implementation of the TBOR:

1. Formulating clear strategic objectives for organizations, including their programs and policies.
2. Translating these objectives into program and policy designs to achieve those goals.
3. Implementing the program and policy designs by creating or changing organizational structures and processes.
4. Monitoring performance, and measuring, evaluating, and reporting results, leading to consequences for the programs.
5. Returning to the strategic objectives to use findings from the earlier phases to update the objectives.<sup>11</sup>

The IRS's Strategic Plan, discussed below, provides a mechanism for the first stage of performance management. To understand how the IRS is achieving its strategic objectives, such as protecting taxpayer rights, it must monitor and evaluate employee performance, measure quality results, and apply these findings.

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8 Timothy R. Hinkin, and Chester A. Schriesheim, "If You don't Hear from Me You Know You are Doing Fine": *The Effects of Management Nonresponse to Employee Performance*, 45 CORNELL HOTEL & REST. ADMIN. Q., vol. 45, 362-72 (2004), <http://scholarship.sha.cornell.edu/articles/213/>.

9 James C. McDavid, Irene Huse, Laura R. L. Hawthorn, *Chapter 1: Key Concepts and Issues*, PROGRAM EVALUATION AND PERFORMANCE MEASUREMENT: AN INTRODUCTION TO PRACTICE, 5 (2d ed. 2013).

10 *Id.*

11 *Id.*



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The criteria used to evaluate employee performance and measure overall case quality and results are key drivers of employee behavior.

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*How Laws, Internal Guidance, Standards, and Measures May Direct Employees to Consider a Taxpayer's Facts and Circumstances*

A multitude of sources and resources impact an employee's ability or willingness to consider a taxpayer's facts and circumstances. These include:

1. **The IRC (or Code)** – The Code is comprised of tax laws that have passed Congress and been signed into law. It is legally binding on the IRS.
2. **Treasury Regulations** – These provide the official interpretation of the IRC by the Department of Treasury and are binding on the IRS.
3. **The Internal Revenue Manual (IRM)** – This is “the primary, official source of IRS ‘instructions to staff’ relating to the organization, administration, and operation of the Service.”<sup>12</sup> Although employees are expected to follow IRM procedures, these procedures are not legally binding.
4. **Critical Job Elements (CJEs)** – CJEs set the standards that the IRS uses to evaluate employees. The IRS defines CJEs as “[a] work assignment or responsibility of such importance that unacceptable performance on the CJE would result in a determination that an employee's overall performance is unacceptable. Regulations require the IRS to establish critical elements and performance standards for employee performance plans and monitor employee progress.”<sup>13</sup>
5. **Quality Attributes** – The IRS measures quality through two systems – the Embedded Quality Review System (EQRS) and the National Quality Review System (NQRS).<sup>14</sup> EQRS is used to evaluate employee performance on cases and rate case actions against quality attributes. NQRS provides independent case review information that is used to determine organizational performance. Many of the same quality attributes are used to review employee performance and assess organizational quality. The Large Business and International Division (LB&I) also has its own quality measurement system (LQMS).
6. **Commitments for Managers and Managerial Officials** – Managers and management officials are rated against critical performance expectations, which are comprised of the statutory Retention Standard for the Fair and Equitable Treatment of Taxpayers,<sup>15</sup> general responsibilities that are common to all managers and management officials,<sup>16</sup> and Commitments. This last component establishes a link between organizational performance and individual performance. Commitments are derived from the Strategic Business Plans, but are specific to each employee, each one providing a distinct action with identified and measurable results.

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12 IRM 1.11.6.1.4, *Definition of Terms and Acronyms* (July 28, 2017).

13 IRM Exhibit 6.430.1-1, *Glossary of Performance Management Terms* (June 14, 2011).

14 IRM 5.13.1, *Embedded Quality Administrative Guidelines* (Oct. 28, 2014).

15 The Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 requires all IRS employees to be evaluated on the fair and equitable treatment of taxpayers. Pub. L. No. 105-206, 112 STAT. 722 § 1204(b) (1998). See IRM 6.430.3.2.2.1, *Retention Standard for the Fair and Equitable Treatment of Taxpayers* (Oct. 28, 2011). Congress later amplified and expanded this by setting out the ten taxpayer rights in the Taxpayer Bill of Rights. Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

16 See IRM 6.430.3.2.2.2, *Responsibilities* (Jan. 1, 2007).

**7. IRS Strategic Plan** – The IRS uses its strategic plan to outline its primary goals and associated objectives for the upcoming four fiscal years.<sup>17</sup>

There are situations where the Code, regulations, or IRM may direct the IRS or an employee to consider an individual taxpayer's facts and circumstances. However, in these examples, the IRS's CJE's, quality attributes, managerial commitments, and FY 2014–2017 Strategic Plan fail to set relevant goals, and evaluate and measure whether the IRS is protecting this part of the *right to a fair and just tax system*. To ensure employees are familiar with and act in accord with the *right to a fair and just tax system*, the IRS needs to set standards through its CJE's and evaluate employees with respect to these standards. In addition, the IRS needs to measure how often its employees comply with certain required job actions to meet a quality attribute. Although discussing every instance where an employee should be considering the facts and circumstances is beyond the scope of this analysis, below are three detailed examples of where the IRS is not ensuring its employees consider and take appropriate action: based on a taxpayer's facts and circumstances as it relates to a taxpayer's underlying liability, a taxpayer's ability to pay, and a taxpayer's ability to provide information timely.<sup>18</sup>

**Underlying Liability: CJE's and quality measures do not evaluate employees and measure quality based on whether employees considered the taxpayer's facts and circumstances when making penalty determinations**

One key area where employees must consider facts and circumstances is penalty determination. As shown in Figure 1.8.1 below, the Treasury Regulation and IRM require looking at the facts and circumstances on a case by case basis to determine whether the taxpayer qualifies for reasonable cause. The IRM instructs that a penalty determination cannot be made until the examiner has developed the facts and circumstances and documented how the law applies to these.

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<sup>17</sup> See, e.g., IRS Pub. 3744, *Internal Revenue Service Strategic Plan (Fiscal Year (FY) 2014-2017)*.

<sup>18</sup> Because the most frequent opportunities for considering a taxpayer's facts and circumstances as they relate to the liability, ability to pay, and ability to provide information timely are in examination and collection, the discussion will primarily focus on some specific IRMs and job series for employees in these areas.

**FIGURE 1.8.1, Law, Guidance, Standards, and Measures Related to Penalty Determination by Revenue Agents**

Statute or Regulation	IRM	CJE	Quality Attribute
<p><b>Treas. Reg. § 1.6664-4 Reasonable cause and good faith exception to section 6662 penalties</b></p> <p>“The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances.”</p>	<p><b>IRM 4.10.9.7.8 Workpapers: Documenting Penalties<sup>19</sup></b></p> <p>“Only after all facts and circumstances surrounding an audit have been developed can a determination be made as to the application of appropriate penalties...The examiner must cite the appropriate regulations, rulings and court decisions that are specific to the case’s facts and circumstances for assertion or non-assertion of penalties.”</p>	<p><b>Internal Revenue Agent Critical Element III, Customer Satisfaction – Application, 3A: Application of Tax Laws<sup>20</sup></b></p> <p>“Generally: obtains and evaluates the customers’ position and addresses the merits during case development.”</p> <p><b>Critical Element V, Business Results – Efficiency, 5C: Gathers Information and Develops Facts<sup>21</sup></b></p> <p>“Generally:</p> <ul style="list-style-type: none"> <li>♦ uses appropriate analytical resources and fact finding or innovative techniques to gather and develop facts that are complete, understandable and logically presented;</li> <li>♦ interprets and follows applicable procedures, guidelines and standards.”</li> </ul>	<p><b>707: Workpapers Support Conclusions<sup>22</sup></b></p> <p>“This attribute measures if the examiner used the activity record to document examination activities and time charges throughout the audit. It also measures if the examiner appropriately prepared workpapers (including scope, depth, and techniques used) to support the conclusions in the case.”</p> <p><b>408: Civil Penalty Determination<sup>23</sup></b></p> <p>“This attribute measures if the examiner properly considers, correctly computes and adequately documents the assertion or non-assertion of Civil penalties.”</p>

In contrast to the regulation and IRM, the CJE makes no mention of a taxpayer’s specific situation. The CJE on applying the tax law only looks at whether the employee obtains and evaluates the taxpayer’s position, without also considering how the taxpayer’s facts and circumstances affect the liability. As an example, a taxpayer may take the position that he should be allowed certain business expense deductions because his tax preparer misunderstood the law. Although the IRS employee may evaluate the taxpayer’s position and conclude he is not allowed the expenses, the employee should still consider the taxpayer’s facts and circumstances. Such consideration could lead to a determination that the taxpayer had reasonable cause based on reliance on the return preparer and should not receive accuracy-related penalties.

The Business Results CJE focuses on developing complete facts, which is important, but it does not adequately measure the *right to a fair and just tax system* because of its sole focus on facts without regard to the personal circumstances of the taxpayer. An example of how this shortcoming harms taxpayers is an individual who failed to report income resulting from cancellation of indebtedness that was reported on a Form 1099-C, *Cancellation of Debt*. It may be a fact that the taxpayer received debt forgiveness but most taxpayers do not know the consequences of cancellation of debt, including that it is taxable unless exceptions apply. If the revenue agent were to consider the taxpayer’s facts and circumstances, he or she would ask about whether the insolvency exception applied, directing the taxpayer to the insolvency worksheet in the IRS Publication 4681, *Canceled Debts, Foreclosures, Repossessions, and Abandonments*,

19 IRM 4.10.9.7.8, *Workpapers: Documenting Penalties* (Aug. 11, 2014).

20 IRS, Performance Plan for Internal Revenue Agent GS-0512 (July 2001).

21 *Id.*

22 IRS, Document 12354, *Field Compliance Embedded Quality, Field & Office Examination Job Aid* (Oct. 2012).

23 *Id.*

and possibly helping the taxpayer complete it. If the taxpayer did not qualify for the exception, the employee could consider the taxpayer's education and understanding of the consequences of debt forgiveness to determine whether the taxpayer may meet the reasonable cause exception to the penalty.

The quality attribute related to the workpapers focuses on the scope and depth of the case, but not whether the facts and circumstances of the taxpayer's specific situation were considered in determining the result. While the quality attribute for penalty determination requires documentation of the assertion or nonassertion of the penalty, there is nothing to ensure the employee thoughtfully considered the taxpayer's specific situation, as opposed to simply following prescribed procedures in computing and asserting the penalty.

Not included in the chart above, the CJEs for Revenue Agent Reviewer and Tax Law Specialist Reviewer do evaluate employees on whether the employee "conducts appropriate amount of research based on the facts and circumstances of each case."<sup>24</sup> However, this standard goes to whether the employee is taking the appropriate amount of time on the examination based on the facts and circumstances, not whether the employee is analyzing and applying the facts and circumstances to determine the liability. Another CJE for the Revenue Agent Reviewer requires that the employee "analyzes case file and other data to become familiar with issues" and "analyzes financial information to work toward effective case resolution."<sup>25</sup> This CJE could be strengthened by requiring the employee to analyze the case file and other data not to just become "familiar with issues" but also to understand the facts and circumstances of the taxpayer's situation.

#### **Ability to Pay: CJEs and quality attributes do not ensure employees consider the facts and circumstances when determining the correct amount of basic living expenses**

The consideration of facts and circumstances required by the *right to a fair and just tax system* also applies to determining a taxpayer's ability to pay. As shown in Figure 1.8.2, the IRC and Treasury regulations require considering the facts and circumstances when determining a taxpayer's basic living expenses, which are used to conclude how much a taxpayer can pay for an offer in compromise (OIC).

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**While the quality attribute for penalty determination requires documentation of the assertion or non-assertion of the penalty, there is nothing to ensure the employee thoughtfully considered the taxpayer's specific situation, as opposed to simply following prescribed procedures in computing and asserting the penalty.**

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<sup>24</sup> IRS, Performance Plan for Revenue Agent Reviewer GS-0512 and Tax Law Specialist Reviewer GS-0987 (Dec. 2007).

<sup>25</sup> *Id.*

**FIGURE 1.8.2, Law, Guidance, Standards, and Measures Related to Determining Ability to Pay by Revenue Officer Advisors and Related Positions**

Statute	Regulation	IRM	CJE	Quality Attribute
<p><b>IRC § 7122(d)(2) Allowances for basic living expenses</b></p> <p>The IRS “shall develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.” The IRS’s guidelines shall provide that IRS employees “shall determine, on the basis of the facts and circumstances of each taxpayer, whether the use of the schedules published under subparagraph (A) is appropriate and shall not use the schedules to the extent such use would result in the taxpayer not having adequate means to provide for basic living expenses.”</p>	<p><b>Treas. Reg. § 301.7122-1(c)(2)</b></p> <p>“[t]he determination of the amount of such basic living expenses will be founded upon an evaluation of the individual facts and circumstances presented by the taxpayer’s case.”</p>	<p><b>IRM 5.8.12.2, Role of the Independent Administrative Reviewer<sup>26</sup></b></p> <p>“The IAR is responsible for reviewing the facts and circumstances of each case to determine if the proposed rejection is reasonable.”</p> <p><b>IRM 5.8.12.6.1, The Review<sup>27</sup></b></p> <p>“If supporting documents indicate any circumstances that could impact either future earning potential or allowable expenses the documentation in the case file must support the decision to exclude or include assets, expenses, and/or income relating to the taxpayer’s circumstances.”</p>	<p><b>Revenue Officer Advisor/Reviewer and Revenue Officer/Independent Administrative Reviewer, Critical Element II, Customer Satisfaction – Knowledge, 2B: Case Analysis<sup>28</sup></b></p> <p>“analyzes case file and other data to become familiar with issues; analyzes financial information to work toward effective case resolution; determines ability to pay by verifying ownership, value and equity in assets.”</p> <p><b>Critical Element II, Customer Satisfaction – Knowledge, 2A: Taxpayer Rights<sup>29</sup></b></p> <p>“informs taxpayers of their rights; ensures that taxpayer’s rights are observed and protected throughout the collection process; protects the confidentiality of taxpayer return and case related information.”</p>	<p><b>432 – Verify/Analyze Ability to Pay<sup>30</sup></b></p> <p>“Use this field to identify if the employee properly evaluated the thoroughness and accuracy of the financial information secured and determined the taxpayer’s ability to pay”</p> <p><b>426 – Review Procedures<sup>31</sup></b></p> <p>“Use this field to identify if the employee followed appropriate Advisory review procedures.” “Rate this attribute “Yes,” if the employee made a determination that resulted in either the correct decision to sustain the rejected IA/OIC based on the circumstances, or a correct and sufficiently documented decision not to sustain the rejection and return the case for further development.”</p> <p><b>607 – Taxpayer Rights<sup>32</sup></b></p> <p>“Use this field to determine if the employee advised the TP/POA of all rights.”</p>

26 IRM 5.8.12.2, *Role of the Independent Administrative Reviewer* (Oct. 28, 2014).

27 IRM 5.8.12.6.1, *The Review* (Oct. 28, 2014). Although there are many IRMs related to ability to pay, here we focus on two that guide employees to consider a taxpayer’s facts and circumstances.

28 IRS, Performance Plan for Revenue Officer Advisor/Reviewer and Revenue Officer/Independent Administrative Reviewer GS-1169 (Mar. 2006). This CJE is the same for Revenue Officers. IRS Performance Plan for Revenue Officer, GS-1169 (July 2001). There are also additional positions that make ability to pay determinations such as Offer-in-Compromise Examiners and Revenue Officer Offer Examiners.

29 IRS, Document 12359, *Field Compliance, Embedded Quality, Field Collection (FC)* (Sept. 2017).

30 IRS, Document 12739, *Embedded Quality Advisory Function Lien Job Aid* (Aug. 2016).

31 IRS, Performance Plan for Revenue Officer Advisor/Reviewer and Revenue Officer/Independent Administrative Reviewer GS-1169 (Mar. 2006). This CJE is the same for Revenue Officers. IRS Performance Plan for Revenue Officer, GS-1169 (July 2001).

32 IRS, Document 12359, *Field Compliance, Embedded Quality, Field Collection (FC)* (Sept. 2017).

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Congress provided a specific directive as to how the *right to a fair and just tax system* would be realized in the context of collection activity. IRC § 7122(d) directs that employees shall determine, based on the facts and circumstances of the taxpayer, whether it is appropriate to use established schedules for calculating living expenses, which are designed to ensure taxpayers have adequate means to provide for basic living expenses. ... Yet, IRS measures focus on formulas and rules, instead of applying judgment and discretion to the individual facts and circumstances.

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To its credit, the IRS procedures, outlined in the IRM, provide for an independent administrative review of all proposed OIC rejections. However, the CJEs for independent administrative reviewers and revenue officers say nothing about looking at a taxpayer's individual facts and circumstances, especially as it relates to determining allowable expenses. To meet the CJE criterion, an employee merely needs to verify ownership, value and equity in assets, without looking at individual facts, such as if the forfeiture of assets would create an economic hardship. Similarly, the quality attribute for ability to pay asks if the employee properly verified that the financial information provided by the taxpayer was thorough and accurate, but does not emphasize looking at individual facts and circumstances that may be unique to the taxpayer and which might alter the analysis.

In fact, as shown in Figure 1.8.2 above, Congress provided a specific directive as to how the right to a fair and just tax system would be realized in the context of collection activity. IRC § 7122(d) directs that employees shall determine, based on the facts and circumstances of the taxpayer, whether it is appropriate to use established schedules for calculating living expenses, which are designed to ensure taxpayers have adequate means to provide for basic living expenses. Congress believed “the ability to compromise tax liability and to make payments of tax liability by installment enhances taxpayer compliance” and “the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system.”<sup>33</sup> Yet, IRS measures focus on formulas and rules, instead of applying judgment and discretion to the individual facts and circumstances.

The Rating Guide Explanation for the Review Procedures attribute does mention looking at the circumstances, but it only requires a “sufficiently documented decision” if the review results in the rejected offer being sent back for further development.<sup>34</sup> The decision to sustain a rejected offer should also be sufficiently documented to show how the taxpayer's circumstances were considered. For example, if the decision to reject the offer was based on a finding that the taxpayer could sell his primary vehicle to pay the tax debt, the consideration of whether the taxpayer had other sources of transportation necessary to continue working in his job should be documented.

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

34 IRS, Document 12739, *Embedded Quality Advisory Function Lien Job Aid* (Aug. 2016).

The catch-all attribute for taxpayer rights, while commendable and beneficial in raising awareness, is not helpful in determining whether an employee's actions were appropriate in light of a taxpayer's circumstances because it is so broad that one cannot ascertain which rights were complied with and which were not.

**Ability to provide information timely: Quality attributes related to timeliness may discourage employees from considering a taxpayer's facts and circumstances when deciding whether to allow the taxpayer additional time to provide information in an examination**

Although the Treasury Regulations do not expressly state that a taxpayer can receive additional time to provide information in an examination, the IRS has decided as a policy matter to allow additional time based on "reasonable circumstances."<sup>35</sup> The IRM provides examples of when this requirement might be met and advises using judgment based on the taxpayer's facts and circumstances. However, as shown in the table below, the CJEs and quality attributes seem to be incompatible with an employee considering a taxpayer's facts and circumstances and providing a taxpayer with additional time if the examination does not involve a complex issue. Figure 1.8.3, below, lists CJEs for revenue agents, even though the IRM advises that a manager or management official must grant the extension of time to provide information in response to a 30-day letter. We discuss managerial commitments below, but here, the CJEs for revenue agents are also relevant because the revenue agent is likely to be the frontline employee who must receive and consider the request for additional time and choose how to present it to a manager.

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<sup>35</sup> IRM 4.10.8.11.8, *Extension of Time to Respond* (Sept. 12, 2014).

**FIGURE 1.8.3, Law, Guidance, Standards, and Measures Related to Extensions of Time to Respond in an Examination**

Regulation	IRM	CJE	Quality Attribute
<p><b>Statement of Procedural Rules 601.105(d)(1)</b>                      “The 30-day letter is a form letter which states the determination proposed to be made...If the taxpayer does not respond to the letter within 30 days, a statutory notice of deficiency will be issued or other appropriate action taken...”</p>	<p><b>IRM 4.10.8.11.8 Extension of Time to Respond</b><sup>36</sup>                      “(1) In general, Statement of Procedural Rules 601.105(d)(1) does not provide for an extension of time to reply to a 30-day letter. However, as a matter of practice, extensions may be granted under reasonable circumstances.                      (2) Reasonable circumstances include but are not limited to the following: The taxpayer retains a representative and demonstrates a need for more time to prepare a meaningful protest. The taxpayer retains a new representative. Sickness or injury of the taxpayer or representative. Issues are complex and require extensive research.”</p> <p><b>IRM 4.19.13.9.6, Taxpayer Requests Additional Time to Respond</b><sup>37</sup>                      “If subsequent time extensions are requested [beyond the automatic 30 day extension], judgment should be used based on the facts and circumstances for the individual case.”</p> <p><b>IRM 4.46.5.7.2, Key Points to Consider and Verify in Preparing an Unagreed Issue Report</b><sup>38</sup>                      “The case manager, in collaboration with the issue manager(s), may approve the request [for an extension of time in which to file a protest] based on the facts and circumstances in each case.”</p>	<p><b>Internal Revenue Agent Critical Element V, Business Results - Efficiency, 5A: Completes Work Timely</b><sup>39</sup>                      “Generally completes work assignments so that both the total time spent and the time span of the activities are commensurate with the nature and complexity of the work. Generally identifies issues that have significant impact and seldom spends time on items of little materiality.”</p> <p><b>LB&amp;I Issue Practice Group Coordinator, Issue Practice Group Subject Matter Expert, Knowledge Network Specialist, Senior Revenue Agent, Critical Element V, Business Results - Efficiency, 5A, Planning and Scheduling</b><sup>40</sup>                      “Generally:                      ♦ plans, schedules, and executes program responsibilities within established time frames;                      ♦ initiates timely actions without managerial follow-up;                      ♦ coordinates activities and recommendations to ensure timely action.”</p>	<p><b>510: Time Span</b><sup>41</sup>                      “This attribute measures if the time span of the case is appropriate for the actions taken. Case actions should be completed in the most efficient manner and not result in unnecessary delays during the examination process.”</p> <p><b>LQMS Technical Standard 2: Execution</b><sup>42</sup>                      “Was the time applied commensurate with the complexity of the Issues?”</p>

36 IRM 4.10.8.11.8, *Extension of Time to Respond* (Sept. 12, 2014). See also IRM 4.10.8.12.8, *Extension of Time to Respond (LB&I Examiners only)* (Aug. 11, 2006), which provides similar guidelines for Large Business and International (LB&I) examiners.

37 IRS, Performance Plan for Internal Revenue Agent GS-0512 (July 2001).

38 IRS, Document 12354, *Field Compliance Embedded Quality, Field & Office Examination Job Aid* (Oct. 2012).

39 IRM 4.19.13.9.6, *Taxpayer Requests Additional Time to Respond* (Jan. 1, 2016).

40 IRM 4.46.5.7.2, *Key Points to Consider and Verify in Preparing an Unagreed Issue Report* (Mar. 9, 2016).

41 IRS, Performance Plan for Issue Practice Group Coordinator, GS-0512, Issue Practice Group Subject Matter Expert, GS-0512, Knowledge Network Specialist, GS-0987, Senior Revenue Agent (Mar. 2016).

42 IRS, LB&I Quality Measurement System Technical Standards (Feb. 2016).



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Both the Critical Job Elements and the quality attributes focus on efficiency, making sure the amount of time the case stays open is consistent with established timeframes and the complexity of the case. Yet, there may be situations where an examination is not complex, and the documentation requested is straightforward, but the taxpayers needs additional time due to unique facts and circumstances.

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Both the CJE's and the quality attributes focus on efficiency, making sure the amount of time the case stays open is consistent with established timeframes and the complexity of the case. Yet, there may be situations where an examination is not complex, and the documentation requested is straightforward, but the taxpayers needs additional time due to unique facts and circumstances. For example, a taxpayer is suffering a medical condition, needs to request documents from abroad, or is unable to take off from a job to obtain the documents immediately.

The LB&I Division uses a checklist for reviewers conducting sample case reviews for its quality measurement system. One checklist item asks: "Were there any delays in the examination? Quality Reviewers consider reasons for delays in responses but rate this area based on the examiner's actions. Did the examiner take into account the taxpayer's not being able to provide information in a timely manner (e.g., if the taxpayer had to get the requested information from a foreign country)?"<sup>43</sup> Other IRS operating divisions could use checklists with similar questions to ensure that where an employee did not appear to meet a timeliness measure, the employee's actions may still be appropriate based on the taxpayer's facts and circumstances.

### A Discussion of a Taxpayer's Right to a Fair and Just Tax System Is Absent in a Number of CJE's

TAS conducted a review of the CJE's of 21 different positions that are part of four major categories of employees: revenue officers, revenue agents, appeals and settlement officers, and OIC specialists. We identified these positions as ones in which employees have regular contact with taxpayers and likely have the authority to use some discretion. This review showed that each of these 21 positions contained the Retention Standard for the Fair and Equitable Treatment of Taxpayers, required by statute.<sup>44</sup> In addition, 14 of the 21 positions had at least one CJE that mentioned taxpayer rights, and five of the 21 positions had two CJE's that mentioned taxpayers' rights. Five of the positions had a CJE specifically devoted to taxpayer rights, which required an employee to:

- Educate the taxpayer of their rights throughout the collection process;
- Ensure that taxpayer's rights are observed and protected throughout the collection process;
- Protect the confidentiality of taxpayer return and case related information; and
- Accurately explain the collection process throughout the case progression.

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43 TBOR and Quality Reviews of LB&I Cases, IRS response to TAS information request (July 13, 2016).

44 See footnote 15, *supra*.

These are desirable and important elements. However, the CJs for the different positions varied greatly in their coverage of the taxpayer's *right to a fair and just tax system*, with some including multiple CJs focusing on fully developing the relevant facts, and others without a single CJE mentioning the facts of the case or the taxpayer's circumstances. Thus, the IRS should conduct a review of all CJs, identifying where it would be appropriate to specifically incorporate a discussion of the taxpayer's *right to a fair and just tax system*, as well as the other nine rights set out in IRC § 7803(a).

**The IRS's guidelines for creating performance commitments for managers as well as its FY 2014-2017 strategic plan do not require or encourage managers or employees to protect taxpayer rights.**

In the above example about allowing a taxpayer more time to provide information, the decision rests with a manager or management official, who is not subject to CJs. Managers are evaluated based on whether they meet general responsibilities and specific commitments, which are unique to each management employee and tied to specific accomplishments. At first glance, it may appear difficult to use commitments to drive a behavior that should be ongoing and consistent — considering a taxpayer's specific facts and circumstances.<sup>45</sup> However, managers could identify specific accomplishments that would drive employees to make this consideration in their daily work. For example, a manager could commit to enhancing the technical knowledge of her direct reports by providing additional training, and state that the commitment will be satisfied if the training includes detailed examples on when a taxpayer's facts and circumstances might lead to a reasonable cause determination. A manager could also commit to reviewing cases where the IRS granted a request for additional time as well as where such requests were denied. This would help the manager determine appropriate timelines for providing additional information in all cases and consider whether employees may be prematurely coming to a determination and issuing a 30-day letter while a taxpayer is still working with examination. The current guidelines for developing managerial commitments are devoid of information about the TBOR or any of the specific rights.<sup>46</sup> The IRS should update this guidance, with examples, of how commitments can further the protection of taxpayer rights.

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**The current guidelines for developing managerial commitments are devoid of information about the Taxpayer Bill of Rights or any of the specific rights.**

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Commitments and other elements of the performance evaluation system are tied to the IRS's strategic goals. The IRS's current strategic plan for FY 2014-2017, contains no information about taxpayer rights outside of a discussion of TAS and the role of non-profit institutions in distributing information about taxpayer rights.<sup>47</sup> The strategic goals related to organizational excellence miss an opportunity for the IRS to commit to protecting taxpayer rights and reflect a disproportionate focus on enforcement.<sup>48</sup> At the time of this writing, the IRS had not yet released its Strategic Plan for FYs 2018-2022, but had drafted

<sup>45</sup> IRM 6.430.3.2.4.1, *Guidelines for Developing Well Constructed Commitments or Objectives* (Oct. 28, 2011).

<sup>46</sup> *Id.*; IRS, *Writing Performance Commitments, A Reference Guide for Managers and Management Officials* (Aug. 23, 2017).

<sup>47</sup> IRS, Publication 3744, *Strategic Plan (FY 2014-2017)* (June 2014).

<sup>48</sup> The associated goals are to “[d]eliver high quality and timely service to reduce taxpayer burden and encourage voluntary compliance” and to “[e]ffectively enforce the law to ensure compliance with tax responsibilities and combat fraud.” IRS, Publication 3744, *Strategic Plan (FY 2014-2017)* (June 2014).

and revised a list of goals, objectives, and activities.<sup>49</sup> In this document, the IRS states its plans to post the TBOR upfront within the Strategic Plan, which will emphasize taxpayer rights as an important IRS priority. Beyond just posting the TBOR, the IRS needs to create goals and objectives related to taxpayer rights, such as committing to training all IRS employees each year on taxpayer rights. Integrating taxpayer rights throughout the strategic plan would have an effect on other IRS standards and measures, including CJs, quality attributes, and commitments, which flow from the IRS's strategic goals.

## CONCLUSION

The above discussion shows the IRS could better evaluate its employees and measure whether their actions are appropriate based on a taxpayer's facts and circumstances. There are likely other examples where the IRS's performance standards and measures either do not account for this part of the taxpayer's *right to a fair and just tax system* or may even be incompatible with it. Although TAS was not able to review individual commitments for managers, the guidance for creating these commitments offers no assurance that managers will take actions or set goals to protect taxpayer rights. Because the Strategic Plan provides a framework for all the IRS's evaluation and measurement systems, it is vital for the specific goals and objectives to provide a link to rights under the TBOR.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Revise its CJs and quality attributes to align with statutory, regulatory, case law, and IRM instructions for employees to consider the specific facts and circumstances that affect taxpayers' underlying liabilities, ability to pay, and ability to provide timely information.
2. Update its guidance for developing commitments to provide examples and emphasize how commitments can further the protection of taxpayer rights.
3. Add information throughout its strategic plan to tie goals and objectives to taxpayer rights under the TBOR and add objectives: (1) to evaluate employees' performance with respect to and in accord with taxpayer rights, and (2) to train all employees on taxpayer rights.
4. Collaborate with TAS in developing and delivering a mandatory annual training on taxpayer rights.

<sup>49</sup> IRS, *FY 2018–2022 Strategic Plan, Overview of Proposed Strategic Goals and Objectives* (Oct. 2017).

**MSP  
#9****OUTREACH AND EDUCATION: The IRS Is Making Commendable Strides to Develop Digitized Taxpayer Services, But It Must Do More to Maintain and Improve Traditional Outreach and Education Initiatives to Meet the Needs of U.S. Taxpayers****RESPONSIBLE OFFICIALS**

Terry Lemons, Chief, Communications and Liaison

Kenneth Corbin, Commissioner, Wage and Investment Operating Division

Mary Beth Murphy, Commissioner, Small Business / Self Employed Operating Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

The IRS has held a longstanding position that taxpayer outreach and education is essential to voluntary compliance.<sup>2</sup> Yet, it continues to shift outreach and education responsibilities to third-party partners. In addition, the IRS is increasingly relying on digital channels to distribute outreach and education information.<sup>3</sup> While digital distribution channels and leveraging third-party partners may enable the IRS to reach large taxpayer populations in a cost-effective manner, it still leaves significant populations of taxpayers behind.<sup>4</sup> It also eliminates the two-way exchange, and in conjunction with the trend away from geographic presence in the taxpayer communities, results in a one-way, filtered, education strategy as well as a remote, impersonal IRS.

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- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).
  - 2 See, e.g., Internal Revenue Manual (IRM) 1.2.19.1.8(2), *Policy Statement 11-93 (Formerly P-1-181)* (July 24, 1989).
  - 3 See, e.g., IRS Small Business Week Tax Tip 2017-01, *IRS Promotes Specialized Online Services during Small Business Week* (Apr. 28, 2017); Wage & Investment Research, *Facilitating Access to Convenient & Efficient IRS Service: W&I Web-First Conjoint Study* (May 11, 2016).
  - 4 In its response to the TAS fact check, the IRS stated that it is “relying more on digital channels since many taxpayers, particularly younger ones, rely on these for their information.” IRS response to TAS fact check (Nov. 20, 2017). While we agree that younger generations are more receptive to online channels, we encourage the IRS to give due consideration to the information needs of those taxpayers without access to digital channels. See Most Serious Problem: *Online Accounts: The IRS’s Focus on Online Service Delivery Does Not Adequately Take into Account the Widely Divergent Needs and Preferences of the U.S. Taxpayer Population*, *supra*; Research Study: *A Further Exploration of Taxpayers’ Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*; National Taxpayer Advocate 2016 Annual Report to Congress, vol. 2, 1-30 (Research Study: *Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*).

A successful outreach strategy is both cost-effective and substantively effective. The IRS appears to have designed its outreach strategy in reaction to cost concerns.<sup>5</sup> However, if it does not develop a research-based outreach strategy, the IRS may not be conducting its outreach initiatives in the most effective manner. To be effective, the outreach and education must (1) include content addressing the taxpayers' information needs, (2) clearly state the message in language the target audience can understand, and (3) use a distribution channel the target recipient can access. Accordingly, the IRS must conduct research as well as review the findings of TAS research to understand the information needs of the diverse taxpayer populations.<sup>6</sup>

In addition to formal research, an effective way to gain an understanding of the information needs of the various diverse local communities is to have a geographic presence (*i.e.*, at least one employee living in or touring through the state or geographic region) rather than generalize the information needs of the entire U.S. taxpayer population from afar. Unfortunately, the IRS outreach functions did not have local presence in about one-third of the states. Specifically, for fiscal year (FY) 2017, the IRS Office of Communications and Liaison (C&L) Stakeholder Liaison (SL) function had 105 employees assigned to various outreach activities in over 33 states and the District of Columbia.<sup>7</sup>

## ANALYSIS OF PROBLEM

### The IRS Centralized Outreach Activities for Individual Taxpayers and Small Businesses

In April 2017, the IRS transferred the SL function of Small Business/Self-Employed (SB/SE) to C&L. There are now several key outreach functions located in C&L:<sup>8</sup>

1. **National Public Liaison (NPL):** NPL promotes and strengthens relationships with external partners and solicits ideas on emerging issues, IRS initiatives, policies, procedures, and guidance.
2. **Stakeholder Liaison (SL):** Provides outreach and education through partnerships with tax professional organizations, industry associations, and government agencies. SL collaborates with these partners to maintain relationships and conduct meetings or events in-person, by phone or email, and through virtual web conferencing. SL also communicates by tweets and provides fact sheets and news releases to partners, who can distribute the material to their members, clients, and constituents.

5 IRS response to TAS fact check (Nov. 20, 2017). The National Taxpayer Advocate previously raised concerns about the dwindling resources allocated to outreach and education since the IRS Restructuring and Reform Act of 1998 (RRA 98). See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress (Most Serious Problem: *The IRS is Substantially Reducing Both the Amount and Scope of Its Direct Education and Outreach to Taxpayers and Does Not Measure the Effectiveness of its Remaining Outreach Activities, Thereby Risking Increased Noncompliance*).

6 See Literature Review: *Fostering Taxpayer Engagement Through Geographic Presence*, vol. 2, *infra*.

7 IRS response to TAS information request (Oct. 13, 2017). In response to TAS's information request for the number of outreach employees assigned to each state, territory, and the District of Columbia, the IRS responded that Communication & Liaison (C&L) had 105 employees assigned to outreach activities spread over 33 states and the District of Columbia. However, the IRS response to fact check stated that these numbers only account for Small Business/Self-Employed (SB/SE) Stakeholder Liaison (SL) employees. Therefore, we do not have details regarding any additional outreach employees. IRS response to TAS fact check (Nov. 20, 2017).

8 In response to the TAS information request, the IRS provided that C&L has two key outreach organizations: National Public Liaison (NPL) and Stakeholder Liaison (SL). IRS response to TAS information request (Oct. 13, 2017). However, in the response to a TAS fact check, C&L stated that outreach is performed by the following C&L organizations in addition to NPL and SL: (1) the Office of Communications (including Media Relations and Social Media) and (2) the Office of Legislative Affairs (including the branch dealing with local congressional offices). However, we did not receive details about the outreach activities performed by and resources allocated to these functions. IRS response to TAS fact check (Nov. 20, 2017).

3. **Tax, Outreach, Partnership, and Education:** C&L recently launched this new branch to focus on building relationships with organizations outside the traditional tax communities.

The following chart summarizes the in-person and virtual outreach events conducted by both NPL and SL in C&L.

**FIGURE 1.9.1, FY 2017 Face-to-Face and Virtual Outreach Events Conducted by C&L NPL and SL<sup>9</sup>**

C&L Outreach Activity	Number of Events	FY 2017 Direct Face-to-Face Participants	FY 2017 Digital Participants
NPL: Tax Forums	5	12,621	N/A
SL: Practitioner Virtual Events	215	N/A	48,133
SL: Practitioner Face-to-Face Events	673	58,106	N/A
SL: Industry Virtual Events	80	N/A	4,759
SL: Industry Face-to-Face Events	238	15,198	N/A
SL: Web Conferencing Outreach Events	31	N/A	33,469
<b>Total</b>	<b>1,242</b>	<b>85,925</b>	<b>86,361</b>

With the exception of Stakeholder Partnerships, Education and Communication (SPEC) in the Wage and Investment (W&I) Division, which is completely dedicated to the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs, the IRS centralized most outreach functions for individuals and small businesses in C&L.<sup>10</sup> The centralized outreach function in C&L bears ultimate responsibility, whether conducted directly or through leveraged partnerships, for helping approximately 151 million individual taxpayers and 62 million small business taxpayers understand and comply with their tax filing and payment obligations.<sup>11</sup> Despite the diverse taxpayer population for which C&L is responsible, the organization allocates only 105 employees to conduct outreach and education. Furthermore, dedicated outreach and education staff are assigned in over 33 states and the District of Columbia, leaving approximately 16 states and the territories of Guam, Puerto Rico and the

- 9 IRS response to TAS information request (Oct. 13, 2017). By comparison, TAS Local Taxpayer Advocates conducted over 4,700 local outreach activities during fiscal year (FY) 2017, accounting for nearly 16,000 hours during the fiscal year, despite having numerous other duties as managers of the TAS local offices. Their efforts reached over 875,000 taxpayers and tax professionals through various outlets including local radio and television. TAS Office of Communications, Stakeholder Liaison, and Online Services, *National Completed Events Summary for 2017* (Oct. 27, 2017).
- 10 IRS response to TAS information request (Oct. 13, 2017). The following organizations maintain a separate outreach function: Tax Exempt/Government Entities Division (TE/GE), Large Business and International Division (LBI), Return Preparer Office (RPO), the Office of Appeals, Criminal Investigation Division (CI), and TAS. IRS response to TAS fact check (Nov. 20, 2017).
- 11 IRS, *2016 Data Book*, Table 2, <https://www.irs.gov/pub/irs-soi/16databk.pdf>; IRS response to TAS fact check (Nov. 20, 2017); IRS response to TAS fact check (Dec. 15, 2016).

U.S. Virgin Islands without any dedicated outreach staff.<sup>12</sup> C&L allocates \$12.1 million of its budget to direct labor costs of employees in NPL and SL to conduct outreach and education activities.<sup>13</sup>

### The IRS Outreach and Education Staff Needs Geographic Presence to Effectively Perform Its Government Function

Before 1998, the IRS was organized into 43 geographically defined districts and service centers.<sup>14</sup> In addition, the IRS encouraged its staff to perform face-to-face outreach by accepting invitations to speaking events and participating in conferences.<sup>15</sup> The previous IRS structure and outreach policy evidences that the organization realized the importance of geographic presence and face-to-face outreach.

Geographic presence among outreach and education staff is vital to understanding the local economy and culture. For example, the IRS may not understand the information needs of natural disaster victims in Puerto Rico or the U.S. Virgin Islands, unless it has employees, preferably C&L employees assigned to outreach activities, on the ground and in the community. These employees can hear firsthand the local issues and concerns of the community. In addition, by engaging with the community, they will gain familiarity with the local norms and understand the best channels to deliver messages. Community engagement places the IRS in the best position to communicate targeted messages on issues relevant to that particular population, as opposed to general messages that are too vague for anyone to see themselves reflected in the information presented.

Accordingly, the IRS should not shift a majority of its outreach and education responsibilities to third-party partners. Relying on partners to deliver the message benefits the IRS because it is a convenient and efficient way to reach a large number of taxpayers. In addition, communicating through third-party partners is crucial when there is a lack of trust in the IRS. For example, the IRS may have a difficult time getting undocumented workers to participate in outreach events and, for these taxpayers, the IRS could use third-party partners as intermediaries. However, in most cases, relying on partners is not as beneficial as actually going out and talking with taxpayers, preparers, and other representatives to really

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**Community engagement places the IRS in the best position to communicate targeted messages on issues relevant to that particular population, as opposed to general messages that are too vague for anyone to see themselves reflected in the information presented.**

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12 IRS response to TAS information request (Oct. 13, 2017). The geographic outreach data provided in the IRS response to TAS information request does not include in-person speeches given by IRS employees who are not dedicated outreach employees. IRS response to TAS fact check (Nov. 20, 2017).

13 In response to TAS's request for the IRS's overall outreach budget, the IRS responded that \$12.1 million of C&L's budget was allocated to outreach activities. IRS response to TAS information request (Oct. 13, 2017). However, in its response to the TAS fact check, the IRS stated that the \$12.1 million figure only applies to labor costs of employees in NPL and SL. IRS response to TAS fact check (Nov. 20, 2017).

14 S. Rep. No. 105-174, 9 (1998); Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 1998*, JCS-6-98 16-17 (1998); IRS Pub. 3349, *Modernizing America's Tax Agency* 1-10 (Apr. 2000), <https://www.irs.gov/pub/irs-utl/27877d00.pdf>.

15 IRM 1.2.19.1.8, *Policy Statement 1-181* (Jul. 24, 1989).

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However, in most cases, relying on partners is not as beneficial as actually going out and talking with taxpayers, preparers, and other representatives to really understand where confusion lies, how to develop better publications and materials, and what national messages need to be modified or reinforced.

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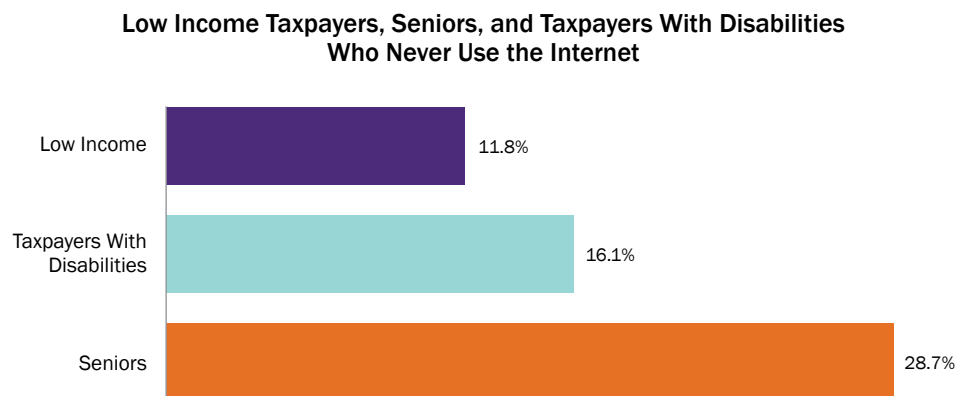
understand where confusion lies, how to develop better publications and materials, and what national messages need to be modified or reinforced.

### Given That Tax Administration Relies on Voluntary Compliance, It Is Incumbent on the IRS to Conduct and Evaluate Research Into Taxpayer Information Needs

To give taxpayers what they need, when they need it, and in a manner they can access, the IRS must conduct and evaluate research into taxpayer information needs. In 2016 and 2017, TAS conducted a nationwide survey of U.S. taxpayers about their needs, preferences, and experiences with IRS taxpayer service conducted entirely by telephone (landline and cell phone).<sup>16</sup> Without evaluating the results from this type of research, the IRS is developing an outreach strategy that may miss the mark and negatively impact taxpayer compliance.

For example, the 2016 and 2017 TAS survey found that about 28 percent of taxpayers do not have broadband access, which translates to over 41 million taxpayers without this type of access, particularly an issue in the vulnerable populations including low income taxpayers, seniors and taxpayers with disabilities. The following chart illustrates the percentages of the respondents in the vulnerable populations who never use the internet:<sup>17</sup>

**FIGURE 1.9.2, Percentages of Low Income Taxpayers, Seniors, and Taxpayers with Disabilities Who Never Use the Internet.**



<sup>16</sup> See Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*; National Taxpayer Advocate 2016 Annual Report to Congress, vol. 2, 1-30 (Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*).

<sup>17</sup> See Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*.



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In addition, the survey found seniors and taxpayers with disabilities are not as confident in their ability to find information they are seeking on the internet as other taxpayers. They are more likely to report they are not able to find information and less likely to state they always find the information they are seeking. Therefore, as the IRS increasingly uses digital outreach channels to distribute information, the IRS outreach strategy should also include alternate distribution channels to reach those taxpayers without broadband access as well as vulnerable taxpayer populations.<sup>18</sup>

### Before Focusing on Digital Outreach and Education, Review Research on How People Process Information They Read Digitally

Before the IRS prioritizes digital outreach and education, it should review research on how people process information they read digitally. Research has shown that people tend to engage in a greater use of short cuts (such as searching for keywords) when reading digital content. Not surprisingly, readers of digital content tend to become distracted and multitask.<sup>19</sup>

Face-to-face outreach events tend to involve the distribution of pamphlets and brochures. In comparison to digital distribution of information, research has shown that people mentally process information easier (*e.g.*, less cognitive effort to process) if they read it on paper. There is a physicality in reading on paper — people tend to remember where on a page they read a specific item and they understand how the information they are currently reading fits into the whole picture, because they can see where the current page is in relation to the entire publication.<sup>20</sup> Research has also found that people recall information better if read on paper.<sup>21</sup>

### IRS Efforts to Educate Taxpayers About the IRS Phone Scam Did Not Reach Far Enough

A practical example of how digital outreach may not reach certain populations can be seen with outreach initiatives warning taxpayers about the IRS phone and email scams. The IRS has conducted extensive outreach and education, mainly through digital channels and leveraged partnerships, detailing the evolving scams, how to avoid becoming a victim, and information on where to report scams.<sup>22</sup> Yet, these scams were raised as a serious problem at many, if not all, of the 12 National Taxpayer Advocate Public

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18 See Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*.

19 Anne Niccoli, *Paper or Tablet? Reading Recall and Comprehension*, *EDUCAUSE REVIEW* (Sept. 28, 2015).

20 Ferris Jabr, *The Reading Brain in the Digital Age: The Science of Paper versus Screens*, *SCIENTIFIC AMERICAN* (Apr. 11, 2013); Roger Dooley, *Paper Beats Digital in Many Ways, According to Neuroscience*, *FORBES* (Sept. 16, 2015).

21 Roger Dooley, *Paper Beats Digital in Many Ways, According to Neuroscience*, *FORBES* (Sept. 16, 2015).

22 The IRS issued and posted news releases and alerts, delivered products in multiple languages via [irs.gov](https://www.irs.gov), social media platforms, presentations at the IRS Nationwide Tax Forums, tax practitioner institutes, webinars, press events, Security Summit meetings and events, advisory board meetings, practitioner meetings, partner visits, industry meetings, state and local governments, congressional visits and congressional phone conferences that include sharing materials for external IRS partners to share with clients and taxpayers. All YouTube videos are close-captioned and the IRS has separate channels for multilingual and deaf taxpayers. IRS response to TAS fact check (Nov. 20, 2017). For two examples of digital products, see IRS, *Tax Scams/Consumer Alerts*, <https://www.irs.gov/uac/tax-scams-consumer-alerts> (visited May 23, 2017); IRS, *Scam Phone Calls Continue; IRS Identifies Five Easy Ways to Spot Suspicious Calls*, IR-2014-84 (Oct. 7, 2016).

Forums held around the country in 2016. Many audience members noted that the IRS's message is not reaching taxpayers in their communities — many of them English as a Second Language (ESL) and Limited English Proficiency (LEP) taxpayers.<sup>23</sup>

Therefore, despite the significant efforts by the IRS to distribute information on the topic, they still did not reach these ESL and LEP taxpayers. Without a local presence, the IRS does not necessarily consider language barriers or the most effective ways to communicate with certain taxpayer populations, such as working with community leaders and local trade and community organizations.

### **Outreach and Education Goes Beyond the Traditional Conveyance of Information and Should Be Part of Every Taxpayer Touch**

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 the related literature review in this report, there is discussion about the importance of the customer experience. Specifically, to build customer confidence, the organization must invest in the micro customer experience. This is the small, subtle, memorable, and affordable gesture that will resonate with customers for years.<sup>24</sup>

In addition to using traditional methods to convey information, such as IRS news releases and the IRS official website, the IRS must take advantage of each and every taxpayer touch to educate taxpayers. Every time an IRS employee has direct contact with a taxpayer regarding an enforcement action, the employee should take the time to ensure that the taxpayer understands how to come into compliance and avoid making similar mistakes in the future, if applicable. Further, when taxpayers take the initiative to visit Taxpayer Assistance Centers (TACs), employees have the perfect opportunity to listen to taxpayers in their own communities and provide targeted information to address their particular needs. In many cases, the TAC employee will be able to read the taxpayer's expressions and determine whether the taxpayer is truly understanding the information provided. Finally, because local TAC employees are well-positioned to identify community-specific information needs, the IRS should have procedures for TAC employees to elevate local information needs to C&L, as deemed appropriate.

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### **Conducting outreach through the use of mobile vans would promote listening, humanizes both the IRS and the taxpayers, and builds taxpayer trust in the IRS.**

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Mobile van units can also serve as an outreach and education presence in the community. The IRS would establish relationships with community leaders in the process of scheduling stops. In addition, when employees engage with the taxpayers who visit the mobile van, they can address account issues, or answer follow-up questions, or even connect taxpayers to a remote expert on a given topic.<sup>25</sup> Taxpayers also feel more at ease while they are on their own turf rather than in a traditional government building. Conducting outreach through the use of mobile vans would promote listening, humanizes both the IRS

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23 For transcripts of the National Taxpayer Advocate's Public Forums, see <https://taxpayeradvocate.irs.gov/public-forums>.

24 See Literature Review: *Fostering Taxpayer Engagement Through Geographic Presence*, vol. 2, *infra*.

25 HM Revenue & Customs, *A New Service for Those Needing the Most Help*, GOV.UK (Feb. 12, 2014), <https://www.gov.uk/government/publications/issue-briefing-a-new-service-for-those-needing-the-most-help/a-new-service-for-those-needing-the-most-help>.

and the taxpayers, and builds taxpayer trust in the IRS.<sup>26</sup> In addition, through these interactions, IRS employees would gain valuable information about the limitations of vulnerable populations, such as seniors, low income, and taxpayers with disabilities.<sup>27</sup>

### Two-Way Communication Is Vital to Maintain Responsiveness

IRS digital outreach and education is currently a form of one-way messaging. In a vacuum, the IRS anticipates the information needs of taxpayers and drafts guidance to address these anticipated needs. However, there is no current method for taxpayers to comment on informal or “unpublished” guidance posted online (such as Tax Topics and Frequently Asked Questions or FAQs), ask more detailed questions, or present their own unique set of facts for a more tailored response.<sup>28</sup> In addition, the IRS does not have a sense of whether taxpayers are receiving or understanding the messages distributed through digital channels.

To maintain trust in the agency, the IRS must be responsive to taxpayer needs. This includes needs particular to certain regions and localities. As an example, the Federal Emergency Management Agency (FEMA) has developed effective two-way communication lines with the local communities. To accomplish its mission, FEMA must distribute important disaster-related information to people who need it and must incorporate critical updates from individuals who are experiencing the changing situation on-the-ground. Because time is a fundamental factor in emergency management, FEMA must fully comprehend the full scope of the disaster. Accordingly, FEMA fully uses two-way communication, generally in the form of social media, to maintain responsiveness.<sup>29</sup>

While the administration of a federally-declared disaster emergency response differs from tax administration, they both share the need to be responsive to the needs of local communities. The IRS must have a way to give and receive information that effectively tailors its outreach and education to address the particular facts and circumstances faced in that specific geographic area. The IRS has noted that it is evaluating new more efficient opportunities to expand two-way dialogue with taxpayers around the country.<sup>30</sup> We look forward to the implementation of new technology that would provide such capability, but we also caution the IRS that such technology should not replace actual geographic presence in the local communities.

26 TAS is planning to purchase or lease one or more mobile units in its outreach and disaster efforts in fiscal year (FY) 2018.

27 An example of the use of mobile vans in local communities to provide outreach and education in addition to the provision of traditional governmental services is the MVA mobile bus. See Maryland Department of Transportation, Motor Vehicle Administration, *MVA Bus Schedule*, <http://www.mva.maryland.gov/locations/bus.htm> (last visited Sept. 5, 2017).

28 See National Taxpayer Advocate Blog: *IRS Frequently Asked Questions Can Be a Trap for the Unwary* (Feb. 26, 2017), <https://taxpayeradvocate.irs.gov/news/irs-frequently-asked-questions-can-be-a-trap-for-the-unwary?category=TaxNews>.

29 *Understanding the Power of Social Media as a Tool in the Aftermath of Disasters*, hearing before the Senate Committee on Homeland Security and Governmental Affairs, Subcomm. on Disaster Recovery and Intergovernmental Affairs (May 4, 2011) (written statement of Craig Fugate, Administrator, Federal Emergency Management Agency); FEMA, *Social Media Provides Online Information and Resources for Survivors* (Oct. 10, 2017), <https://www.fema.gov/news-release/2017/10/10/social-media-provides-online-information-and-resources-survivors> (last visited Nov. 3, 2017); Dina Fine Maron, *How Social Media is Changing Disaster Response*, *Scientific American* (June 7, 2013), <https://www.scientificamerican.com/article/how-social-media-is-changing-disaster-response/> (last visited Nov. 3, 2017).

30 IRS response to TAS information request (Oct. 13, 2017).

### An International Approach: Her Majesty's Revenue and Customs (HMRC)<sup>31</sup>

The IRS can learn from the experience of other taxing authorities in developing an effective outreach and education strategy that meets taxpayers' needs. In an effort to close the tax gap, Her Majesty's Revenue and Customs (HMRC) in the United Kingdom developed a research-based outreach strategy. In fact, the first of HMRC's eight key compliance activities states: "Identifying how to deal with customers in the most appropriate way. This ranges from educating them about their tax responsibilities to providing local help and support."<sup>32</sup>

To provide more targeted and tailored service to taxpayers, HMRC commissioned research into the estimated 1.5 million customers who need extra help to get their taxes right. These customers included individuals who experienced a specific event in their lives (such as a family member's death or approaching retirement), or those with low literacy levels, medical conditions, or disabilities. HMRC used the research results to design a service strategy that is accessible to more taxpayers. HMRC trained its employees to identify when a customer needs extra help. Some of these customers may need extra help from a specialist over the phone, with arranged call-backs, and possibly face-to-face meetings. Others may need face-to-face support, delivered by a team of mobile advisors at convenient locations rather than fixed locations with limited opening times. Such locations include government offices, community buildings, and a person's own home.<sup>33</sup> HMRC also established improved working relationships with community organizations. HMRC's initiative allowed the agency to refine its personalized services by offering a select group of taxpayers the support that suits them best.<sup>34</sup> It also allowed HMRC to close all of its brick-and-mortar Enquiry Centres, even as it retained the ability to meet face-to-face with taxpayers based on their specific needs.

The IRS services strategy appears to have the same end goal as HMRC — efficiently use outreach resources to "free up" resources to effectively provide personalized services to the population who actually need more help. However, the IRS has not conducted research to determine how to best support its diverse taxpayer base. Moreover, the IRS has significantly reduced the scope, coverage, and availability of face-to-face assistance over the last decade.<sup>35</sup> Therefore, without any relevant data on taxpayer information needs, the IRS has little basis to justify its substantial shift toward digital outreach and education and almost complete reliance on third-party intermediaries to deliver outreach and education.

31 HM Revenue & Customs, Issue Briefing, *Helping Those Who Need It Most* (March 2013), <https://www.gov.uk/government/publications/helping-those-who-need-it-most>; HM Revenue & Customs, Issue Briefing, *Our Approach to Tax Compliance* (Sept. 2012).

32 HM Revenue & Customs, Issue Briefing, *Our Approach to Tax Compliance* (Sept. 2012).

33 HM Revenue & Customs, *A New Service for Those Needing the Most Help*, GOV.UK (Feb. 12, 2014), <https://www.gov.uk/government/publications/issue-briefing-a-new-service-for-those-needing-the-most-help/a-new-service-for-those-needing-the-most-help>; Nick Huber, AccountingWEB, *HMRC to Close Walk-in Tax Enquiry Centres* (Feb. 12, 2014).

34 HM Revenue & Customs, Issue Briefing, *Helping Those Who Need It Most* (Mar. 2013); HM Revenue & Customs, *A New Service for Those Needing the Most Help* (Feb. 12, 2014), <https://www.gov.uk/government/publications/issue-briefing-a-new-service-for-those-needing-the-most-help/a-new-service-for-those-needing-the-most-help> (last visited Sept. 5, 2017).

35 See Most Serious Problem: *Taxpayer Assistance Centers (TACs): Cuts to IRS Walk-In Sites Have Left the IRS With a Substantially Reduced Community Presence and Have Impaired the Ability of Taxpayers to Receive In-Person Assistance*, *infra*; National Taxpayer Advocate 2016 Annual Report to Congress 86-97 (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*); National Taxpayer Advocate 2014 Annual Report to Congress 31-45 (Most Serious Problem: *IRS Local Presence: The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*).

## CONCLUSION

To protect the taxpayer's right to be informed, the IRS must develop a research-based outreach and education strategy. Not all taxpayers have the same information needs. The most effective way to understand the information needs of the various diverse local communities is to have geographic presence rather than generalize the information needs of the entire U.S. taxpayer population from afar. Both the IRS and taxpayers are harmed if they cannot engage in two-way conversations, ideally in the form of a face-to-face meeting, because both parties have so much to learn from each other.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Conduct research into the outreach and education needs of taxpayers, broken down by various demographics.
2. Evaluate and implement two-way digital communication models into the outreach and education strategy (instead of one-way messaging).
3. Incorporate into the IRS outreach and education strategy the findings of TAS research on taxpayers' varying abilities and attitudes toward IRS taxpayer service, as well as the needs and preferences of low income and Hispanic taxpayers, and the recommendations from the National Taxpayer Advocate's 2016 Public Forums.
4. Assign at least one employee to conduct outreach activities in each state, territory, and the District of Columbia (and who resides in that state, territory, or district) and provide each employee with sufficient resources to travel and engage in regular face-to-face communications with taxpayers throughout the state.
5. Establish a program in which the IRS provides various services, including traditional face-to-face outreach and education, through the use of mobile taxpayer assistance stations (vans) in rural and underserved communities.

**MSP  
#10****TAXPAYER ASSISTANCE CENTERS (TACs): Cuts to IRS Walk-In Sites Have Left the IRS With a Substantially Reduced Community Presence and Have Impaired the Ability of Taxpayers to Receive In-Person Assistance****RESPONSIBLE OFFICIAL**

Kenneth Corbin, Commissioner, Wage and Investment

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

Taxpayer Assistance Centers (TACs), formerly called walk-in sites, became the primary local face of the IRS after the IRS reorganized around central campus locations and business divisions, severely reducing the IRS presence in local communities.<sup>2</sup> However, recent changes to TACs have chipped away at the services provided and the ability of taxpayers to receive prompt, in-person service, and negatively impacted the image of the IRS in local communities. Specifically, the National Taxpayer Advocate is concerned that:

- The IRS has closed 30 TACs since fiscal year (FY) 2011, a reduction of over seven percent.<sup>3</sup>
- In FY 2017, the first full year of the appointment system, the IRS served 3.2 million taxpayers at TACs compared to 4.4 million taxpayers in FY 2016.<sup>4</sup>
- The IRS has reduced TAC staffing from 2,254 employees in late February 2011 to 1,586 employees in late February 2017, a decline of about 30 percent.<sup>5</sup>
- 111 TACs, approximately 30 percent of all TACs, have either zero employees or one employee, resulting in a closed or virtually closed TAC.<sup>6</sup>

As the IRS moves towards online self-service it must consider taxpayers who cannot complete tasks online or prefer not to use the internet for interacting with the IRS. Reducing a service to the point that taxpayers can no longer easily access it, then declaring no one uses the service and eliminating it entirely

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).

2 Internal Revenue and Restructuring Act of 1998 (RRA 98), Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998) (codified at IRC § 7801). RRA 98 required the IRS to reorganize its structure around business units serving specific taxpayer populations as opposed to its previous geographically based structure.

3 IRS response to TAS information request (Dec. 23, 2014); IRS response to TAS information request (Nov. 3, 2017). IRS had 401 TAC locations in 2011 but that number is down to 371 in 2017.

4 IRS response to TAS information request (Sept. 13, 2017). IRS response to TAS information request (Nov. 3, 2017).

5 IRS response to TAS information request (Sept. 13, 2017; Nov. 3, 2017). Figures in the text are for Feb. 26, 2011 and Feb. 18, 2017. The number of employees declined at the end of the fiscal year (FY) primarily due to seasonal staffing with 1,898 employees in 2011 vs. 1,435 in 2017 on September 30th of each year.

6 IRS response to TAS information request (Nov. 3, 2017).

has proven successful for the IRS in the past and it appears the IRS is moving in the same direction with TACs. Further, the IRS should not discount the value of a presence in local communities — being able to interact with an employee in real life helps humanize the agency for taxpayers and provides the IRS with real time information about tax issues affecting local areas.<sup>7</sup> Nor can it ignore the consequences to taxpayer rights, particularly the *right to quality service* and the *right to be informed* that occur when taxpayers' access to taxpayer service methods is reduced or restricted.

## ANALYSIS OF THE PROBLEM

### The State of TACs in FY 2017

The IRS currently operates 371 TACs in the 50 states, the District of Columbia, and Puerto Rico.<sup>8</sup> The TACs provide the main source of in-person, face-to-face assistance from the IRS to taxpayers. Approximately 3.2 million taxpayers visited a TAC in FY 2017.<sup>9</sup> The IRS has been reducing the services offered in TACs for many years and recently switched to a mainly appointment based service model for TACs.<sup>10</sup> While the IRS has restricted the topics it addresses at TACs, only answers tax law questions (both on the phones and in TACs) during the filing season, and no longer offers return preparation at the TACs, taxpayers continue to seek out TAC services.<sup>11</sup>

Of the TACs, 24 have zero employees, so are closed for all intents and purposes, and 87 have one employee and are subject to closure if that employee is sick, on leave, or in training.<sup>12</sup> Five TACs were staffed only seasonally.<sup>13</sup> Six TACs were open fewer than 35 hours per week.<sup>14</sup> Seven TACs were staffed by circuit riders.<sup>15</sup> Overall, TAC staffing is down nearly 30 percent since FY 2011.<sup>16</sup>

### TAC Service in Some States Is Nearly Non-Existent

While overall TAC availability has been drastically reduced in terms of services offered, employees on staff, and locations, the situation is particularly dire in certain states. In Montana, the IRS lists six TAC locations.<sup>17</sup> Of these six TACs, half have zero or one employee, one TAC with one employee is only staffed seasonally, and total TAC employees in Montana dropped from 11 in FY 2014 to eight in FY 2017.<sup>18</sup> Faring worse are the 3.1 million residents of Iowa,<sup>19</sup> with only five TACs, 60 percent of which

7 For a discussion of the geographic footprint of the IRS, see National Taxpayer Advocate 2016 Annual Report to Congress 86-97 (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*).

8 IRS response to TAS information request (Nov. 3, 2017).

9 *Id.*

10 See, e.g., 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*). IRS, *Contact Your Local Office*, <https://www.irs.gov/help-resources/contact-your-local-irs-office> (last visited Aug. 16, 2017).

11 See IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), <https://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.

12 IRS response to TAS information request (Nov. 3, 2017).

13 *Id.*

14 *Id.*

15 IRS response to TAS fact check (Dec. 19, 2017).

16 From February 2011 to February 2017, Taxpayer Assistance Center (TAC) staffing fell from 2,254 to 1,586, a decrease of 30 percent. Similarly, from September 2011 to September 2017, staffing fell from 1,898 to 1,435 in TACs.

17 IRS response to TAS information request (Nov. 3, 2017).

18 *Id.*

19 Census Bureau, *Quick Facts Iowa*, <https://www.census.gov/quickfacts/IA> (last visited Sept. 21, 2017).

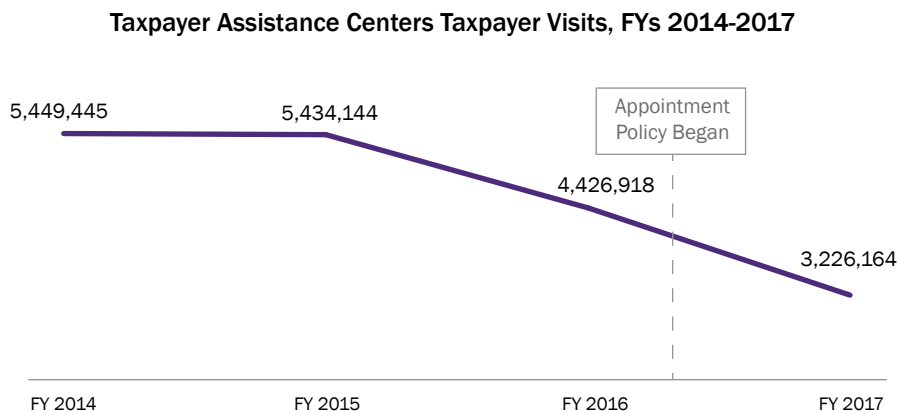
Reducing a service to the point that taxpayers can no longer easily access it, then declaring no one uses the service and eliminating it entirely has proven successful for the IRS in the past and it appears the IRS is moving in the same direction with Taxpayer Assistance Centers.

are unstaffed or have one employee and only six total TAC employees in the state.<sup>20</sup> These taxpayers have approximately one TAC employee per 500,000 residents of the state. The situation in Vermont is equally grim — of Vermont’s four TACs, only one is staffed with more than one employee, one is unstaffed, and one is serviced by a shared, circuit-riding employee.<sup>21</sup> For residents in these and other states, finding an IRS employee for face-to-face assistance is a monumental task.

**The IRS Changed TACs From Walk-In Sites to Mostly By Appointment**

By the end of calendar year 2016 the IRS moved from a walk-in system for TAC service to a mostly by appointment only system.<sup>22</sup> Prior to changing to a mostly appointment based system at TACs, 4.4 million taxpayers visited TACs in FY 2016.<sup>23</sup> In FY 2017, the first full year of the appointment system, only 3.2 million taxpayers visited TACs, a decrease of 27 percent.<sup>24</sup>

**FIGURE 1.10.1, TAC Visits from FY 2014–2017<sup>25</sup>**



20 IRS response to TAS information request (Nov. 3, 2017).

21 *Id.*

22 Memorandum from Debra Holland, Commissioner, W&I to All W&I Employees (Dec. 13, 2016) (on file with TAS). Additionally, it is important to note that the IRS did not have a global view system for selecting appointments for taxpayers. As a result, scheduling employees scrolled ahead weeks in advance to find an appointment for a taxpayer where the chance would be greater for availability rather than looking at the next few days individually to find the next available appointment for a taxpayer, delaying the taxpayer’s ability to secure a TAC appointment. The Commissioner, W&I, informed the National Taxpayer Advocate that the IRS now intends to procure a global calendar system, hoping this issue would be resolved going forward. Conversation between the Commissioner, W&I and the National Taxpayer Advocate (Sept. 6, 2017).

23 IRS response to TAS information request (Sept. 13, 2017).

24 IRS response to TAS information request (Sept. 13, 2017, Nov. 3, 2017).

25 *Id.*



In addition to implementing an appointment system, the IRS has created a triage system whereby it attempts to resolve the taxpayer's concerns over the phone when the taxpayer calls to make a TAC appointment before the IRS employee will schedule an appointment for the taxpayer. In FY 2017, approximately 3.5 million taxpayers called for a TAC appointment and about half or nearly 1.7 million did not make an appointment.<sup>26</sup>

The National Taxpayer Advocate believes that conserving IRS in-person resources for those taxpayers who need face-to-face service is an important goal; however, she is concerned about where the nearly 350,000 taxpayers (the difference between taxpayers served at TACs in FY 2015 and taxpayers served in TACs in FY 2017 plus taxpayers triaged in FY 2017) are now turning for tax assistance.<sup>27</sup> While the National Taxpayer Advocate is pleased that the IRS indicates it now allows TAC managers to accept walk-ins at the manager's discretion, she urges the IRS to allow both appointments and walk-ins at TACs to provide options for taxpayers. Additionally, while the IRS indicates that taxpayers can still walk-in to complete certain tasks (making payments, picking up forms, etc.), and that managers can accept walk-ins for other services, the IRS website providing information about contacting your local office provides no such information.<sup>28</sup>

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26 IRS response to TAS information request (Nov. 3, 2017).

27 IRS response to TAS information request (Sept. 13, 2017 and Nov. 3, 2017). TAS is concerned that the number of taxpayers "triaged" may not accurately reflect taxpayers who resolved their issues during the initial phone call. The numbers provided by the IRS simply report the total number of taxpayers who initially called seeking a TAC appointment and the number of taxpayers who did not schedule an appointment during that phone call.

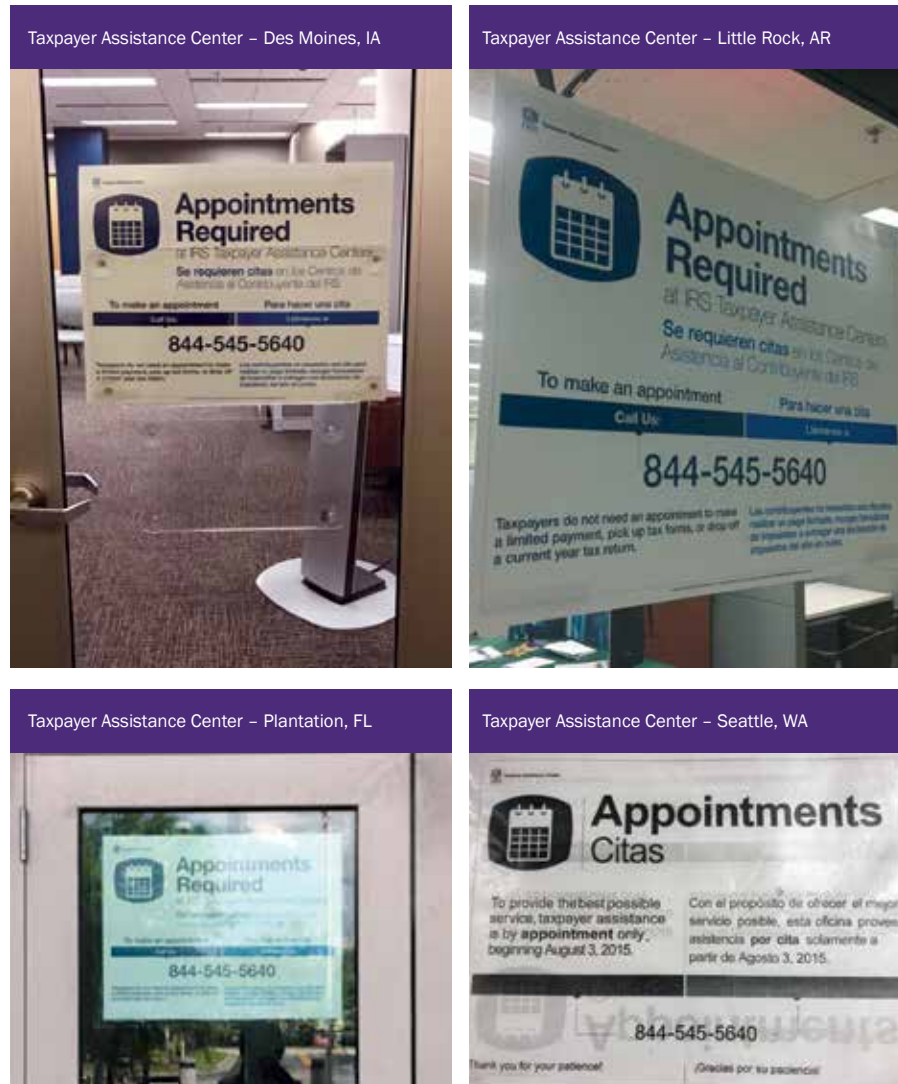
28 IRS, *Contact Your Local Office*, <https://www.irs.gov/help-resources/contact-your-local-irs-office> (last visited Sept. 21, 2017).

FIGURE 1.10.2

The screenshot shows the IRS website's 'Contact Your Local IRS Office' page. At the top, there is a navigation bar with links for 'Filing', 'Payments', 'Refunds', 'Credits & Deductions', 'News & Events', 'Forms & Pubs', and 'Help & F'. The IRS logo is on the left, and a search bar and 'Subscriptions' link are on the right. Below the navigation bar, there is a 'Related Items' sidebar with links to 'Contact the IRS', 'Where to file addresses', 'International Taxpayers', and 'Payment Plans'. The main content area features a heading 'Contact Your Local IRS Office' with a heart icon, a printer icon, and language options: 'Español | 中文 | 한국어 | TiếngViệt | Русский'. An information icon indicates that 'All Taxpayer Assistance Centers (TACs) now operate by appointment.' Below this, a text block states that nearly every tax issue can be resolved online or by phone, but if help is needed from a TAC, an appointment must be scheduled. To the right, a 'Self-Service Options' box lists links for Refunds, Transcript, Identity Theft, Free File, Payments, and Tax Forms. A 'Missing Your Form SSA-1099?' sidebar offers an instant replacement for a free my Social Security account. The 'Locate a Taxpayer Assistance Center' section provides instructions on using the Office Locator and notes that centers are closed on federal holidays. An 'In-Person Document Review Provided for Form W-7 Applicants' section mentions that participating TAC locations will review identification documents for those who submit Form W-7 in person. The page footer indicates it was last reviewed or updated on 04-Feb-2017.

Further, taxpayers who visit TACs without an appointment are greeted with the signs pictured below.

**FIGURE 1.10.3, Appointment Only Signs on TACs**



Between the messaging on the IRS website and these signs adorning the doors of TACs, the IRS is telling taxpayers not to come in without first calling, and providing no indication that a taxpayer could even walk in if they so desired. The National Taxpayer Advocate is concerned about this messaging and what is actually happening to taxpayers who visit a TAC to complete a task, such as making a payment, which the IRS maintains taxpayers can do without an appointment.<sup>29</sup>

<sup>29</sup> For further information regarding the National Taxpayer Advocate's concerns about what taxpayers are experiencing if they visit a TAC without an appointment, see <https://taxpayeradvocate.irs.gov/news/nta-blog-taxpayer-assistance-center-service-continues-to-decline-impairing-taxpayers-ability-to-receive-in-person-assistance?category=TaxNews>.

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Taxpayers have the *right to quality service* and when the agency charged with administering the tax code says it can't help, the IRS is violating the rights of all taxpayers, and in particular those without the resources to seek outside help.

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### The IRS Is the Agency of “No,” Harming Vulnerable Taxpayer Populations and Impacting Taxpayer Rights

The IRS arguably touches the lives of more people than any other United States government agency. It is hard to imagine anyone who lives in the United States, or is a United States citizen, or has ever done business in the United States, not having to interact with the IRS at some point in time. Yet, the IRS continues to reduce the services it provides, preferring to pursue a policy of “low cost” at the expense of service and protecting taxpayer rights. Want a tax return prepared? Do it yourself, pay someone else to do, or if you meet the income requirements you can go to a Volunteer Income Tax Assistance (VITA) site. But don't ask the IRS, it doesn't offer return preparation anymore.

This is particularly concerning in light of recent natural disasters. VITA sites, which only prepare returns for taxpayers within their income restrictions, do not prepare returns with casualty losses.<sup>30</sup> Taxpayers in disaster areas affected by the year's catastrophic hurricanes are being warned to beware of scammers — with so much on their plates, where should these taxpayers turn for tax assistance at this time when they cannot turn to the IRS? Instead, these taxpayers are left to sort through finding a reputable tax preparer or waiting until next filing season to claim their disaster losses. Instead of saying “no” in times of disaster, the IRS could deploy mobile vans and staff nearby TACs with onsite employees such as revenue agents or revenue officers to meet taxpayer demand and implement a policy of assisting taxpayers in disaster areas with filing amended returns. Further, the IRS could also use co-located employees at peak times of the year where taxpayer demand for TAC services outpaces the availability to assist additional taxpayers.

Adding insult to injury, the IRS no longer answers tax law questions outside of the tax filing season, which runs from January to mid-April.<sup>31</sup> So, any taxpayers currently facing hardship caused by the recent hurricanes cannot even call the IRS to get a tax law question answered. Taxpayers have the *right to quality service* and when the agency charged with administering the tax code says it can't help, the IRS is violating the rights of all taxpayers, and in particular those without the resources to seek outside help.

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30 For a detailed discussion of VITAs, see Most Serious Problem: *VITA/TCE Programs: IRS Restrictions on Volunteer Income Tax Assistance (VITA) and Taxpayer Counseling for the Elderly (TCE) Programs Increase Taxpayer Burden and Adversely Impact Access to Free Tax Preparation for Low Income, Disabled, Rural, and Elderly Taxpayers*, *infra*. See also IRS, Pub. 3676-B. For example, in areas currently affected by hurricane damage, like Houston, there is only one VITA site open within 100 miles of Houston and its hours are limited to 10am-2pm. See <https://irs.treasury.gov/freetaxprep/jsp/vita.jsp?zip=77005&lat=29.7183467&lng=-95.43061410000001&radius=100>. See also IRS, Pub. 4012 (Rev. 10-2017).

31 IRM 21.3.4.2(1) (Oct. 1, 2017). See also IRM 21.3.4.3.4 (Oct. 27, 2016) (providing an exception at the manager's discretion).

## Alternative Face-to-Face Service Methods Are Important, But Are Not a Substitute for a TAC

### *Partnership With Social Security Administration (SSA)*

While the National Taxpayer Advocate is pleased that the IRS is pursuing partnerships with other government agencies, as she has recommended, the recommendation was not to replace current TAC locations with partner sites, but instead, to use partner sites to expand the reach of IRS face-to-face services to underserved communities.<sup>32</sup> The IRS is currently testing a pilot program with the SSA where the IRS will place TAC employees in four SSA locations.<sup>33</sup> Each of these TACs is a one employee TAC; therefore, during this pilot, those TACs will be effectively closed.<sup>34</sup> If the IRS is merely using this program to prove it can provide TAC services in a co-located space and release the space leased by the IRS for TACs in these areas, then this program will not result in a net positive number of taxpayers now having access to TACs who did not previously have such access.

### *Virtual Service Delivery (VSD)*

The National Taxpayer Advocate recommended for many years that the IRS pursue VSD to reach taxpayers without ready access to IRS face-to-face services.<sup>35</sup> However, again, the National Taxpayer Advocate does not believe that VSD kiosks should replace TACs, rather kiosks should be used as a supplement to already existing TACs where demand outstrips employee availability and as a tool to reach rural and underserved communities. Additionally, the National Taxpayer Advocate is very concerned that the IRS's implementation of VSD has not kept pace with the available technology, resulting in outdated technology that does not allow taxpayers to complete the tasks they need to complete.<sup>36</sup> With the advent of mobile phone video technology, the IRS must keep pace with the ways that taxpayers can connect with the services they need in its mission to provide top quality taxpayer service.

### *Mobile Vans*

The National Taxpayer Advocate has long urged the IRS to test a properly designed mobile van program.<sup>37</sup> While the IRS has previously indicated that it has piloted a van program, TAS and the National Taxpayer Advocate have not had the opportunity to review either the design or the results from this program, only the IRS assertion that it was unsuccessful.<sup>38</sup> In contrast, this summer, the IRS created posters for the main IRS building, one of which featured a tax van from the 1970s, depicted below.

32 See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 267-77 (Most Serious Problem: *The IRS Has Been Reluctant to Implement Alternative Service Methods that Would Improve Accessibility for Taxpayers Who Seek Face-to-Face Assistance*).

33 IRS response to TAS information request (Sept. 13, 2017).

34 The four "home" TACs of the employees in the pilot program are: North Platte, NE; Danville, VA; Presque Isle, ME; and New London, CT. IRS response to TAS information request (Sept. 13, 2017).

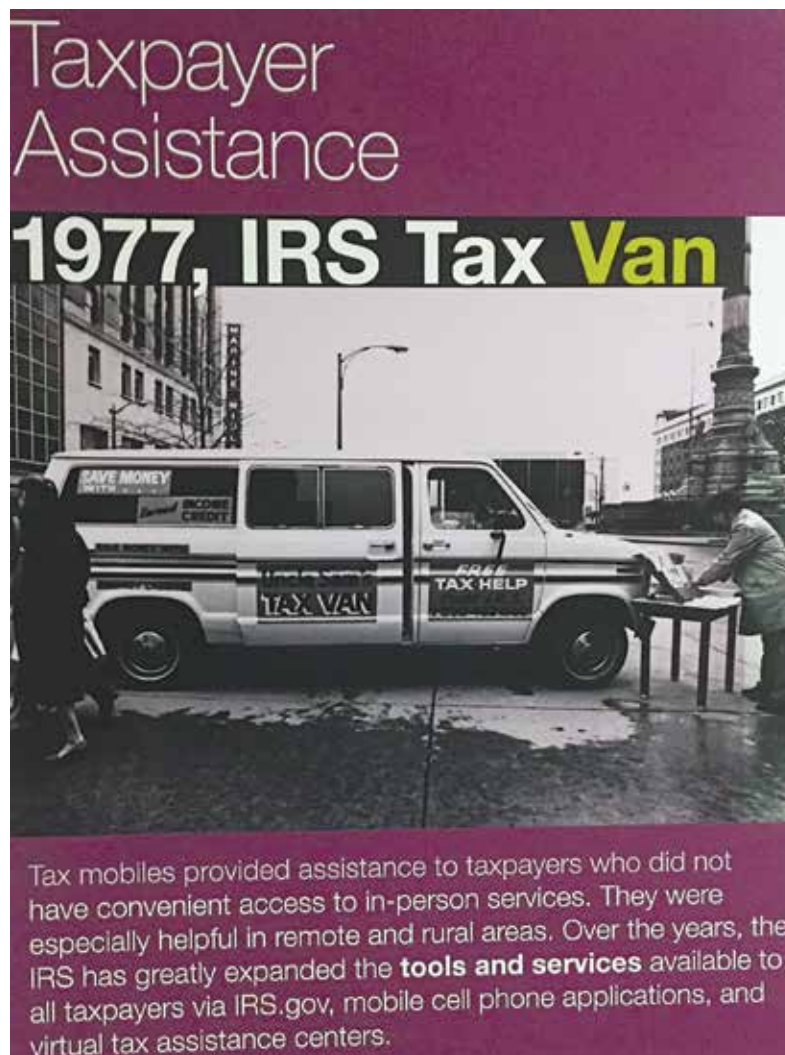
35 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 154-62 (Most Serious Problem: *Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services*); National Taxpayer Advocate 2012 Annual Report to Congress 462-68; National Taxpayer Advocate 2012 Annual Report to Congress 302-18.

36 See Most Serious Problem: *Appeals: The IRS's Decision to Expand the Participation of Counsel and Compliance Personnel in Appeals Conferences Alters the Nature of Those Conferences and Will Likely Reduce the Number of Agreed Case Resolutions, infra*; Most Serious Problem: *Online Accounts: The IRS's Focus on Online Service Delivery Does Not Adequately Take into Account the Widely Divergent Needs and Preferences of the U.S. Taxpayer Population, infra*.

37 See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 267-77 (Most Serious Problem: *The IRS Has Been Reluctant to Implement Alternative Service Methods that Would Improve Accessibility for Taxpayers Who Seek Face-to-Face Assistance*); National Taxpayer Advocate 2008 Annual Report to Congress 95-113 (Most Serious Problem: *Taxpayer Service: Bringing Service to the Taxpayer*).

38 National Taxpayer Advocate 2010 Annual Report to Congress 267-77.

FIGURE 1.10.4



While the poster indicates taxpayers can now complete tasks online and thus implies a van is a relic of a different era, other programs serving similar populations as the IRS have found vans meet the needs of these populations.

Recently, an article appeared in the *Washington Post* regarding a Washington, D.C. area food bank that is bringing its food to where the populations it serves are most likely to gather.<sup>39</sup> The National Taxpayer Advocate strongly urges the IRS to implement a similar program and additionally use the vans to service presidentially declared disaster areas.<sup>40</sup>

39 Bui, Lynn, *Slowing the Revolving Door of Prison with Corn Bread, Cabbage and Chocolate*, WASH. POST (July 24, 2017).

40 TAS is currently exploring the potential to secure and operate its own mobile van with the ability to deploy TAS services to disaster areas.

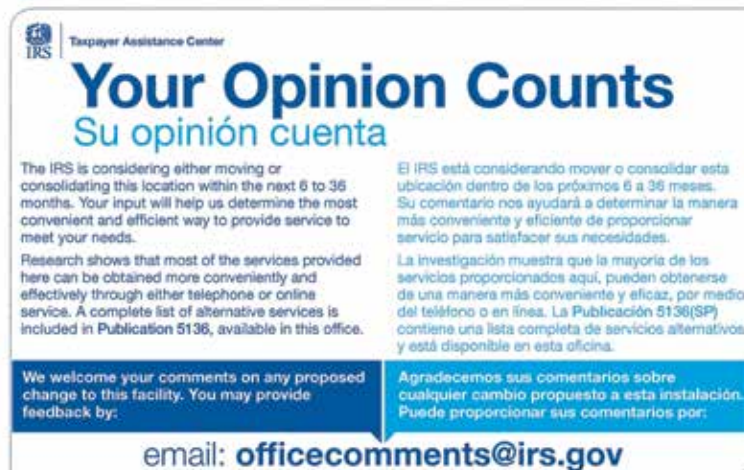
### *Taxpayers Prefer Familiar Services*

TAS recently completed a survey of taxpayers focused on preferred service delivery methods. One point in particular stood out — taxpayers prefer to use the first service channel (phone, web, TAC) they attempted to use to complete a task and expressed a preference to not use a different method.<sup>41</sup> Further, specific taxpayer populations were more likely to use a TAC, namely the low income and the elderly.<sup>42</sup> Additionally, low income taxpayers reported the loss of some services available at the TACs would have a negative impact.<sup>43</sup> Vulnerable populations were more likely to report that they never go on the internet compared to other taxpayer populations.<sup>44</sup> As the IRS moves toward internet self-help and away from in-person assistance, findings from taxpayer needs and preferences studies must shape service decisions.

### *Before Closing a TAC, the IRS Must Consider the Community Needs*

Recent language in the Senate Report accompanying the Senate version of the FY 2017 appropriations bill contains specific language addressing service at TACs.<sup>45</sup> In particular, the report directs the IRS to hold a public forum in the community where it is planning to close a TAC and to inform the Senate and House appropriations committees.<sup>46</sup> The National Taxpayer Advocate is concerned that the IRS may not be following this directive. The sign depicted below recently appeared on the door of the TAC in Texarkana, Texas:

**FIGURE 1.10.5**



41 TAS, *Observations from Services Priorities Data* (Oct. 4, 2017) (on file with TAS).

42 Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*.

43 *Id.*

44 *Id.* Nearly 30 percent of seniors, almost 12 percent of low income, and about 16 percent of disabled respondents reported they never use the internet. This compares with only about three to five percent of their counterparts saying they do not use the internet.

45 S. REP. No. 114-280, at 32-34 (2016).

46 *Id.*

While the sign invites the public to comment on the proposed changes to the TAC, it is unlikely the public will ever see the sign. The Texarkana TAC is located on the 5th floor of a federal building and the public must have an appointment to get in the building. However, the TAC has been unstaffed since FY 2016, so taxpayers cannot get an appointment and will never see the sign.<sup>47</sup> TAS is unaware of any IRS plans to hold a public forum for comment on the potential closure of the Texarkana TAC. Posting a sign on a door no one can access asking for comments seems an ideal way for the IRS to state that the public raised no objections to the closure of the TAC and simply close the TAC. Such a sign does not appear to meet the directive from the Senate.

## CONCLUSION

The National Taxpayer Advocate strongly supports providing taxpayer service via many delivery channels. The IRS must meet taxpayers where they are and through the methods they prefer in order to provide service to the greatest number of taxpayers possible. The least expensive method is not necessarily the best, and reducing current services without providing other methods for taxpayers to access those services creates a self-fulfilling prophecy — reduce service to the point that taxpayers can no longer easily access it, then declare the service unused and unnecessary and cut it completely. Such a strategy worked as the IRS undermined its own return preparation services, and it appears to be moving in that direction with its face-to-face services. If a TAC has no employees, taxpayers can't use it, then the IRS declares no one is using the TAC and closes it. Reducing the IRS presence across the country at a time when the population is increasing,<sup>48</sup> scammers abound,<sup>49</sup> taxpayers are subject to recurrent information breaches that threaten their tax information,<sup>50</sup> and natural disasters present immediate tax issues,<sup>51</sup> does not protect taxpayer rights, particularly the *right to quality service*.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Institute a dual appointment and walk-in structure at TACs at the taxpayer's choice.
2. Request the funding for, and in consultation with TAS, develop a pilot mobile van program.
3. Answer tax law questions throughout the year, at both TACs and on the phones.
4. Reinstate return preparation for amended disaster-based casualty loss returns.
5. Staff TACs during peak times with co-located staff such as revenue officers or revenue agents to handle overflow and appointments.

47 IRS response to TAS information request (Sept. 13, 2017).

48 Census Bureau, *US and World Population Clock*, <https://www.census.gov/popclock/>.

49 IRS, *Tax Scams/Consumer Alerts*, <https://www.irs.gov/newsroom/tax-scams-consumer-alerts> (last visited Sept. 26, 2017).

50 Alyssa Newcomb, *Massive Equifax Data Breach Could Affect Half of the U.S. Population*, NBC NEWS (Sept. 10, 2017, 6:01 PM), <https://www.nbcnews.com/tech/security/massive-equifax-data-breach-could-impact-half-u-s-population-n799686>.

51 See, e.g., Meghan Keneally, *Breaking Down Hurricane Irma's Damage*, ABC NEWS (Sept. 11, 2017, 1:28 PM), <http://abcnews.go.com/US/breaking-hurricane-irmas-damage/story?id=49765357>.



MSP  
#11**VITA/TCE PROGRAMS: IRS Restrictions on Volunteer Income Tax Assistance (VITA) and Taxpayer Counseling for the Elderly (TCE) Programs Increase Taxpayer Burden and Adversely Impact Access to Free Tax Preparation for Low Income, Disabled, Rural, and Elderly Taxpayers****RESPONSIBLE OFFICIALS**

Kenneth Corbin, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

The Volunteer Income Tax Assistance (VITA) program provides free basic income tax return preparation with electronic filing to taxpayers who generally make \$54,000 or less,<sup>2</sup> including low-wage workers, persons with disabilities, taxpayers living in rural communities, Native Americans, and taxpayers with limited English proficiency.<sup>3</sup> In addition to VITA, the Tax Counseling for the Elderly (TCE) program offers free tax help for taxpayers 60 years of age and older, specializing in questions about pensions and retirement-related issues.<sup>4</sup> IRS-certified volunteers in these programs are associated with IRS partners, which are often non-profit organizations that receive grants from the IRS.<sup>5</sup>

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).
- 2 The \$54,000 figure is based on the Earned Income Tax Credit (EITC) threshold; family size is not a factor. See IRS response to TAS Information Request (Sept. 21, 2017). Each year, the IRS suggests an income threshold for which free tax preparation will be offered. For example, in Tax Year 2015, the income threshold was \$53,000 while the EITC threshold for a family filing married filing jointly with three or more children, was \$53,267. See IRS, *2015 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates*, <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/eitc-income-limits-maximum-credit-amounts-1-year> (last visited Oct. 19, 2017).
- 3 Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites provide free tax preparation services for qualified individuals in conjunction with IRS assistance and direction. See IRS, *Free Tax Return Preparation for Qualifying Taxpayers*, <https://www.irs.gov/individuals/free-tax-return-preparation-for-you-by-volunteers> (last visited May 17, 2017).
- 4 Section 163 of the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2810 (1978) authorizes the IRS to enter into agreements with private or nongovernmental public non-profit agencies and organizations, exempt under IRC § 501, providing training and technical assistance to volunteers engaged in free tax help for the elderly.
- 5 See Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2810 (1978), § 163. In Fiscal Year (FY) 2017, the IRS partnered with 55 national partners. See also IRS response to TAS Information Request (Sept. 21, 2017).

Of about 143 million individual tax return filers in Processing Year (PY) 2017, 108 million or approximately 75 percent may be eligible to have their returns prepared at VITA and TCE sites.<sup>6</sup> During fiscal year (FY) 2017, VITA and TCE programs prepared over 3.5 million individual income tax returns.<sup>7</sup> This total does not reflect the number of taxpayers who sought assistance from VITA or TCE sites but were turned away because the issues they sought help with were deemed “out-of-scope.”<sup>8</sup> Notably, in FY 2017, VITA and TCE sites were reported to have a 93 percent accuracy rate.<sup>9</sup>

The National Taxpayer Advocate has long emphasized that restrictions and limitations the IRS imposes on VITA and TCE sites, compounded with the elimination of tax preparation services at Taxpayer Assistance Centers (TACs), increase taxpayer burden and may adversely impact the ability of low income, disabled, rural, and elderly taxpayers to obtain free tax return preparation services and meet their reporting obligations.

More specifically, we have identified the following issues pertaining to the IRS administering VITA and TCE programs:

- VITA/TCE programs are subject to restrictions that impede their effectiveness;
- VITA and TCE income limits, which do not account for family size, adversely impact free tax preparation for otherwise eligible taxpayers;
- The IRS’s lack of tracking volunteers certified in specific “in-scope” law issues results in VITA and TCE programs being unable to assist eligible taxpayers;
- Most VITA and TCE tax preparation sites are open only until mid-April each year, further confounding the problem of taxpayers going without the assistance they need; and
- The IRS unreasonably restricts grant funds to be used as compensation for screeners, quality reviewers, and Certified Acceptance Agents (CAAs).

## ANALYSIS OF PROBLEM

### Background

#### *History of VITA and TCE Programs*

The Tax Reform Act of 1969 resulted in the formation of the VITA Program.<sup>10</sup> IRS personnel recruited and trained volunteer tax preparers and then assigned them to community sites, such as libraries and community centers.<sup>11</sup> In 2000, the IRS created Stakeholder Partnerships, Education and Communication (SPEC), the outreach and education office of the IRS’s Wage and Investment Division,

6 TAS Research & Analysis, Compliance Data Warehouse (CDW), Individual Returns Transaction File (IRTF), data drawn Nov. 6, 2017. The number of individual filers is based on primary taxpayers who filed IRS Forms 1040, 1040A, and 1040EZ in Processing Year (PY) 2017. This number excludes amended returns. Some taxpayers may have filed multiple taxable year returns in a given processing year.

7 Letter by Frank Nolden, Director, Stakeholder Partnerships, Education and Communication; IRS Publication 4012, *VITA/TCE Volunteer Resource Guide* (Oct. 2, 2017).

8 See IRS Publication 5220, *VITA/TCE Volunteer Site Scope & Referral Chart* (Dec. 2016). Topics the IRS prohibits VITA programs from addressing are referred to as “out-of-scope” topics.

9 See FY 2017 Stakeholder Partnerships, Education and Communication (SPEC) Quality Statistical Sample (QSS) Review Results (July 5, 2017).

10 Pub. L. No. 91-172, 83 Stat. 487 (1969) (codified as amended in scattered sections of 26 U.S.C. and 42 U.S.C.).

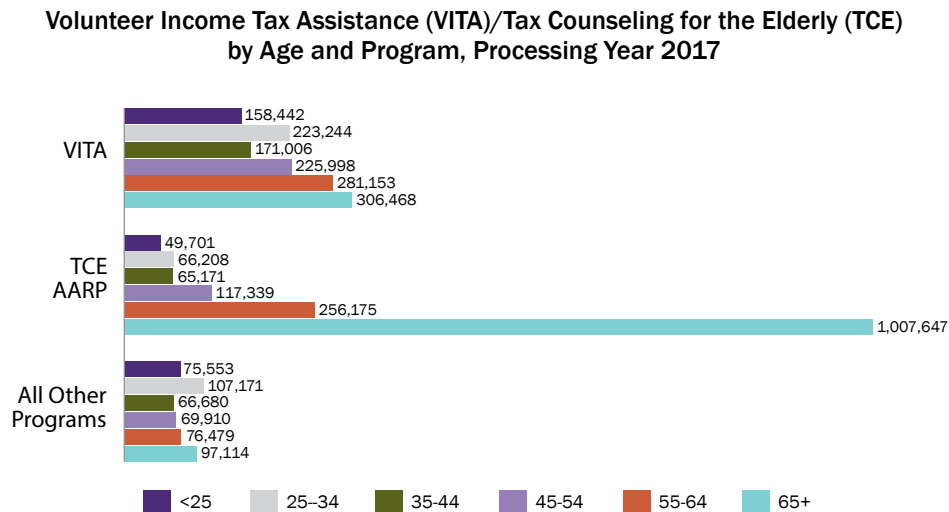
11 Steve Holt, *Ten Years of the EITC Movement: Making Work Pay Then and Now*, Metropolitan Policy Program at Brookings, 2 (Apr. 2011).

which manages the VITA and TCE programs.<sup>12</sup> Its creation led to the IRS’s emphasis on developing and supporting community partnerships rather than providing direct service.<sup>13</sup>

*Diversity of VITA Taxpayers and Partners*

The population of the United States is large and diverse in its taxpayer service needs, requiring VITA to be adaptable to the vulnerable populations it serves. During the 2016 tax year, 90 percent of that year’s nearly 3.5 million VITA taxpayers had annual incomes equal to or less than \$50,000.<sup>14</sup> Nearly 42 percent of VITA and TCE filers were age 65 or older.<sup>15</sup> As depicted in the figure below, the vast majority of older taxpayers using the volunteer programs file their returns at TCE sites.

**FIGURE 1.11.1, VITA/TCE Tax Returns by Age and Program: Processing Year 2017<sup>16</sup>**



Additionally, more than 400,000 taxpayers filed their returns at sites located in rural areas of the country.<sup>17</sup> Whether low income, disabled, military, or elderly, taxpayer groups have different needs, all which VITA must be prepared to serve. During FY 2017, taxpayers visited 11,400 VITA and TCE sites,

12 See Internal Revenue Manual (IRM) 22.30.1.1, *Program Scope and Objectives* (Oct. 1, 2017). Stakeholder Partnerships, Education and Communication (SPEC) manages the VITA and TCE programs and handles the outreach and education functions of the IRS.

13 *Id.* By working with partners already established in local communities, SPEC has better access to lower income and underserved populations in those communities. The National Taxpayer Advocate has pointed out, however, that the IRS’s disappearing geographic footprint has significant downfalls. See, e.g., National Taxpayer Advocate 2016 Annual Report to Congress 86-97 (Most Serious Problem: *Geographic Focus*) (discussing how the lack of access to local IRS employees may result in taxpayers turning to both legitimate and illegitimate internet resources for tax information, where anonymity provides cover for behavior people might not normally consider).

14 IRS response to TAS Information Request, VITA-TCE Demographics attachment (Sept. 21, 2017).

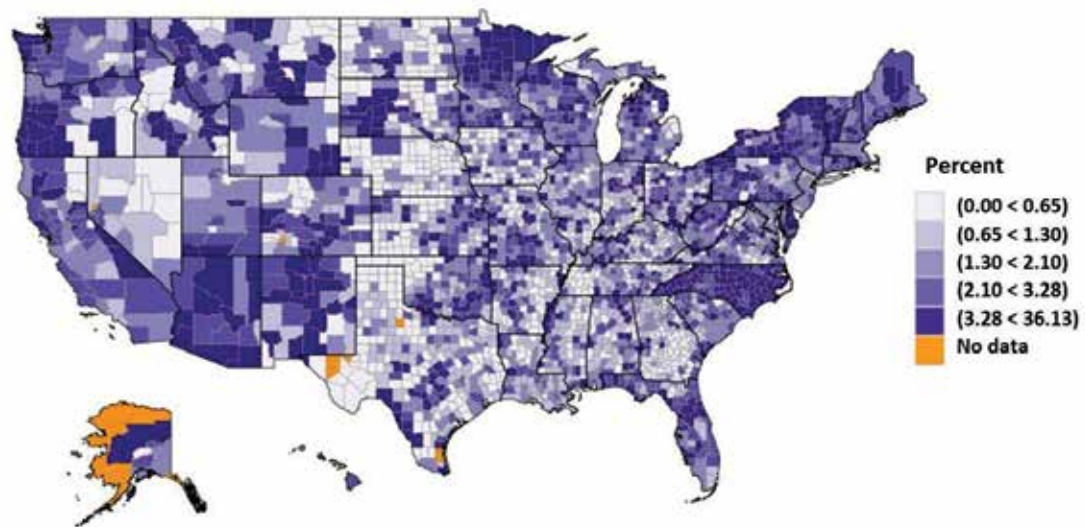
15 *Id.*

16 The “All Other” category is comprised of Facilitated Self-Assistance, Grant Programs, TCE (non-AARP), Co-located VITA programs, and Military VITA programs. TAS Research & Analysis, CDW, IRTF, data drawn Nov. 14, 2017.

17 IRS response to TAS Information Request, Percent of Target Population Filed Tax Returns with VITA/TCE Sites attachment (Sept. 21, 2017).

using the efforts of more than 87,000 volunteers.<sup>18</sup> The map below depicts where taxpayers, who visited VITA/TCE sites during tax season 2017, were located.

**FIGURE 1.11.2, Percent of VITA and TCE Returns in U.S. Counties: Filing Season 2017<sup>19</sup>**



The sheer diversity of the most vulnerable taxpayer populations signals the difficulty in creating guidelines that apply equally to all groups. Tax issues that are considered out-of-scope for one group may not make sense to consider out-of-scope for another. One solution is that some out-of-scope decisions can be made on a regional basis. For example, a VITA program in rural Iowa should be equipped to prepare a Schedule F for a farmer, even if a VITA program in New York City is not. To support taxpayers with more complex issues, the IRS can develop additional certification levels for volunteers. Additionally, current VITA regulations exclude most self-employed taxpayers and Schedule E filers. For example, nearly a quarter of the U.S. population supplement their income in the sharing economy.<sup>20</sup> Of those, 85 percent make less than \$500 per month.<sup>21</sup> However, taxpayers in these categories very often include low income, limited English proficiency (LEP), and elderly taxpayers who are exactly the type of taxpayer VITA ought to serve and who are easy prey for unscrupulous, dishonest, or incompetent tax preparers.

18 FY 2017 Stakeholder Partnerships, Education and Communication (SPEC) Quality Statistical Sample (QSS) Review Results (July 5, 2017).

19 TAS Research & Analysis, CDW, IRTF, data drawn Nov. 6, 2017. The percentage was calculated by taking the number of tax returns prepared by VITA & TCE sites and dividing it by the total number of tax returns filed in PY 2017. 'No data' means that no tax returns appear in the CDW ENTITY database (as of Sept. 2017) for the indicated counties. A ratio of zero indicates that no one in the county used VITA/TCE services even though some positive number of tax returns were filed. Counties with a ratio of zero are included in the category of 0.00 to 0.65 percent.

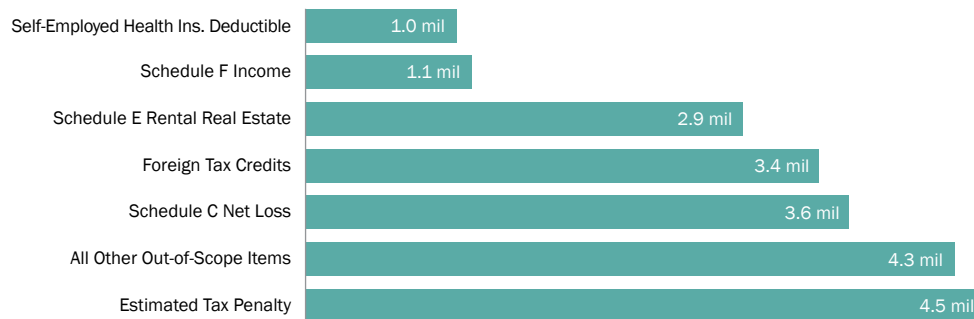
20 Pew Research Center, *Gig Work, Online Selling and Home Sharing* (Nov. 17, 2016), [www.pewinternet.org/2016/11/17/gig-work-online-selling-and-home-sharing/](http://www.pewinternet.org/2016/11/17/gig-work-online-selling-and-home-sharing/). The sharing economy (also known as the gig economy) can be described as "collaborative consumption" or a "peer-to-peer market" that links a willing provider to a consumer of goods or services (coordinated through a community-based online service). See also Most Serious Problem: *SHARING ECONOMY: Participants in the Sharing Economy Require Further Guidance from the IRS, infra*.

21 Washington Post, *Side Hustles Are the New Norm* (July 3, 2017).

Nearly 21 million taxpayers who otherwise would have been eligible (based on age and income criteria) in processing year 2017 to seek Volunteer Income Tax Assistance had out-of-scope items.

**FIGURE 1.11.3, VITA-Eligible Filers with VITA and TCE Out-of-Scope Items: Processing Year 2017<sup>22</sup>**

**VITA-Eligible Filers With VITA and TCE Out-of-Scope Items, Processing Year 2017**



As depicted in Figure 1.11.3, nearly 21 million taxpayers who otherwise would have been eligible (based on age and income criteria) in PY 2017 to seek VITA or TCE assistance had out-of-scope items.<sup>23</sup> About 4.5 million taxpayers contended with issues related to an estimated tax penalty, the single largest out-of-scope item.

<sup>22</sup> TAS Research & Analysis, CDW, IRTF, data drawn Nov. 6, 2017.

<sup>23</sup> The figure of 20.8 million for 2017 reflects the number of taxpayers as of September 2017 and will increase as extension and other late filers are included.

### VITA/TCE Programs Are Subject to Restrictions That Impede Their Effectiveness

Because VITA programs are staffed primarily by volunteers who are not tax professionals, the IRS has been concerned about allowing volunteers to prepare returns that involve legal complexity. To address this concern in part, the IRS has established a regime of testing for volunteers.<sup>24</sup> Volunteers must certify in tax law in one of four courses — Basic, Advanced, Military, or International.<sup>25</sup> There are also two optional specialty courses — Cancellation of Debt (COD) and Health Savings Accounts (HSAs) — and two supplemental training courses for Puerto Rico returns and foreign student returns.<sup>26</sup> A volunteer who tests and passes a particular certification level can prepare all tax returns that fall within the scope of that level.

The IRS, however, provides inconsistent information about what topics are out-of-scope for VITA and TCE volunteers. The IRS Publication 5220, *VITA/TCE Volunteer Site Scope & Referral Chart, Depiction of What is In-Scope Versus Out-of-Scope for Varying Taxpayers*,<sup>27</sup> Appendix 1, was developed to list in-scope tax law topics in a centralized location.<sup>28</sup> In fact, SPEC contends it does not maintain a list of out-of-scope issues.<sup>29</sup> Yet, Publication 5220 identifies several tax law topics determined to be out-of-scope for its volunteers, no matter what their certification level.<sup>30</sup> Publication 5220 is confusing and overly complex, and is difficult for volunteers, much less Customer Service Representatives (CSRs), to identify which issues assistance can be provided under the VITA and TCE programs.<sup>31</sup>

As illustrated in the table below, one VITA publication, IRS Publication 4491, *VITA/TCE Training Guide*, lists over 100 additional out-of-scope issues.<sup>32</sup> Yet another VITA publication, IRS Publication 4012, *VITA/TCE Volunteer Resource Guide*, incorporates a version of IRS Publication 5220 but leaves out the columns depicting which additional specialty tax law certifications are required, whether the Interactive Tax Law Assistance (ITA) is available, and whether a particular tax law topic can be referred to a VITA/TCE site.<sup>33</sup> IRS Publication 3676-B, *IRS Certified Volunteers Providing Free Tax Preparation*, lists additional issues with which VITA and TCE Volunteers will not assist, further confusing the matter of what is considered out-of-scope.<sup>34</sup> None of the IRS publications provide a comprehensive list of out-of-scope issues.

24 IRS, Volunteer Training Certification, <https://www.irs.gov/individuals/volunteer-training-certification> (Rev. Sept. 30, 2017).

25 The VITA certification test is contained in IRS Pub 6744, *VITA/TCE Volunteer Assistor's Test/Retest* (Rev. Oct. 2017). A minimum score of 80% is required to pass each certification test.

26 Only volunteers who have passed the Advanced exam may choose to test for Military and International certifications. The HSA exam requires that volunteers be certified at the Basic level or higher, while the COD exam requires an Advanced level certification. See IRS, *Volunteer Training Certification*, <https://www.irs.gov/individuals/volunteer-training-certification> (Rev. Sept. 30, 2017).

27 See IRS Publication 5220, *VITA/TCE Volunteer Site Scope & Referral Chart* (Dec. 2016).

28 IRS response to TAS Information Request (Sept. 21, 2017).

29 *Id.*

30 *But see* IRS Publication 4012, *VITA/TCE Volunteer Resource Guide* (2016 Returns). Ironically, SPEC allows volunteers to use the IRS provided software to prepare and electronically file their own tax return and the returns of family and friends since “[u]nlike VITA/TCE returns, these returns have no income or tax law limitations.”

31 If a volunteer consults Publication 5220 for scope guidance in assisting a low income nonresident taxpayer, the volunteer will find that a volunteer would need to have both an Advanced and an International certification to assist the taxpayer. For instance, if the volunteer continues across the “Foreign Taxpayers” row on the chart, he or she will also find that no Interactive Tax Assistance (ITA) is available, nor can the return be referred to a particular site. A referral would only occur if the IRS knows which VITA site might have a volunteer certified at the appropriate level to assist with the issue.

32 IRS Publication 4491, *VITA/TCE Training Guide* (Rev. Oct. 2017).

33 IRS Publication 4012, *VITA/TCE Volunteer Resource Guide* (Rev. Oct. 2017).

34 Per IRS Publication 3676-B, *IRS Certified Volunteers Providing Free Tax Preparation* (Rev. Nov. 2016).

**FIGURE 1.11.4, Out-of-Scope Issues Identified Per IRS VITA Publications<sup>35</sup>**

Publication	Number of tax topics deemed out-of-scope	Number of tax topics in-scope but with limitations	Number of tax topics that can be referred only to AARP
Pub. 4491, VITA/TCE Training Guide (Rev. Oct. 2016)	111	—	—
Pub. 3676-B, IRS Certified Volunteers Providing Free Tax Preparation Flyer (Rev. Nov. 2016)	8	—	—
Pub. 5220, VITA/TCE Volunteer Site Scope & Referral Chart (Rev. Dec. 2016)	6	—	11
Pub 4012, VITA/TCE Volunteer Resource Guide 2016 Tax Returns (Rev. Dec. 2016)	10	7	—

Although many tax law topics justifiably are considered out-of-scope because of their complexity, there are others that SPEC should allow volunteers to assist with if they are certified at the appropriate level. For example, preparation of tax returns with Schedule C are in scope for VITA/TCE, but only under certain conditions.<sup>36</sup> A Schedule C is basically only in scope for VITA if a Schedule C-EZ would otherwise be allowed except that business expenses are between \$5,000 and \$25,000. Thus, VITA and TCE volunteers cannot assist most entrepreneurs who qualify to take an office-in-home deduction, including, for example, day-care providers. Nor can they assist Uber/Lyft drivers if they have over

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**Disaster victims, as a taxpayer population, have characteristics that justify Volunteer Income Tax Assistance (VITA) assistance. Yet, claiming any casualty loss is out of scope for VITA. For all of its efforts in assisting disaster-area taxpayers, the IRS still does not permit these taxpayers to seek tax preparation assistance at VITA and Tax Counseling for the Elderly sites.**

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35 IRS Publication 5220, *VITA/TCE Volunteer Site Scope & Referral Chart*, line 15a-b, SEP/SIMPLE IRAs is reportedly pending an update to show this item as an in-scope topic for VITA/TCE, which will cause the number of tax topics in IRS Publication 5220 that can be referred only to AARP to drop to ten. IRS response to TAS fact check (Dec. 13, 2017). IRS Publication 3676-B, *IRS Certified Volunteers Providing Free Tax Preparation Flyer* states that VITA will not prepare the following: (1) Schedule C with losses; (2) Complicated Schedule D (capital gains and losses); (3) Form SS-5 (request for Social Security Number); (4) Form 8606 (non-deductible IRA); (5) Form 8615 (minor's investment income); (6) Form SS-8 (determination of worker status for purposes of federal employment taxes and income tax withholding); and (7) Parts 4 & 5 of Form 8962 (Premium Tax Credits).

36 In February 2011, SPEC initiated a Schedule C pilot program to determine the effectiveness of allowing tax law issues or topics relating to small business owners into the VITA/TCE program. SPEC ultimately determined that pilot sites, although preparing Schedule C returns with about 99 percent accuracy, were not preparing many returns with the expanded parameters, such as business use of home and depreciation expenses and the Schedule C Pilot was discontinued. Although SPEC agreed to allow return preparation with business expenses up to \$25,000, there is now stricter criteria for VITA-prepared Schedule C returns than existed under the Schedule C pilot. Criteria includes: depreciation is not allowed; no Section 179 expensing in lieu of depreciation; no business use of home; cash only accounting method; no businesses with inventory; no businesses with employees; only standard mileage (actual not allowed); and no business losses.

\$25,000 in business expenses.<sup>37</sup> Similarly, VITA cannot assist someone who rents out his or her home in Airbnb<sup>38</sup> or HomeAway<sup>39</sup> for more than 14 days because of the requirement to depreciate.<sup>340</sup>

Additionally, VITA may not assist taxpayers affected by hurricanes and other natural disasters. To claim a casualty loss on a prior year return, taxpayers must file amended returns or claim their loss on their current year tax returns. The IRS suggests that volunteer preparers have two years of previous experience and be trained and certified at the advanced level before preparing prior year or amended returns.<sup>41</sup> Disaster victims, as a taxpayer population, have characteristics that justify VITA assistance.<sup>42</sup> Yet, claiming any casualty loss is out of scope for VITA. For all of its efforts in assisting disaster-area taxpayers, the IRS still does not permit these taxpayers to seek tax preparation assistance at VITA and TCE sites.<sup>43</sup>

Another group of vulnerable taxpayers are those whose debts are canceled or forgiven. Despite being the very population who might be eligible for such relief and least likely to pay for professional representation, cancellation of debt due to bankruptcy or insolvency<sup>44</sup> is considered out-of-scope for VITA programs, even though IRS publications include clear worksheets that could be automated for assistance in preparation.<sup>45</sup>

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- 37 An Uber driver's tax return is in scope only if all of the following are true: the deduction for car expenses is claimed using the standard mileage rate — not the actual expense method (to qualify, the standard mileage rate must have been used for the first year the car was used for business); the total of all business expenses is less than \$25,000; the driver does not pay helpers — whether as subcontractors or employees; and there is a profit from the business. See IRS Publication 4491, *VITA/TCE Training Guide* (2017 Returns).
- 38 Airbnb is an online marketplace enabling people to lease or rent short-term lodging including vacation rentals, apartment rentals, homestays, hostel beds, or hotel rooms. See <https://www.airbnb.com/about/about-us> (last visited Nov. 13, 2017).
- 39 HomeAway, Inc. is an online marketplace, offering vacation rentals throughout the world, often for less than the cost of traditional hotel accommodations. See <https://www.homeaway.com/info/media-center/presskit> (last visited Dec. 4, 2017).
- 40 If a taxpayer rents his or her dwelling unit to others that he or she also uses as a personal residence, limitations may apply to the rental expenses that can be deducted. Taxpayers are considered to use their dwelling unit as a residence if they use it for personal purposes during the tax year for more than the greater of 14 days, or ten percent of the total days they rent it to others at a fair rental price. See IRC § 280a(d).
- 41 IRS, Fact Sheet for SPEC Partners, Preparing Prior Year and Amended Returns at VITA/TCE sites (Aug. 2016), <https://www.irs.gov/pub/irs-utl/fact-sheet-prior-year-and-amended-returns.pdf> (last visited May 15, 2017).
- 42 People who are of low socio-economic status (SES) are more likely to live in housing that is vulnerable to disasters. They also may live in areas where risks from disasters are higher. Because people of low SES have fewer assets, they have less to lose, and when they experience financial loss in disasters, the loss has a greater financial impact on them than it will on people of higher SES, as the loss is proportionally greater. They also may have their savings concentrated in fewer possessions, and so they may be more vulnerable to economic losses in disasters than people of higher SES who have their savings distributed more widely and saved in financial institutions. See Disaster Technical Assistance Center Supplemental Research Bulletin, *Greater Impact: How Disasters Affect People of Low Socioeconomic Status*, [https://www.samhsa.gov/sites/default/files/programs\\_campaigns/dtac/srb-low-ses.pdf](https://www.samhsa.gov/sites/default/files/programs_campaigns/dtac/srb-low-ses.pdf) (July 2017).
- 43 During August and September 2017, Hurricanes Harvey, Irma, and Maria caused unprecedented and catastrophic damage in Puerto Rico, U.S. Virgin Islands, Florida, Georgia, and Texas. The IRS immediately responded, providing extensive relief that postpones various tax deadlines, and other special assistance for disaster-area taxpayers. See IRS, *IRS Offers Help to Hurricane Victims: A Recap of Key Tax Relief Provisions Available Following Harvey, Irma and Maria*, <https://www.irs.gov/newsroom/irs-offers-help-to-hurricane-victims-a-recap-of-key-tax-relief-provisions-available-following-harvey-irma-and-maria> (Sept. 26, 2017).
- 44 Cancellation of indebtedness can involve auto loans, credit card debt, medical care, professional services, installment purchases of furniture or other personal property, mortgages, and home equity loans. See IRS Publication 4491, *VITA/TCE Training Guide* (Rev. Oct. 2017); IRS Publication 5182, *VITA/TCE Specialty Course – Cancellation of Debt (COD)– Principal Residence* (Rev. Dec. 2014). The insolvency must have occurred immediately before the debt was canceled. See IRS Publication 4681, *Canceled Debts, Foreclosures, Repossessions, and Abandonments* (Feb. 1, 2017); IRS Publication 4491, *VITA/TCE Training Guide* (Rev. Oct. 2017).
- 45 See IRS Publication 4681, *Canceled Debts, Foreclosures, Repossessions, and Abandonments* (Feb. 1, 2017). Worksheets include an insolvency worksheet, used to help calculate the extent the taxpayer was insolvent immediately before the cancellation of debt, and a worksheet for foreclosures and repossessions, used to figure the amount of gain or loss from the foreclosure or repossession.



Additionally, although SPEC's rural strategy focuses on assisting those taxpayers in underserved, rural areas, VITA programs cannot assist farmers in tax preparation. Returns with Schedule F, *Profit or Loss From Farming*, are considered out-of-scope for VITA and TCE programs.<sup>46</sup> About 2.06 million farms are currently in operation.<sup>47</sup> By arbitrarily restricting low income farmers from VITA and TCE Programs, the IRS is further burdening a vulnerable taxpayer population that should have access to free tax preparation.

Each of the examples discussed above show that an out-of-scope classification has serious impact on the very taxpayer population that Congress intended to be served by VITA and TCE Programs. The IRS believes that expanding the scope may burden volunteers to learn complex tax law topics and topics that come up infrequently.<sup>48</sup> The consequence, however, is that many taxpayers who would otherwise qualify for VITA services and truly need person-to-person assistance may have to seek assistance from unregulated and unqualified preparers or attempt to use self-service, risking error.

One potential solution is to require a higher certification level for issues impacting specific taxpayer populations, but not declaring them out of scope. Tax professionals with the skill set and knowledge to help taxpayers, such as tax attorneys, certified public accountants and enrolled agents, who are also VITA volunteers, should be able to prepare out-of-scope returns to address topics where there is a need but no access to service.

### VITA and TCE Income Limits, Which Do Not Account for Family Size, Impede Access to Free Tax Preparation for Otherwise Eligible Taxpayers

The IRS acknowledges that the definition of in-scope refers to permissible tax law topics in a tax return and does not refer to income levels.<sup>49</sup> Since the value of low to moderate income can vary depending on the cost of living for a geographic location, the IRS instead urges partners to exercise sound judgment in establishing income limitations for return preparation.<sup>50</sup>

Current limitations exclude many taxpayers who are low income under Low Income Taxpayer Clinic (LITC) guidelines, yet are excluded from VITA income guidelines.<sup>51</sup> In order to qualify for assistance from an LITC, generally a taxpayer's income must be below 250 percent of the current year's federal poverty guidelines, based on family size and with income adjustments for Hawaii and Alaska, as indicated in Figure 1.11.5 below.<sup>52</sup> A system similar to the LITC financial guidelines, which account for

46 Farmers must file a Form Schedule F, *Profit or Loss From Farming*, to report their farming income and claim their expense deductions. A farm includes livestock, dairy, poultry, fish, fruit, and truck farms. It also includes plantations, ranches, ranges, and orchards and groves. See IRS Publication 225, *Farmer's Tax Guide* (Oct. 19, 2017).

47 United States Department of Agriculture, *Farming and Farm Income*, <https://www.ers.usda.gov/data-products/ag-and-food-statistics-charting-the-essentials/farming-and-farm-income/> (Oct. 11, 2017).

48 IRS response to TAS Information Request (Sept. 21, 2017).

49 *Id.*

50 Interestingly, in September 2017, the Treasury Inspector General for Tax Administration (TIGTA) found that VITA and TCE grantees continue to prepare tax returns for taxpayers with income amounts that exceed the suggested income threshold set for the Volunteer Program. TIGTA reported it is concerned that when taxpayers with incomes exceeding the Volunteer Program's income threshold have their tax returns prepared, it limits the resources available to assist those taxpayers for which Congress appropriated the VITA grant funds. See TIGTA, *Improvements Are Needed to Ensure That the Volunteer Income Tax Assistance Grant Program Extends Tax Return Preparation to Underserved Populations*, Ref. No. 2017-40-088 (Sept. 20, 2017).

51 See IRS Publication 3319, *Low Income Taxpayer Clinic 2018 Grant Application Package and Guidelines* (Rev. Apr. 2017). Per IRC § 7526(b)(1)(B)(i), at least 90 percent of taxpayers represented by an LITC must have incomes that do not exceed 250 percent of the federal poverty level.

52 IRS, *Information for Taxpayers Seeking LITC Services*, <https://www.irs.gov/advocate/low-income-taxpayer-clinics/low-income-taxpayer-clinic-income-eligibility-guidelines> (Rev. Aug. 4, 2017).

family size and income, as well as include flexibility for extenuating circumstances, would expand the reach of VITA services to the low income community.

**FIGURE 1.11.5, 250 percent of Federal Poverty Guidelines<sup>53</sup>**

Size of Family Unit	48 Contiguous States, D.C., and Puerto Rico	Alaska	Hawaii
1	\$30,150	\$37,650	\$34,650
2	\$40,600	\$50,725	\$46,675
3	\$51,050	\$63,800	\$58,700
4	\$61,500	\$76,875	\$70,725
5	\$71,950	\$89,950	\$82,750
6	\$82,400	\$103,025	\$94,775
7	\$92,850	\$116,100	\$106,800
8	\$103,300	\$129,175	\$118,825
For each additional person, add	\$10,450	\$13,075	\$12,025

### The IRS's Lack of Tracking Sites With Volunteers Certified in Specific "In-Scope" Law Issues Results in VITA and TCE Programs Being Unable to Assist Large Segments of Eligible Taxpayers

Publication 5220 also includes several "in-scope" tax law topics<sup>54</sup> but specifies that taxpayers with those issues may not be referred to VITA sites because the IRS has not identified volunteers with the appropriate certifications to assist those taxpayers. Moreover, because the Publication 5220 chart is found only online, taxpayers with limited internet access<sup>55</sup> may not know for which topics they can seek assistance.

As noted in Publication 5220, Appendix 1, there is a column entitled, "Can a Taxpayer's Tax Return with this Tax Law be Referred to a VITA/TCE site?" If there is a "No" in that column, the corresponding tax law topics cannot be referred to any VITA/TCE site, therefore rendering them *de facto* out-of-scope. This is because the IRS is not tracking which sites have volunteers who are certified to assist with these issues. Including this information in the IRS tracking system is crucial in managing the VITA Program.

Tracking volunteer certification levels and where those volunteers provide services should be simple. After all, the SPEC Coordinator or Partner already must validate the volunteer's credentials and verify

<sup>53</sup> This table is based on the Federal Poverty Guidelines published at 81 Fed. Reg. 8831-32 (Jan. 31, 2017).

<sup>54</sup> These topics include: Foreign taxpayers or those with foreign income; Schedule E, Supplemental Income and Loss (rental real estate); Cancellation of debt income (mortgage or credit cards); Health savings account deduction; and Foreign tax credit. IRS Publication 5220, *VITA/TCE Volunteer Site Scope & Referral Chart* (Dec. 2016).

<sup>55</sup> Over 33 million taxpayers do not have broadband access at home, significantly limiting their online activities. Of this number, 28.5 percent are low income, 40 percent are senior, and 31.9 percent are disabled taxpayers. National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 1-30 (Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*). See also National Taxpayer Advocate 2016 Annual Report to Congress 21 (Special Focus: *IRS FUTURE STATE: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*).

that the volunteer certified by passing the appropriate test. The IRS captures data on volunteers but is not tracking it in a way that would enable the IRS to administer the program more effectively and to better meet the needs of its target populations.<sup>56</sup> The Treasury Inspector General for Tax Administration (TIGTA) also has indicated its concern about the IRS's lack of a centralized list of volunteers who have achieved advanced certification.<sup>57</sup> Although its information management system is fully capable of tracking this information, the IRS argues that SPEC does not include this capability for several reasons, which include adhering to privacy guidelines intended to limit the digital storage and access to Personally Identifiable Information (PII) and averting the task of inputting and maintaining records for volunteers, their certifications, and the specific sites where they may be volunteering on a given day.<sup>58</sup>

Identifying and tracking the certification level of volunteers at VITA sites, however, would not violate privacy guidelines (and if the guidelines do consider such tracking a violation, then the IRS should review its policies to align with the specific situations presented). Such tracking would assist customer service representatives in directing taxpayers to volunteers who can help. *Notably, SPECTRM<sup>59</sup> does allow for comments to be stored to indicate special limitations or capabilities for particular sites, but these comments are not searchable for specific tax law issues.*<sup>60</sup> The IRS appears to have designed the VITA and TCE programs to minimize what it is responsible for, preferring instead to stay at the level of limited utility.

### Most VITA and TCE Tax Preparation Sites Are Open Only Until April 15th Each Year, Further Confounding the Problem of Taxpayers Going Without the Necessary Assistance They Need

Not all taxpayers file their tax returns by the April tax deadline. The IRC recognizes that there are legitimate reasons why a taxpayer may not do so.<sup>61</sup> Taxpayers may request a six-month automatic extension to file which moves the return filing deadline to October 15th.<sup>62</sup> The ability to request an extension to file suggests that the taxpayer should have access to assistance to meet their statutory requirement at least until October 15th. Instead, the IRS appears to abandon these taxpayers after April 15th. The VITA Hotline is staffed only from mid-January to mid-April each year.<sup>63</sup> Thus, in order to obtain a list of VITA sites open year-round, taxpayers must access the VITA Locator on [irs.gov](http://irs.gov) and then plug in their zip code and the number of miles they are willing to travel, or call the IRS

56 See IRS response to TAS Information Request (Sept. 21, 2017).

57 In its September 2017 audit report, TIGTA stated that the IRS does not have reasonable assurance that the complex tax returns prepared by volunteers from 2014-2016 were prepared by volunteers with the appropriate training and certification. See TIGTA, *Improvements Are Needed to Ensure That the Volunteer Income Tax Assistance Grant Program Extends Tax Return Preparation to Underserved Populations*, Ref. No. 2017-40-088 (Sept. 20, 2017).

58 IRS response to TAS Information Request (Sept. 21, 2017).

59 SPEC's information management system, Stakeholder Partnerships, Education & Communications Total Relationship Management (SPECTRM), is the database system developed for use by SPEC to manage and coordinate the VITA and TCE programs. See IRS response to TAS Information Request (Sept. 21, 2017).

60 IRS response to TAS Information Request (Sept. 21, 2017).

61 For example, taxpayers impacted by presidentially declared disasters may need assistance in filing amended returns declaring casualty losses after April 15th.

62 See IRS Form 4868, *Application for Automatic Extension of Time to File U.S. Individual Income Tax Return* (2016). Although the IRS does not track how many Forms 4868 are prepared at VITA and TCE sites, we know many taxpayers within VITA income eligibility file returns with extensions. For example, in TY 2016, 36,243 taxpayers with income of \$54,000 or less and who used a VITA or TCE site, filed returns with extensions. TAS Research & Analysis, CDW, IRTF, data drawn Nov. 7, 2017.

63 The Hotline phone number is listed in IRS Publication 5220, *VITA/TCE Volunteer Site Scope & Referral Chart* (Dec. 2016) as (800) 829-8482. For eight months of the year, a recording directs callers to search online for answers to their questions via the Interactive Tax Assistant.

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The IRS appears to have designed the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs to minimize what it is responsible for, preferring instead to stay at the level of limited utility.

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Assistor telephone line so that Assistors can search the VITA locator for the taxpayer. Without year-round person-to-person assistance, VITA-eligible taxpayers with limited digital access or functional or computer literacy will face challenges.

### The IRS Unreasonably Restricts Grant Funds to Be Used As Compensation for Quality Reviewers, Qualified Tax Experts (QTEs), and Certified Acceptance Agents (CAAs)

Since FY 2008, the IRS has also provided financial assistance to some VITA programs through matching grants.<sup>64</sup> The IRS, however, does not allow VITA or TCE to use grant funds as compensation for tax assistors or preparers, screeners, or quality reviewers.<sup>65</sup> The IRS also restricts funding of CAAs who assist non-citizens in obtaining Individual Taxpayer Identification Numbers (ITINs) needed to file U.S. tax returns. The IRS maintains that grant funds may not be used to compensate the services of volunteers so that volunteers will remain under the veil of the Volunteer Protection Act.<sup>66</sup> It also maintains that paying for a portion of a volunteer's activity also adds complexity to managing volunteers.<sup>67</sup>

Identifying and tracking the certification level of volunteers at VITA sites, however, would not violate the IRS's argument regarding extra burdens and liability imposed on the sites is misleading because VITA and TCE sites are already responsible for managing day-to-day activities. Similar to the Low Income Tax Clinic (LITC) Program, where a paid Qualified Tax Expert (QTE) is required to be on staff to assist the pro bono attorneys and assist with cases, the IRS could allow paid quality reviewers/experts to assist VITA volunteers. Moreover, the quality reviewer/expert could be specialized based on the location of the VITA site.<sup>68</sup> To support those higher more complex issues, IRS can develop additional certification levels, such as a home office module, a disaster loss module, or a Schedule C or F module. Spending funds on paid quality reviewers and QTEs will address TIGTA's concerns,<sup>69</sup> create stability and continuity of the programs, and enable sites to develop their own training materials for complex issues (such as disaster losses or home office deductions).

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64 As part of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Congress enacted IRC § 7526 to authorize funding for the Low Income Tax Clinic (LITC) grant program. Subject to the availability of appropriated funds, the IRS may award grants of up to \$100,000 per year to qualifying organizations for the development, expansion, or continuation of an LITC. In Grant Year 2016, VITA grantees helped prepare more than 1.5 million tax returns. See TIGTA, *Improvements Are Needed to Ensure That the Volunteer Income Tax Assistance Grant Program Extends Tax Return Preparation to Underserved Populations*, Ref. No. 2017-40-088 (Sept. 20, 2017). See also IRS Publication 3319, *Low Income Taxpayer Clinic 2018 Grant Application Package and Guidelines* (Rev. Apr. 2017).

65 IRM 22.30.1.8.3.1.2(1), *Compensation for the Grant Program* (Oct. 1, 2011).

66 IRS response to TAS Information Request (Sept. 21, 2017).

67 See Report Card to National Taxpayer Advocate 2014 Annual Report to Congress 55-66 (Most Serious Problem: VITA/TCE FUNDING: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations), [https://www.irs.gov/pub/tas/2014ARC\\_ReportCard.pdf](https://www.irs.gov/pub/tas/2014ARC_ReportCard.pdf) (last visited Dec. 4, 2017).

68 For instance, VITA sites in rural areas may want QTEs in preparing returns with Schedule F, Profit or Loss from Farming.

69 See TIGTA, *Improvements Are Needed to Ensure That the Volunteer Income Tax Assistance Grant Program Extends Tax Return Preparation to Underserved Populations*, Ref. No. 2017-40-088 (Sept. 20, 2017).

## CONCLUSION

One of the VITA and TCE program's goals is making voluntary compliance easier by improving issue resolution across all interactions with taxpayers.<sup>70</sup> The restrictions and limitations the IRS imposes on VITA and TCE sites prevent the IRS from achieving this goal, increase taxpayer burden, and may adversely and significantly impact the ability of vulnerable taxpayers to obtain free tax return preparation services and meet their reporting obligations. Moreover, published restrictions confuse taxpayers and cause many otherwise eligible individuals to turn to paid tax filing services or to prepare their own returns. These shortcomings burden taxpayers because those who cannot obtain free filing assistance may pay more in taxes than they are legally required to pay, or seek preparation services from unqualified or unscrupulous preparers, undermining voluntary compliance and eroding the *taxpayer's rights to be informed, to quality service, and to pay no more than the correct amount of tax.*

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Allow VITA and TCE Partners, at their discretion, to prepare returns with issues that are currently out-of-scope, including:
  - Home office deduction (*e.g.*, day care providers);
  - Standard mileage vs actual costs (*e.g.*, Uber/Lyft drivers);
  - Casualty losses (*e.g.*, disaster relief);
  - Cancellation of debt due to bankruptcy or insolvency; and
  - Farm income.
2. Implement financial guidelines for the VITA/TCE Program which account for both family size and income, similar to that used by LITC Programs.
3. Create a tracking system for volunteers and their certifications so that taxpayers can be referred to a specific VITA or TCE site handling a specific tax law issue.
4. Ensure that more volunteer tax sites are open until October 15 each year.
5. Allow grant funds to be used for quality review and QTEs, CAAs, and year-round services at select sites.

<sup>70</sup> IRS Publication 1084, *VITA/TCE Volunteer Site Coordinator Handbook* (Rev. Oct. 2017).

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#12****EARNED INCOME TAX CREDIT (EITC): The IRS Continues to Make Progress to Improve Its Administration of the EITC, But It Has Not Adequately Incorporated Research Findings That Show Positive Impacts of Taxpayer Education on Compliance****RESPONSIBLE OFFICIAL**

Kenneth Corbin, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

The Earned Income Tax Credit (EITC) is a tax credit targeted at low income workers (primarily workers with children).<sup>2</sup> It has become one of the government's largest means-tested anti-poverty programs.<sup>3</sup> For Tax Year (TY) 2015 returns filed during 2016, over 27 million taxpayers received about \$67 billion in EITC.<sup>4</sup> For the same time period, the average amount of EITC was more than \$2,455.<sup>5</sup> However, as the Department of Treasury recently reported, the EITC rules of eligibility are “complex and lead to high overclaim error rates.”<sup>6</sup> In addition to complex rules, the population eligible to claim the EITC is constantly churning, with approximately one-third of the eligible population changing every year.<sup>7</sup>

1 See Taxpayer Bill of Rights (TBOR), <https://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)).

2 Pub. L. No. 94-12, § 204, 89 Stat. 26 (1975). The preference to provide Earned Income Tax Credit (EITC) benefits to families with children is seen in the stark difference between the amount of benefits available to childless workers and to workers with children. The most a married couple with no children could receive in EITC benefits for tax year (TY) 2016 was \$506. A married couple with three children was eligible for a maximum of \$6,269 in EITC benefits in TY 2016. IRS, Publication 596, *Earned Income Credit (EIC)* 31-33 (Dec. 21, 2016).

3 Congressional Budget Office, *Federal Means-Tested Programs and Tax Credits – Infographic* (Feb. 11, 2013), <https://www.cbo.gov/publication/43935>.

4 IRS, *About EITC*, <https://www.eitc.irs.gov/eitc-central/about-eitc/about-eitc>.

5 *Id.*

6 Department of Treasury, *Agency Financial Report Fiscal Year 2016* 160 (Nov. 2016).

7 IRS, *EITC Fast Facts*, <https://www.eitc.irs.gov/Partner-Toolkit/basicmaterials/ff>. For a detailed explanation for how EITC eligibility and benefits calculation works, see National Taxpayer Advocate 2015 Annual Report to Congress 240-42.

As a result of the complex rules and the ever-changing population of eligible taxpayers, the EITC is associated with a high improper payment rate.<sup>8</sup> To its credit, the IRS has reached out to a broad array of experts via its two EITC Summits, resulting in many suggestions about how to improve EITC administration, education, and compliance. The IRS and TAS also work jointly on the EITC Audit Improvement team, which has worked to expand the list of acceptable documentation to substantiate an EITC claim and to allow the use of third-party affidavits during EITC audits. Nevertheless, while the IRS does conduct EITC taxpayer education initiatives, its primary tool to combat the improper payment rate thus far has been the audit process.<sup>9</sup>

Over the years, the National Taxpayer Advocate has encouraged a multi-pronged approach to reducing the number of improper claims for EITC while encouraging eligible claims. For example, the National Taxpayer Advocate has recommended enhancing taxpayer communication and education, using an examination process tailored to the needs of low income taxpayers, and strengthening the program overseeing EITC return preparers.<sup>10</sup> The National Taxpayer Advocate has the following concerns with how the IRS administers the EITC:

- The IRS has not adequately studied the impact of taxpayer education on EITC compliance;
- TAS research shows providing a dedicated helpline for EITC taxpayers during the tax season improves EITC compliance; and
- Progress is being made with the IRS joint EITC Audit Improvement team, but more can be done to help low income taxpayers, particularly in the area of acceptance of alternative documentation.

## ANALYSIS OF PROBLEM

### Background

Research has shown that the EITC can offer both short-term and long-term support to eligible taxpayers. One study of EITC claims between 1989 and 2006 found that sixty-one percent of taxpayers claimed the EITC for only a period of one or two years.<sup>11</sup> The study also found that 20 percent of taxpayers

<sup>8</sup> An improper payment is defined as “any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements” and “any payment to an ineligible recipient.” Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111–204, § 2(e) (2010), amending Improper Payments Information Act of 2002, Pub. L. No. 107–300 (2002) by striking § 2(f) and adding (f)(2). The IRS estimates that for fiscal year (FY) 2016, between 22.2 percent (\$15.5 billion) and 25.9 percent (\$18.1 billion) of the total EITC program payments of \$69.8 billion were improper. Department of Treasury, *Agency Financial Report Fiscal Year 2016* 49 (Nov. 2016).

<sup>9</sup> National Taxpayer Advocate 2015 Annual Report to Congress 248-60.

<sup>10</sup> For recent recommendations, see National Taxpayer Advocate Fiscal Year 2018 Objectives Report to Congress 61-69 (*TAS Continues to Pursue Improvements to the IRS’s Administration of the Earned Income Tax Credit (EITC), Particularly With Recent Changes to the Law*); National Taxpayer Advocate 2016 Annual Report to Congress 138-50 (*Earned Income Tax Credit (EITC): The Future State’s Reliance on Online Tools Will Harm EITC Taxpayers*); National Taxpayer Advocate 2015 Annual Report to Congress 240-47 (*Earned Income Tax Credit (EITC): The IRS Does Not Do Enough Taxpayer Education in the Pre-filing Environment to Improve EITC Compliance and Should Establish a Telephone Helpline Dedicated to Answering Pre-filing Questions From Low Income Taxpayers About Their EITC Eligibility*); National Taxpayer Advocate 2015 Annual Report to Congress 248-60 (*Earned Income Tax Credit (EITC): The IRS Is Not Adequately Using the EITC Examination Process As an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance*); National Taxpayer Advocate 2015 Annual Report to Congress 261-83 (*Earned Income Tax Credit (EITC): The IRS’s EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*).

<sup>11</sup> Tim Dowd and John B. Horowitz, *Income Mobility and the Earned Income Tax Credit: Short-Term Safety Net or Long-Term Income Support*, PUBLIC FINANCE REVIEW 29 (2011).

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The Earned Income Tax Credit (EITC) is a “temporary safety net during periods of either anticipated or unanticipated income or family structure shocks” but also a long-term assistance for taxpayers “with children who are entrenched in the lowest-income brackets.”

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claimed the EITC for five or more years.<sup>12</sup> Thus, the EITC is a “temporary safety net during periods of either anticipated or unanticipated income or family structure shocks” but also a long-term assistance for taxpayers “with children who are entrenched in the lowest-income brackets.”<sup>13</sup>

The EITC may be most beneficial during times of change in the taxpayer’s family structure or economic wellbeing. One study reviewed EITC claim rates according to the qualifying child’s age and found that in the year a child is born, there is a 43 percent chance of the EITC being claimed and then this number decreases over time.<sup>14</sup> Additionally, when a taxpayer’s financial situation deteriorates because of an unanticipated job loss or long-term illness, he or she may suddenly find him or herself eligible for the EITC. Indeed, tax credits such as the EITC played an important role in the financial safety net for taxpayers during the recent Great Recession.<sup>15</sup>

The EITC is critical in helping financially vulnerable families. While Social Security benefits provide support to the elderly and those with disabilities, tax credits including the EITC and the Child Tax Credit reduce the number of children in poverty by 6.7 percent.<sup>16</sup> The positive effects for children who live in families receiving the EITC are long-term: these children do better in school, mothers and infants have improved health, and the children have higher college attendance rates.<sup>17</sup>

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12 Tim Dowd and John B. Horowitz, *Income Mobility and the Earned Income Tax Credit: Short-Term Safety Net or Long-Term Income Support*, PUBLIC FINANCE REVIEW 3 (2011).

13 *Id.*

14 *Id.* The authors of this study surmise that “some of the decline likely represents the normal anticipated shock that having a newborn has on family labor income in the year of birth, thereby reducing income in the year of birth and increasing eligibility.”

15 For the period of time including the Great Recession, between 2007 and 2010, poverty rates only rose by 0.5 percent despite the largest rise in unemployment since the Great Depression. Credit for this is due to the expansion of Supplemental Nutrition Assistance Program (SNAP) and tax credits. The Council of Economic Advisers, *The War on Poverty 50 Years Later: A Progress Report* 22 (Jan. 2014).

16 The Council of Economic Advisers, *The War on Poverty 50 Years Later: A Progress Report* 27 (Jan. 2014).

17 Center on Budget and Policy Priorities, *EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children’s Development, Research Finds* (Oct. 1, 2015). One study built on the connection between those living in poor economic conditions and increased stress manifesting itself in higher blood pressure, higher cholesterol, and other physical effects. The study found that the expansion of EITC in the Omnibus Reconciliation Act of 1993 led to a decrease in the number of “reported bad mental health days for mothers with a high school degree or lower and two or more children compared to a similar woman with only one child” and “increased the probability of reporting excellent or very good health status.” William N. Evans and Craig L. Garthwaite, *Giving Mom a Break: the Impact of Higher EITC Payments on Mental Health*, AMERICAN ECONOMIC JOURNAL: ECONOMIC POLICY 286 (May 2014). Another study looked at the increased EITC available with the Omnibus Reconciliation Act of 1993 and found that larger EITC benefits led to positive impacts in children’s educational achievements both now and into the future. Michelle Maxfield, *The Effects of the Earned Income Tax Credit on Child Achievement and Long-Term Educational Attainment*, MICHIGAN STATE UNIVERSITY JOB MARKET PAPER 31 (Nov. 14, 2013).



### The IRS Made Great Strides By Following Up With Its Second Earned Income Tax Credit (EITC) Summit This Year

The IRS hosted its first EITC Summit (Summit) June 29–30, 2016. The objective of the Summit was to “obtain perspectives from an array of stakeholders on improving compliance while fostering participation.”<sup>18</sup> The Summit opened a constructive dialog between the IRS and people from various sectors, such as the tax profession industry, state and federal agencies, consumer advocates, research institutes, volunteer site coordinators, and Low Income Tax Clinics (LITCs). Overall, the Summit addressed the following issues:

- Reducing overclaims;
- Improving participation; and
- Improving administration.

As a result of the Summit, the IRS received many useful suggestions to pursue going forward. For instance, to increase participation, the participants suggested a strong outreach program that would focus on how changes to the traditional family structure can impact EITC eligibility and how such taxpayers can substantiate their EITC claims. Additionally, outreach and education was a major component of the group’s suggestions for improving EITC participation. Specifically, participants suggested the IRS create partnerships with non-tax parties, including child service workers, pediatricians, veterans’ organizations, and divorce attorneys.<sup>19</sup> To improve administration of the EITC, participants suggested ways to ease taxpayer burden during an audit. For example, the IRS could look at prior year returns to see if income levels and qualifying children were the same (or similar). Second, if a qualifying child is not claimed by anyone else in that tax year, the IRS could require the taxpayer to send only “minimal documentation” to substantiate the residency test.<sup>20</sup>

The IRS held another EITC Summit in September 2017 and identified some outreach “concepts.”<sup>21</sup> For 2018, the IRS intends to include messaging geared to childless workers.<sup>22</sup> The IRS will also devote resources to veterans and rural taxpayers.<sup>23</sup> While vague, this response shows that the IRS is at least aware of the need for greater outreach and education.

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**The Earned Income Tax Credit (EITC) Summit opened a constructive dialog between the IRS and people from various sectors, such as the tax profession industry, state and federal agencies, consumer advocates, research institutes, volunteer site coordinators, and Low Income Tax Clinics.**

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18 IRS, *Earned Income Tax Credit Summit, Identifying New Approaches for Administration of the EITC* 3.

19 *Id.* at 10.

20 *Id.* at 15.

21 IRS response to TAS information request (Nov. 14, 2017).

22 *Id.*

23 *Id.*

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Vulnerable groups, including low income taxpayers, are less likely to have broadband access at home, feel less skilled doing internet research, and feel less secure sharing personal financial information over the internet.

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### The IRS Has Not Adequately Studied the Impact of Taxpayer Education on EITC Compliance

The National Taxpayer Advocate consistently advocates that low income taxpayers need services specifically tailored to their unique needs.<sup>24</sup> Most recently, TAS studied how taxpayers' service preferences, usage patterns, and usage effectiveness vary by demographic group within the taxpayer population.<sup>25</sup> This study found that vulnerable populations (including low income taxpayers) are less equipped to rely on the internet for services. In particular, vulnerable groups, including low income taxpayers, are less likely to have broadband access at home, feel less skilled doing internet research, and feel less secure sharing personal financial information over the internet.<sup>26</sup> This type of research should be driving the IRS's approach to EITC compliance. However, the IRS is taking the opposite approach, by relying on automation and self-help modules to educate low income taxpayers.<sup>27</sup>

The National Taxpayer Advocate's position that greater education is connected to improved compliance is supported by research. The current approach used by the IRS may be considered a "neoclassical economic approach," meaning a taxpayer is driven by "profit-maximizing motives" when he or she considers tax compliance.<sup>28</sup> For instance, what are the odds the taxpayer will be audited? How much will the fine be if the taxpayer is audited?

However, research shows that instead, tax administration generally (and EITC administration in particular) could benefit from adopting a "slippery slope" framework. Under this theory, voluntary tax compliance is achieved by "taking actions to increase power and build trust," not just by using an iron fist.<sup>29</sup> As explained in one study, "A synergistic climate is characterized by high mutual trust between taxpayers and authorities. Taxpayers are willing to comply, and tax administration provides customer-oriented services."<sup>30</sup>

The IRS is already taking some action to move from a system reliant on audits to one that provides customer-oriented services for EITC taxpayers. As noted above, it has engaged in a conversation with a diverse group of people who work with the EITC and it has attempted to fine-tune its EITC outreach and

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24 National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 1-87 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*); National Taxpayer Advocate 2007 Annual Report to Congress 222-41 (*EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2015 Annual Report to Congress 240-47 (*Earned Income Tax Credit (EITC): The IRS Does Not Do Enough Taxpayer Education in the Pre-filing Environment to Improve EITC Compliance and Should Establish a Telephone Helpline Dedicated to Answering Pre-filing Questions From Low Income Taxpayers About Their EITC Eligibility*).

25 National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 3-30 (*Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*).

26 *Id.* at 4.

27 National Taxpayer Advocate 2016 Annual Report to Congress 138-50.

28 Erich Kirchler, Christoph Kogler, and Stephan Muehlbacher, *Cooperative Tax Compliance: From Deterrence to Deference*, *Current Directions in Psychological Science* 87-88 (Apr. 2014).

29 *Id.* at 88.

30 *Id.* at 89.

education program. The National Taxpayer Advocate encourages the IRS to expand its customer service by offering a dedicated toll-free helpline for EITC questions, discussed below.<sup>31</sup>

### *TAS Research Shows Pre-Filing Season Letters Can Improve EITC Compliance*

In 2016, the National Taxpayer Advocate sent 6,564 letters to taxpayers who appeared to have erroneously claimed the EITC on their 2014 returns, whose 2014 returns were not audited, but who appeared to be as noncompliant as those who were audited.<sup>32</sup> The TAS letter explained the requirements for claiming EITC in plain language, identified the specific requirement the recipient did not appear to meet, and suggested sources of additional information and assistance, including TAS. TAS then conducted a study to compare the level of compliance shown on taxpayers' 2015 returns among three groups:

- Taxpayers the IRS identified as appearing to have erred in claiming EITC on their 2014 return but whose 2014 returns were not audited, and were sent the TAS letter;
- Taxpayers whose 2014 returns were not audited and had similar characteristics as the returns of taxpayers who received the TAS letter, but who were not sent the TAS letter; and
- 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.<sup>33</sup>

Key findings of this study include:

- 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. In fact, 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.
- Audited taxpayers whose 2014 return appeared to contain a duplicate claim for EITC were less likely to claim the EITC on their 2015 returns than taxpayers in either of the other two groups.<sup>34</sup>

TAS continued this study in 2017.<sup>35</sup> This year's results show that when it comes to the relationship test, the sample group broke the same rule 72 percent of the time compared to 77 percent of taxpayers in the

31 National Taxpayer Advocate 2016 Annual Report to Congress 138-50.

32 National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 33-52 (*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*). See also National Taxpayer Advocate, *Earned Income Tax Credit (EITC): TAS Study Finds that Sending an Informative, Tailored Letter to Taxpayers Who Appear to Have Erroneously Claimed EITC Can Avert Future Noncompliance* (Oct. 11, 2017), <https://taxpayeradvocate.irs.gov/news/nta-blog-eitc-TPLetters-avert-noncompliance?category=TaxNews>; National Taxpayer Advocate 2017 Annual Report to Congress, vol. 2, (*Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently In Error and Were Not Audited But Were Sent an Educational Letter From the Taxpayer Advocate Service, Part 2: Validation of Prior Findings and the Effect of an Extra Help Phone Number and a Reminder of Childless-Worker EITC*), *infra*.

33 The IRS selects returns that claim EITC for audit using the Dependent Database (DDb). It is a tool that combines data from IRS and third-party sources such as the Social Security Administration. When a return is filed, the IRS compares the return against these data and scored for a probability of noncompliance. Dept. of Treasury, *Report to Congress on Strengthening Earned Income Tax Credit Compliance Through Data Driven Analysis* 14 (July 5, 2016).

34 National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 33-52.

35 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently In Error and Were Not Audited But Were Sent an Educational Letter From the Taxpayer Advocate Service, Part 2: Validation of Prior Findings and the Effect of an Extra Help Phone Number and a Reminder of Childless-Worker EITC*, *infra*.

control group, a statistically significant reduction of five percentage points that, if projected to the entire 2015 population, would result in a savings of over \$53 million in erroneous EITC claims.<sup>36</sup>

### TAS Research Shows Providing a Dedicated Helpline for EITC Taxpayers During The Tax Season Improves EITC Compliance

In the 2017 study, TAS added an additional sample of 1,197 taxpayers who were offered in the letter the availability of a dedicated “Extra Help” telephone line staffed by TAS employees trained to answer taxpayer questions about the letter and the EITC eligibility rules.<sup>37</sup> Taxpayers who received the TAS letter with the available Extra Help telephone line broke the same rule related to residency 67 percent of the time; this is seven percentage points less than the 74 percent of the taxpayers in the control group who broke the same rule, and is statistically significant at the 95 percent confidence level. If projected to the entire 2015 population who only broke a Dependent Database (DDb) rule indicating the child may not have resided with the taxpayer, sending the TAS letter with the available Extra Help telephone line would result in a savings of over \$44 million in erroneous EITC claims.<sup>38</sup> Taxpayers who received the TAS residency letter without the Extra Help line number, broke the same residency rules 74 percent of the time, which was not statistically different from the control group.<sup>39</sup>

Offering the Help line could be particularly helpful since the IRS could talk to the taxpayer directly and identify areas of confusion. Based on the data referenced above, just offering the Help line may help reduce repeat EITC errors. The IRS could then apply this knowledge and improve EITC outreach, education, and procedures for all EITC taxpayers. Based on a review of calls received on the Help line, TAS has been able to identify two areas that received repeat questions: the rules of claiming a dependent versus the EITC, and the rules that are involved when parents have shared custody of a qualifying child.

This approach is similar to that of the United Kingdom’s tax authority, Her Majesty’s Revenue and Customs (HMRC), which provides a hotline for general tax credit questions and a hotline dedicated

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**This year’s results show that when it comes to the relationship test, the sample group broke the same rule 72 percent of the time compared to 77 percent of taxpayers in the control group, a statistically significant reduction of five percentage points that, if projected to the entire 2015 population, would result in a savings of over \$53 million in erroneous Earned Income Tax Credit (EITC) claims.**

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36 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently In Error and Were Not Audited But Were Sent an Educational Letter From the Taxpayer Advocate Service, Part 2: Validation of Prior Findings and the Effect of an Extra Help Phone Number and a Reminder of Childless-Worker EITC*.

37 *Id.* Only 967 of those letters were deliverable and the study is based on that group. TAS received 35 calls to the Extra Help telephone line during this study.

38 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently In Error and Were Not Audited But Were Sent an Educational Letter From the Taxpayer Advocate Service, Part 2: Validation of Prior Findings and the Effect of an Extra Help Phone Number and a Reminder of Childless-Worker EITC*, *infra*.

39 *Id.*

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Taxpayers who received the TAS letter with the available Extra Help telephone line broke the same rule related to residency 67 percent of the time; this is seven percentage points less than the 74 percent of the taxpayers in the control group who broke the same rule, and is statistically significant at the 95 percent confidence level.

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solely to child benefit credits.<sup>40</sup> This approach helps meet HMRC's strategy to promote compliance and prevent noncompliance "as early as possible."<sup>41</sup>

### **Progress is Being Made with the IRS Joint EITC Audit Improvement Team But More Can Be Done to Help Low Income Taxpayers, Particularly in the Area of Acceptance of Alternative Documentation**

#### *Improvements to Internal Revenue Manual (IRM) 4.19.14-1 will allow acceptance of documents likely to be used by low income taxpayers*

TAS is an active participant on a collaborative IRS team dedicated to identifying ways to improve the audit process for taxpayers claiming the EITC. One area of improvement includes the identification of acceptable documents for substantiating EITC claims, which are particular to the circumstances of low income taxpayers. This is something for which the National Taxpayer Advocate has consistently advocated.<sup>42</sup> Previous internal guidance provided a list of acceptable documentation to substantiate an EITC claim; however, the list was very narrow and did not reflect the types of documentation and methods of proof that would most likely be available or best-suited for taxpayers claiming the EITC. Through the work of the EITC Audit Improvement Team, the IRS added IRM 4.19.14-1 in July 2016. This IRM section will foster acceptance of substantiating documentation outside of the traditional EITC documentation, which typically includes letters from schools and doctor offices. In addition to listing various "new" documents for Examination employees to consider, such as paternity test results, eviction notices, and statements from homeless shelters, the internal guidance informs Examination employees that this list is not all-inclusive. The National Taxpayer Advocate applauds the IRS for expanding acceptable documentation and she will continue to advocate for a wide range of additional documents to be added to IRM 4.19.14-1.

The EITC Audit Improvement Team has also identified employee training as a concern with the revisions to IRM 4.19.14-1. While the intent behind enhancing the list of documents in the IRM was to foster a mindset that would be open to considering alternatives for substantiating an EITC claim, it appears the additional documents, while helpful, have not created an environment where employees feel they can consider a multitude of documents. The EITC Audit Improvement Team will also work to tackle this obstacle.

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40 Her Majesty's Revenue and Customs (HMRC), *Child Tax Credit and Working Tax Credit: Why Overpayments Happen* 10 (Apr. 2017).

41 HMRC, *Our Strategy* 4 (June 2017).

42 National Taxpayer Advocate 2015 Annual Report to Congress 253-54; National Taxpayer Advocate 2011 Annual Report to Congress 305; National Taxpayer Advocate 2007 Annual Report to Congress 222, 225; National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 20.

### *The IRS will introduce the use of third-party affidavits in EITC audits*

The National Taxpayer Advocate believes that a third-party affidavit should be incorporated into the EITC audit process as a tool for any taxpayer to use for substantiating his or her claim, and will help reduce the improper payment rate. TAS advanced this objective during its participation on the EITC Audit Improvement team and recently the IRS announced that it will allow the use of third-party affidavits as proof of residency for a limited population of taxpayers, beginning in TY 2018.<sup>43</sup> The use of affidavits will be limited to those taxpayers who “appear to meet the relationship requirement for claiming EITC based on information available to the IRS from the U.S. Department of Health and Human Services’ Federal Case Registry and information from the Social Security Administration.”<sup>44</sup> The IRS will add the affidavit to the initial audit mailing for the limited population, but those taxpayers will be allowed to use the affidavit at all stages of the audit.<sup>45</sup> While the option to use affidavits will be known to taxpayers and representatives who receive this audit notice, it does not appear that the IRS will be broadly advertising this tool.

The National Taxpayer Advocate applauds the IRS’s decision to adopt the limited use of third-party affidavits and looks forward to seeing how this decision will improve the audit process for taxpayers. However, TAS will continue to work to expand the use of affidavits to all EITC taxpayers because affidavits are a tool proven to help taxpayers. In 2005, the IRS studied the use of affidavits as part of its EITC Qualifying Child Residency Certification Study.<sup>46</sup> The study found that affidavits had the highest rate of acceptance at 82 percent, compared to an overall acceptance rate of 64 percent for all document types.<sup>47</sup> The study concluded that this outcome was reasonable because affidavits had dedicated lines for all of the information, explaining “as long as the affidavit was filled out completely, it would contain all the required information to be accepted.”<sup>48</sup> If the affidavit became available to all EITC taxpayers, it would help educate claimants about EITC eligibility rules and further the public perception that the IRS is trying to help taxpayers correctly claim the EITC. It will also honor the taxpayers’ *right to a fair and just tax system*.<sup>49</sup>

### *Templates are available on irs.gov to make traditional documentation easier to obtain*

Some taxpayers cannot use traditional documentation to substantiate their case. For instance, if a taxpayer is relying on school records, which are maintained by school year, the information may not be enough for IRS purposes, which is needed by calendar year. In other instances, a doctor’s office may have adequate records but might not prepare the letter on letterhead in a way that meets IRS standards. In order to make it easier for taxpayers to use traditional documentation, the EITC Audit Improvement Team developed templates for several traditional sources of substantiation: school records, medical records, and childcare provider records. These templates provide language for the taxpayer to provide directly to the school, doctor’s office, or childcare provider. These templates will eliminate guesswork for offices helping taxpayers and will provide an easy tool for taxpayers to use. However, one downside is that

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43 IRS response to TAS information request (Nov. 14, 2017).

44 *Id.*

45 *Id.*

46 IRS, *IRS Earned Income Tax Credit (EITC) Initiative Final Report to Congress 7* (Oct. 2005).

47 *Id.* at 33.

48 *Id.*

49 IRC §7803(a)(3)(J).

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Based on a review of calls received on the Help line, TAS has been able to identify two areas that received repeat questions: the rules of claiming a dependent versus the Earned Income Tax Credit (EITC), and the rules that are involved when parents have shared custody of a qualifying child.

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the templates are not easily accessible on [irs.gov](https://www.irs.gov).<sup>50</sup> These templates are also available on the TAS website as part of the TAS Tax Toolkit, EITC educational material.<sup>51</sup>

## CONCLUSION

The EITC is a powerful tool to improve the financial status of low income families. TAS's most recent research shows that an educational letter sent in the pre-filing season had a positive impact on EITC compliance and taxpayer education. A dedicated Help line may provide targeted assistance to the particular taxpayers who need it and give the IRS a better sense of what taxpayers find particularly confusing. Given the complexity of the EITC and the numerous ways in which eligibility can be affected, education will be the key to improving EITC compliance. The EITC Summits hosted by the IRS will go a long way in improving EITC claims. However, the IRS should be utilizing research, such as that conducted by TAS, to improve its efforts as well.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Send out pre-filing season letters to taxpayers who break certain return filters. These letters should be written in plain language and be tailored to the taxpayer's particular needs.
2. Provide a dedicated toll-free Help line for EITC taxpayers during the filing season.
3. Expand the list of acceptable documentation under IRM 4.19.14-1 and train employees on the importance of this list.
4. Continue to expand the use of third-party affidavits, thereby making them available to all EITC taxpayers.

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50 The template for school records is found at: <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/school-template>. The template for medical records is found at: <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/healthcare-template>. The template for childcare providers is available at: <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/childcare-template>.

51 TAS, *Claiming the Earned Income Tax Credit (EITC)*, <https://taxpayeradvocate.irs.gov/get-help/claiming-the-eitc>.

**MSP  
#13****MILITARY ASSISTANCE: The IRS's Customer Service and Information Provided to Military Taxpayers Falls Short of Meeting Their Needs and Preferences****RESPONSIBLE OFFICIAL**

Kenneth Corbin, Commissioner, Wage and Investment Division.

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

There are about 1.3 million active duty service members, and over 800,000 Reserves and National Guard personnel in the United States.<sup>2</sup> Those in uniform have undergone repeated deployments to war zones and many have endured extreme, and often invisible, psychological pain.<sup>3</sup> Whether stationed domestically or overseas, or serving on active duty or reserve duty, service members encounter questions about how to apply statutory extensions when returning from combat deployments, how the capital gain exclusion applies to them when selling their homes, whether to include nontaxable combat pay in earned income for purposes of the Earned Income Tax Credit (EITC), and whether they can make early Individual Retirement Account (IRA) withdrawals without incurring penalties. Their tax challenges are compounded if they must face the IRS alone in resolving post-filing tax disputes.

The demanding situations of military personnel, in addition to the unique issues they face, call for dedicated taxpayer service and information that meets the needs and preferences of these taxpayers. Yet, the IRS does not have employees assigned solely to assist service members. The IRS's service to this taxpayer population instead is generally limited to posting information on the web, and providing tax software and training to military partners who prepare tax returns at military installations around the

- 1 See Taxpayer Bill of Rights (TBOR), <http://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)).
- 2 National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2017 Conference Report, Pub. L. No. 114-840, § 401. The NDAA is an annual bill that sets policies and budgets for the U.S. Department of Defense (DoD). DoD, *About the Department of Defense (DoD)*, <https://www.defense.gov/About/> (last visited Dec. 18, 2017).
- 3 Some veterans may suffer from mental disorders, such as Post-Traumatic Stress Disorder (PTSD). See *National Institute of Mental Health, Post-Traumatic Stress Disorder*, <https://www.nimh.nih.gov/health/topics/post-traumatic-stress-disorder-ptsd/index.shtml> (Feb. 2016). See also National Taxpayer Advocate 2009 Annual Report to Congress 351-56 (Legislative Recommendation: *Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income*).



world.<sup>4</sup> However, much of the IRS's information about military tax issues is inadequate,<sup>5</sup> obsolete,<sup>6</sup> or just plain wrong.<sup>7</sup>

The National Taxpayer Advocate has identified the following issues pertaining to the IRS customer service for military taxpayers:

- IRS online information and publications for the military is insufficient and outdated;
- Complex military tax issues warrant a special unit of Stakeholder Partnership, Education and Communication (SPEC) staffed with veterans whose responsibilities are to develop and conduct outreach, education, and assistance to current military taxpayers and the organizations that provide tax assistance to these taxpayers;
- SPEC lacks funding that would enable them to travel to overseas military locations to provide face-to-face training to military Volunteer Income Tax Assistance (VITA) volunteers; and
- A dedicated toll-free telephone line for service members and their families, both in and out of tax season, is essential for this population.

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4 See, e.g., Internal Revenue Manual (IRM) 22.30.1.8.7.1.5.2, *Military* (Sept. 26, 2016). For example, military Volunteer Income Tax Assistance (VITA) volunteers Army-wide prepared over 108,000 tax returns on average from calendar years (CY) 2013 to 2016. During fiscal year 2017, they prepared 87,806 federal tax returns, including approximately 13,000 that were prepared at overseas locations. Army's Client Information System (CIS), Sep. 9, 2017; CIS, Dec. 9, 2017; CIS, Dec. 11, 2017. The numbers of military tax returns are all input into the Army's CIS by the Officers in Charge of the individual tax centers world-wide and maintained by the U.S. Army Legal Assistance Policy Division in Washington, D.C.

5 For example, service members may invest as much as \$54,000 in an Individual Retirement Account (IRA) when serving in a combat zone; however, this information is missing from the IRS website. See IRS, *Tax Information for Members of the Military*, <https://www.irs.gov/individuals/military> (last visited Dec. 18, 2017). Additionally, nowhere on [irs.gov](https://www.irs.gov) can a veteran find information on the Combat-Injured Veteran Tax Fairness Act of 2016. This legislation provides veterans additional time to claim a refund if they had taxes improperly withheld from their severance pay.

6 For example, the *Miscellaneous Provisions — Combat Zone Service* link on [irs.gov](https://www.irs.gov) indicates it was last reviewed in August 2017; however, only the IRA contribution for 2006 is provided: “[t]he IRA contribution limit for 2006 is \$4,000 for those under age 50 and \$5,000 for those 50 and over.” See IRS, *Miscellaneous Provisions — Combat Zone Service*, <https://www.irs.gov/newsroom/miscellaneous-provisions-combat-zone-service> (last visited Dec. 19, 2017).

7 For example, [irs.gov](https://www.irs.gov) reports the death gratuity paid to survivors of deceased service members is \$12,000 for deaths occurring after Sep. 10, 2001. The death gratuity program actually provides for a tax-free payment of \$100,000 to eligible survivors of members of the Armed Forces who die while on active duty or while serving in certain reserve statuses. See IRS, *Highlights: Military Family Tax Relief Act*, <https://www.irs.gov/newsroom/highlights-military-family-tax-relief-act> (last visited Dec. 19, 2017). The death gratuity has been at the \$100,000 level since 2006. See NDAA for Fiscal Year 2006, Pub. L. No. 109-163, § 664 (2006).

## ANALYSIS OF PROBLEM

### Background

#### *The Number of Military Taxpayers Is Now Increasing*

Over the past 50 years, the size of the military has shrunk to about 1,338,000 active duty service members,<sup>8</sup> an 85 percent decrease from the 8,744,000 service members during the Vietnam War.<sup>9</sup> As those numbers have fallen, the connections between military personnel and the civilian population appear to be growing more distant, prompting also a perception that the public does not understand the problems service members face.<sup>10</sup>

Although the size of the military has been cut significantly in recent years, that number is now increasing.<sup>11</sup> Active-duty end strengths<sup>12</sup> were required to increase by 24,000 service members by September 30, 2017.<sup>13</sup> The Army succeeded in meeting its 2017 recruiting and retention goals across the active Army and National Guard,<sup>14</sup> as did the Air Force.<sup>15</sup> In FY 2018, the size of the military will increase by an additional, nearly 20,000 troops.<sup>16</sup>

8 See Defense Manpower Data Center, *DoD Personnel, Workforce Reports & Publications, Military Personnel Current Strength*, [https://www.dmdc.osd.mil/appj/dwp/dwp\\_reports.jsp](https://www.dmdc.osd.mil/appj/dwp/dwp_reports.jsp) (last visited Dec. 19, 2017).

9 See Department of Veterans Affairs, *America's Wars Fact Sheet*, [https://www.va.gov/opa/publications/factsheets/fs\\_americas\\_wars.pdf](https://www.va.gov/opa/publications/factsheets/fs_americas_wars.pdf) (Apr. 2017).

10 Pew Research Center Social and Demographics Trends, *The Military-Civilian Gap: Fewer Family Connections*, <http://www.pewsocialtrends.org/2011/11/23/the-military-civilian-gap-fewer-family-connections> (Nov. 23, 2011).

11 See Defense Manpower Data Center, *DoD Personnel, Workforce Reports & Publications, Military Personnel Current Strength*, [https://www.dmdc.osd.mil/appj/dwp/dwp\\_reports.jsp](https://www.dmdc.osd.mil/appj/dwp/dwp_reports.jsp) (last visited Dec. 19, 2017). From FY 2011 to FY 2016, U.S. military personnel decreased nine percent from 1,424,317 to 1,301,308. Congress began decreasing the size of the military in anticipation of the withdrawal of U.S. forces from Iraq in 2011, the drawdown of U.S. forces in Afghanistan which began in 2012, and budgetary constraints. End-strengths for the Air Force and Navy have been generally declining since 2001. See Congressional Research Service (CRS), *FY2016 National Defense Authorization Act: Selected Military Personnel Issues* (Dec. 15, 2015). However, the military has now been mandated to increase in size. See National Defense Authorization Act for Fiscal Year 2018 Conference Report to Accompany H.R. 2810, § 401, at 193-194.

12 The term “end-strength” refers to the authorized strength of a specified branch of the military at the end of a given fiscal year, while the term authorized strength means “the largest number of members authorized to be in an armed force, a component, a branch, a grade, or any other category of the armed forces.” 10 United States Code (U.S.C.) § 101(b)(11).

13 See National Defense Authorization Act for Fiscal Year 2018 Conference Report to Accompany S. 1519, § 401, at 125.

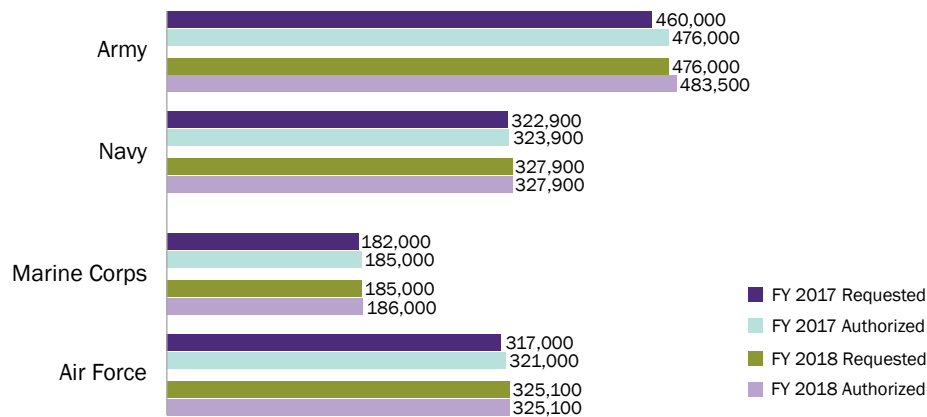
14 See Defense News, *Personnel chief: The Army is preparing to grow the force by 17,000 soldiers in 2018*, <https://www.defensenews.com/news/your-army/2017/10/08/personnel-chief-the-army-is-preparing-to-grow-the-force-by-17000-soldiers-in-2018/> (Oct. 8, 2017).

15 See Air Force Times, *Air Force Hits Recruiting Goals With 33,000 New Airmen*, <https://www.airforcetimes.com/news/your-air-force/2017/10/15/air-force-hits-recruiting-goals-with-33000-new-airmen/> (Oct. 15, 2017).

16 See National Defense Authorization Act for Fiscal Year 2018 Pub. L. No. 115-91, § 401. Authorized end strengths for active duty military personnel by September 30, 2018 is 483,500 for the Army, 327,900 for the Navy, 186,000 for the Marine Corps, and 325,100 for the Air Force. The Army will grow by at least 7,500, the Navy by nearly 4,000, the Marine Corps by 1,000, and the Air Force by about 4,100. Reserve forces will grow by about 3,400.

FIGURE 1.13.1<sup>17</sup>

## Active-Duty Military Personnel, FYs 2017-2018



Reserves and National Guard personnel numbers are set to increase as well by the end of FY 2018.<sup>18</sup>

### *Tax Issues Unique to the Military Are Complex*

Tax issues pertaining to the military add a layer of complexity to a tax system that has grown more complex by the year.<sup>19</sup> These issues, discussed more thoroughly below, include extensions of tax filing deadlines, especially for those serving overseas; combat zone income exclusions; tax abatement for service members who die in combat zones or qualified hazardous duty areas; IRA contributions from tax-free combat pay; tax return signature authority without a power of attorney; unique capital gains exclusions for service members who sell their homes; deductions for relocation expenses, travel expenses for reservists, and military uniforms; waivers for early withdrawals from IRAs; rules pertaining to the choice of service members to include their nontaxable combat pay as earned income for purposes of EITC; and refund claims under the Combat-Veterans Tax Fairness Act of 2016.

17 The annual federal budget process begins with a detailed proposal from the President that is developed through an interactive process between agencies and the President's Office of Management and Budget (OMB). The President's budget request is simply a proposal by the administration of its fiscal goals and policy preferences. See *Center on Budget and Policy Priorities, Policy Basics: Introduction to the Federal Budget Process*, <https://www.cbpp.org/research/policy-basics-introduction-to-the-federal-budget-process> (Aug. 23, 2017). This request has no binding authority on Congress. See also National Defense Authorization Act for Fiscal Year 2018 Report to Accompany S. 1519, § 401.

18 See National Defense Authorization Act for Fiscal Year 2017, Pub. L. No. 114-328, § 411; see also National Defense Authorization Act for Fiscal Year 2018 Conference Report to Accompany H.R. 2810, § 411, at 193-194.

19 For a detailed discussion on the efforts by the National Taxpayer Advocate in urging Congress to simplify the tax code, see National Taxpayer Advocate 2016 Annual Report to Congress 305-324 (Legislative Recommendation: *Tax Reform: Simplify the Internal Revenue Code Now*).

**EXTENSION OF TAX RETURN FILING DEADLINES.** Service members who serve in a combat zone<sup>20</sup> or qualified hazardous duty area<sup>21</sup> are allowed additional time to take care of tax matters.<sup>22</sup> This extension applies to the deadline for filing an annual tax return, paying any tax due, and filing a claim for a refund.<sup>23</sup> Additionally, service personnel are not charged interest or penalties attributable to the delayed deadline.<sup>24</sup> The deadline is extended for at least 180 days after the latter of the last day the taxpayer is in a combat zone or qualified hazardous duty area, or the last day of any continuous qualified hospitalization for wounds, disease, or injury sustained while serving in the combat zone.<sup>25</sup> In addition to the 180 days, the deadline is extended by the number of days that were left for the service member to file when he or she entered a combat zone.<sup>26</sup> For example, if a service member enters a combat zone on April 5, ten days before the tax filing deadline of April 15, the service member had ten days remaining to file a tax return. These ten days are then added to his or her 180-day extension, affording the service member 190 days after leaving the combat zone to file his or her tax return.

Additionally, whether in or outside of a combat zone or qualified hazardous duty area, if a service member's ability to pay an income tax liability is materially affected by his or her military service, payment of tax is deferred up to 180 days after termination of service, without any accrual of interest or penalties for that period.<sup>27</sup> This rule is broader than the extension under Internal Revenue Code (IRC) § 7508, in that it applies to all service members, whether deployed in a combat zone or not. The statute of limitations against the collection of tax deferred under this section is suspended for the period of military service of the service member and for an additional period of 270 days thereafter.<sup>28</sup> To receive this deferment, the service member must make a written request that is supported by evidence that his ability to pay is materially affected by his military service.

**EXTENSION TO FILE FOR SERVICE MEMBERS OVERSEAS.** Service members stationed abroad at the time of the filing due date automatically get two more months, until June 15, to file their returns.<sup>29</sup> If service members still need the additional four months, until October 15, to file, overseas service members must submit Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*, by June 15.

20 See IRC § 112(c)(2). The term “combat zone” means any area which the President of the United States by Executive Order designates, for purposes of this section or corresponding provisions of prior income tax laws, as an area in which Armed Forces of the United States are or have engaged in combat.

21 A Qualified Hazardous Duty Area (QHDA) is treated in the same manner as if it were a combat zone. See DoD Financial Management Regulation, DoD 7000.14-R ¶ 440203 (July 2016). “NOTE: In order to have [combat zone tax exclusion] treatment of wages for services performed in a QHDA, a member must be entitled to hostile fire or imminent danger pay while performing service in the QHDA.” *Id.*

22 See IRC § 7508(a).

23 The extension also applies to filing a petition with the Tax Court for redetermination of a deficiency, or for review of a decision rendered by the Tax Court; allowance of a credit or refund of any tax; bringing suit upon any such claim for credit or refund; assessment of any tax; giving or making any notice or demand for the payment of any tax; collection, by levy or otherwise; bringing suit by the United States, or any officer on its behalf, in respect of any liability in respect of any tax; and any other act required or permitted under the internal revenue laws specified by the Secretary. See IRC § 7508(a).

24 IRC § 7508(a); See also IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016).

25 *Id.*

26 *Id.*

27 50 U.S.C. § 4000 (a)-(b). While there is no definition in the Servicemembers Civil Relief Act (SCRA) of the term “materially affected,” courts generally require that military duties prevent the member from appearing in court at the designated time and place or assisting in the preparation or presentation of a case, or substantially impair the member's ability to pay financial obligations. Thus, a court will determine whether a service member's ability to pay an income tax liability is materially affected by his military service on a case-by-case basis.

28 50 U.S.C. § 4000 (a), (c).

29 See Treas. Reg. § 1.6081-5(a)(6). Extensions are granted only to file forms, not to make payments.

**COMBAT ZONE INCOME EXCLUSION.** While a service member is serving in a combat zone as an enlisted member or as a warrant officer for any part of a month, all of his or her income for that month is exempt from federal taxes.<sup>30</sup> For officers, the monthly exclusion is capped at the highest rate of enlisted pay, plus any hostile fire or imminent danger pay received.<sup>31</sup> In some cases, service outside a combat zone can be considered service in a combat zone if the Department of Defense (DoD) designates it in direct support of military operations in the combat zone, or if the service qualifies for duty subject to hostile fire or imminent danger pay.<sup>32</sup> Geographic areas that are considered tax-qualified combat zones are listed on the IRS website. *However, this list is out-of-date.*<sup>33</sup>

**TAX ABATEMENT IN CASE OF DEATH.** A service member who dies in a combat zone or qualified hazardous duty area, or as a result of wounds, disease, or injury incurred while serving in the combat zone is exempt from income tax for the taxable year in which death occurs and any prior taxable year ending on or after the first day served in a combat zone or qualified hazardous duty area.<sup>34</sup> Because an amended return is a claim for refund, it is subject to the statutory period of limitations that applies to refunds.<sup>35</sup> However, service members who are deployed outside of the United States, away from their permanent duty stations, and are serving in support of a qualified hazardous duty area<sup>36</sup> are allowed an extension of time allowed for performing most acts required by the IRC.<sup>37</sup> Such an extension can hold a previous tax year open longer than three years.<sup>38</sup> Moreover, the service member's tax liability is forgiven for all income, not just military compensation.<sup>39</sup>

**IRA CONTRIBUTIONS FROM COMBAT PAY.** While combat pay is generally nontaxable, it is included in income for purposes of calculating the limits on contributions and deductions for an IRA.<sup>40</sup> The earnings on contributions will also be tax-free when withdrawn, assuming the service member

30 IRC § 112; Treas. Reg. § 1.112-1; see also, IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016).

31 *Id.* See also DoD Financial Management Regulation, DoD 7000.14-R ¶ 440203 (July 2016).

32 See DoD Financial Management Regulation, DoD 7000.14-R ¶ 440203 (July 2016).

33 The DoD has certified Tajikistan, Kyrgyzstan, and Uzbekistan as "in direct support" of a military operation in a combat zone through May 31, 2014 only. The IRS website, <https://www.irs.gov/newsroom/combat-zones>, lists them as still receiving combat zone benefits. Additionally, Syria was designated by the Secretary of Defense as an "in direct support" area beginning Jan. 1, 2004. The IRS website does not list Syria at all. Lebanon's certification as an "in direct support" area is through February 11, 2020. The IRS website does not indicate that its certification is for a limited time. See DoD Financial Management Regulation, DoD 7000.14-R ¶ 440223 (July 2016).

34 IRC § 692(a)(2); see also Treas. Reg. § 1.692-1; Rev. Proc. 2004-26, 2004-19 I.R.B. 890. The word, "a" in the phrase, "in a combat zone" is significant. In short, a service member who has had multiple deployments to combat zones over the years and then dies in a combat zone, may have multiple years of taxes forgiven, depending on the amount of time the service member has spent outside of combat zones between deployments.

35 Under IRC § 6511(a), a taxpayer must file a claim for credit or refund of an overpayment within: 1) three years from the time the return was filed, or 2) two years from the time the tax was paid, whichever is later. If no return was ever filed by the taxpayer then the claim must be filed within two years of payment of the tax.

36 See DoD Financial Management Regulation, DoD 7000.14-R (July 2016).

37 IRC § 7508(a)(1)(E) provides service members serving in a combat zone an automatic extension to file a claim for refund for the period that the service member is in the combat zone, and for the next 180 days thereafter.

38 IRC § 7508(a); IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016).

39 This may be important for a reservist service member or a service member with large investment income.

40 Heroes Earned Retirement Opportunities Act, Pub. L. No. 109-227, § 2 (2006).

qualifies.<sup>41</sup> Combat pay service also entitles service members to invest as much as \$54,000 in an IRA when serving in a combat zone.<sup>42</sup> This is important information missing from the IRS website.<sup>43</sup>

**RETURN SIGNATURE AUTHORITY.** Generally, joint returns must be signed by both spouses. However, if a service member is deployed to a combat zone, a power of attorney is not needed to sign the return on the deployed spouse's behalf.<sup>44</sup> The other spouse must attach to the return a signed statement explaining the combat zone status.<sup>45</sup> If a service member deployed to a combat zone is deemed missing in action, a joint return can be filed under the same rules for up to two years after the termination of the combat zone designation of the deployment location.<sup>46</sup> The joint return will be considered valid even if it is later determined that the missing spouse died before the year covered by the return.<sup>47</sup>

**CAPITAL GAINS EXCLUSION FOR SALE OF PRIMARY RESIDENCE.** Taxpayers, whether civilian or military, can generally avoid paying capital gains taxes on the sale of their home if they owned it and used it as their qualifying principal residence for two out of the five years preceding the sale, permitting homeowners to exclude up to \$250,000 in gains for individuals or \$500,000 for married couples.<sup>48</sup> Service members, however, can suspend the five-year test period for up to ten years when they are assigned to a duty station that is at least 50 miles from the house for a period of 90 days or more.<sup>49</sup>

**RELOCATION EXPENSES.** Service members are permitted to deduct the reasonable unreimbursed expenses of relocating themselves and their families, without having to meet the distance and time tests.<sup>50</sup>

**TRAVEL EXPENSES FOR RESERVISTS.** If service members are called more than 100 miles away from home to perform Reserve duties, they can generally deduct any unreimbursed travel expenses.<sup>51</sup>

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- 41 If a taxpayer is age 59½ or over, he may withdraw any amount from his Roth IRA as long as the account has been open for at least 5 years. If a taxpayer is under age 59½, he may withdraw the exact amount of his Roth IRA contributions with no penalties, although there are several exceptions that enable Roth IRA plan participants to withdraw funds from Roth IRAs that otherwise would be subjected to ordinary income taxes and the ten percent early withdrawal penalty. IRC § 408A(d)(2)(A)(i).
- 42 Deployed military members can exceed the \$18,500 annual Elective Deferral Limit. See IRC § 415(b)(2)(H); IRC § 415(c); See also IRM 4.72.7.3, *Annual Additions* (May 22, 2017); IRS Notice 2016-62, 2016-2 C.B. 725; and Thrift Savings Plan, *Contribution Limits*, <https://www.tsp.gov/PlanParticipation/EligibilityAndContributions/contributionLimits.html> (last visited Dec. 19, 2017). The annual addition limit for 2018 is set to increase to \$55,000. See IRS Notice 2017-64.
- 43 See IRS, <https://www.irs.gov/individuals/military> (last visited Dec. 19, 2017).
- 44 See Treas. Reg. §1.6012-1(a)(5).
- 45 *Id.* See also IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016); Associate Chief Counsel (Procedure & Administration) Desk Guide, Chapter 1, *Filing Requirements*, <https://www.irs.gov/pub/irs-utl/PADeskbook.pdf> (last visited Dec. 6, 2017).
- 46 See IRC § 6013(f).
- 47 *Id.* See also IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016).
- 48 See IRC § 121(b)(2)(A); see also 2003 Military Family Tax Relief Act, Pub. L. No. 108–121, § 101 (2003).
- 49 See IRC § 121(d)(9). This period of suspension cannot last longer than 10 years and can be on only one property at a time. See also IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016).
- 50 See IRC § 217; see also IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016). The Distance Test mandates that a taxpayer's new principal workplace must be at least 50 miles farther from his or her old home than his old workplace was. For example, if a taxpayer's old workplace was three miles from his or her old home, the taxpayer's new workplace must be at least 53 miles from that home. The Time Test mandates that a taxpayer must work full time in the general area of his new workplace for at least 39 weeks during the 12 months right after he or she moves.
- 51 See 2003 Military Family Tax Relief Act, Pub. L. No. 108–121, § 109 (2003); see also IRS Pub. 529, *Miscellaneous Deductions* (Dec. 2016). This deduction is an above-the-line deduction and is allowed whether or not the taxpayer elects to itemize.

**UNIFORM EXPENSES.** If service members are prohibited from wearing certain uniforms when off duty, they can generally deduct the cost to buy and maintain those uniforms if those expenses are in excess of two percent of their Adjusted Gross Income (AGI).<sup>52</sup>

**IRA EARLY WITHDRAWALS.** Because a call to active duty sometimes creates financial hardship for reservists whose military income is much lower than their civilian pay, early withdrawal penalties may be waived. If a service member takes money from his IRA, 401(k) or certain other retirement plans, the IRS may waive the ten percent penalty tax normally applied for withdrawals before age 59½.<sup>53</sup>

**EARNED INCOME.** A service member's nontaxable pay, such as combat pay, the Basic Allowance for Housing (BAH),<sup>54</sup> and the Basic Allowance for Subsistence (BAS),<sup>55</sup> is not included in the earned income for EITC purposes.<sup>56</sup> However, the military service member and spouse can each choose to have their nontaxable combat pay included in earned income for purposes of the EITC.<sup>57</sup> This scenario is usually seen during tax years in which the service member has a lengthy deployment in a combat zone, where his or her income is nontaxable. Including it as earned income may decrease the amount of tax the service member owes and may mean a larger refund, assuming he is still eligible for the EITC.

**SEVERANCE PAY FOR WOUNDED VETERANS.** The Combat-Injured Veterans Tax Fairness Act of 2016<sup>58</sup> gives veterans who retired from the military for medical reasons additional time to claim a refund if they had taxes improperly withheld from their severance pay. The DoD will identify veterans impacted by the law and send notices to them. These veterans will have the opportunity to file

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- 52 See IRC § 132(a)(3) and IRC § 162. An employee can exclude from gross income any fringe benefit which qualifies as a working condition fringe under IRC § 132(a)(3). A "working condition fringe" includes any property or services provided by an employer to an employee to the extent that, if the employee paid for such property or services, such payment would be allowed as a deduction under IRC § 162 as an ordinary trade or business expense. See also IRS Pub. 529, *Miscellaneous Deductions* (Dec. 2016). Generally, military taxpayers cannot deduct the cost of uniforms if they are on full-time active duty in the armed forces. However, a reservist can deduct the unreimbursed cost of his uniform if military regulations restrict him from wearing it except while on duty as a reservist. If local military rules do not allow a service member to wear his uniform when he is off duty, he can deduct the amount by which the cost of buying and keeping up these uniforms is more than the uniform allowance he receives.
- 53 See IRC § 72(t)(2)(G). See also National Taxpayer Advocate 2015 Annual Report to Congress 401-408 (Legislative Recommendation: *Hardship Withdrawals: Provide a Uniform Definition of a Hardship Withdrawal from Tax-Advantaged Retirement Arrangements*) (describing the complexities involved in tax-advantaged retirement plans and arrangements). There are several different definitions of "hardship," depending on the taxpayer's type of retirement plan or arrangement. The National Taxpayer Advocate has long-advocated for uniform rules regarding the definition of "hardship" and the tax consequences of hardship withdrawals from tax-advantaged plans. *Id.*
- 54 The Basic Allowance for Housing (BAH) is a U.S. based allowance prescribed by geographic duty location, pay grade, and dependency status. It provides uniformed service members equitable housing compensation based on housing costs in local civilian housing markets within the United States when government quarters are not provided. See Defense Travel Management Office, *Basic Allowance for Housing (BAH)*, <http://www.defensetravel.dod.mil/site/bah.cfm> (last visited Dec. 19, 2017).
- 55 Basic Allowance for Subsistence (BAS) is a monthly allowance meant to offset costs for a service member's meals. All enlisted members get full BAS, but pay for their meals, including those provided by the government. BAS is linked to the price of food. Each year it is adjusted to account for the increase in food prices, as measured by the USDA food cost index. This is why the increase to BAS will not necessarily be the same percentage as that applied to the increase in the pay table, as annual pay raises are linked to the increase of private sector wages. See Military Pay and Benefits, *Basic Allowance for Subsistence (BAS)*, <http://militarypay.defense.gov/Pay/Allowances/BAS.aspx> (last visited Dec. 19, 2017).
- 56 See IRC § 32. The Earned Income Tax Credit (EITC) is an anti-poverty program consisting of a refundable tax credit available to certain low income working taxpayers and their families.
- 57 The Working Families Tax Relief Act of 2004 gave taxpayers the option to include combat pay in EITC earned income. The Heroes Earnings Assistance and Relief Tax Act of 2008 made this change permanent. See Working Families Tax Relief Act of 2004, Pub. L. No. 108-311, § 104; Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, § 102.
- 58 Combat-Injured Veterans Tax Fairness Act of 2016, Pub. L. No. 114-292, 130 Stat. 1500 (2016).

amended returns dating back to 1991 to recover amounts that were withheld.<sup>59</sup> The IRS's website has no information about this significant provision, even on the Disabled Veterans link, in spite of the IRS's review of the web page as recently as November 27, 2017.<sup>60</sup>

### *IRS Service to the Military Taxpayers Largely Relies on the irs.gov web pages and the VITA Program*

The IRS does not have SPEC employees assigned solely to assist service members.<sup>61</sup> Similarly, very few military tax experts outside the IRS are available to assist the tens of thousands of active and reserve military taxpayers with preparing returns and other tax issues.<sup>62</sup> Additionally, there are no dedicated telephone lines for service members to call the IRS with questions. Instead, the IRS disseminates important tax information to service members via its website, using a broad brush.<sup>63</sup>

The IRS primarily relies on VITA volunteers to help with tax return preparation at military installations worldwide.<sup>64</sup> During FY 2017, military VITA volunteers Army-wide prepared 87,806 federal tax returns, and averaged over 108,000 tax returns from calendar years (CY) 2013 to 2016.<sup>65</sup> Of the returns prepared at Army installations during CY 2017, over 13,000 were prepared at overseas locations.<sup>66</sup>

The challenging situations of military personnel, in addition to the unique issues they face, call for a proactive approach to assisting this taxpayer population, as well as IRS employees who understand their needs.

### **IRS Online Information and Publications for the Military Are Insufficient and Outdated**

The irs.gov website appears to have a relatively comprehensive page for military service members, grouping its information in categories: current military personnel, those serving in a combat zone, former military personnel, and disabled veterans.<sup>67</sup> The page includes numerous links within each category to the Armed Forces Tax Guide;<sup>68</sup> particular legislation affecting service members, such as

59 Combat-Injured Veterans Tax Fairness Act of 2016, Pub. L. No. 114-292, 130 Stat. 1500 (2016).

60 See IRS, *Special Tax Considerations for Veterans*, <https://www.irs.gov/individuals/military/special-tax-considerations-for-veterans> (last visited Dec. 18, 2017).

61 The primary intermediary for IRS outreach to military personnel and their families is the Armed Forces Tax Council, which has a representative from each of the five military branches — Army, Air Force, Navy, Marines, and Coast Guard. See Internal Revenue Manual (IRM) 22.30.1.3.1.1, *Volunteer Income Tax Assistance (VITA)* (Jan. 10, 2013).

62 Currently, two active duty Army Judge Advocates world-wide possess Army-funded Tax LL.M.s (Master of Laws). The Army Judge Advocate General's Corps generally selects one Judge Advocate every two - four years to obtain a Tax LL.M. at Army expense. Attorneys from other service branches (Marines, Air Force, and Navy) may attend a week-long military income tax course each year prior to the tax season to prepare them to administer their military VITA programs. Email communication to TAS from Chief, Career Management Branch, Personnel, Plans & Training Office, Office of the Judge Advocate General, United States Army (Sept. 28, 2017) (on file with TAS).

63 See IRS, *Tax Information for Members of the Military*, <https://www.irs.gov/individuals/military> (last visited Dec. 19, 2017).

64 Commanders temporarily assign service members to prepare returns during tax season and provide space and equipment for tax centers. The IRS supports these efforts by providing tax software and training service members to address military specific tax issues.

65 See Army's CIS, Dec. 9, 2017. The numbers of military tax returns are all input into the Army's CIS by the Officers in Charge of the individual tax centers world-wide and maintained by the U.S. Army Legal Assistance Policy Division in Washington, D.C.

66 See Army's CIS, Dec. 9, 2017.

67 See, *Tax Information for Members of the Military*, <https://www.irs.gov/individuals/military> (last visited Dec. 19, 2017).

68 IRS Publication 3, *Armed Forces Tax Guide* (2016).



tax provisions provided in the Military Family Tax Relief Act of 2003;<sup>69</sup> filing topics with additional links to publications, form instructions, and other specific guidance; information about the military tax exclusion;<sup>70</sup> special tax considerations for disabled veterans; information for retirees, such as veterans education benefits,<sup>71</sup> taxable versus nontaxable income;<sup>72</sup> and Frequently Asked Questions (FAQs) about the Uniformed Services and Reemployment Rights Act (USERRA) and the “Veterans and Sailors Civil Relief Act of 1940 (SSCRA).”<sup>73</sup>

Notably, however, the reference to the SSCRA on the *irs.gov* website is significantly out of date, and the reference to the “Veterans and Sailors Civil Relief Act” is wrong.<sup>74</sup> The Act does not contain the word *Veterans*.<sup>75</sup> The Servicemembers Civil Relief Act (SCRA), was enacted over 14 years ago, on December 19, 2003, in response to the increased use of Reserve and National Guard military units in the Global War on Terrorism, and as a modernization and restatement of the protections contained in the SSCRA.<sup>76</sup> Additionally, this well-established legislation concerns individuals currently in the military, called to active duty from the Reserves or National Guard, or deployed service members, as opposed to veterans who have previously served.<sup>77</sup> Not only does the legislation not pertain to veterans, but its title does not and never did have the word “Veterans” in it.

The IRS’s website further reports, “The death gratuity paid to survivors of deceased Armed Forces members rises to \$12,000 and is not taxable (was \$6,000, with \$3,000 tax-free) ... for deaths occurring after 9/10/2001.”<sup>78</sup> The \$12,000 figure is grossly out-of-date. The death gratuity program actually provides for a tax-free payment of \$100,000 to eligible survivors of members of the Armed Forces who

69 Among the provisions of the Military Family Tax Relief Act of 2003 are tax provisions related to the following: death benefits; sale of principal residence; deduction for overnight travel expenses of National Guard and Reserve members; Department of Defense Homeowners Assistance Program; combat zone extensions expanded to contingency operations; dependent care assistance programs; and Military Academy attendees. See 2003 Military Family Tax Relief Act, Pub. L. No. 108–121 (2003).

70 A service member serving in a combat zone may exclude the following income: basic pay, reenlistment bonuses, school loan repayments associated with the months in a combat zone, Imminent Danger/Hostile Fire Pay, discharge benefits (*i.e.*, selling accrued leave earned while in a combat zone), and awards and other financial incentives. See DoD Financial Management Regulation, DOD 7000.14-R (July 2016).

71 See U.S. Department of Education, *Information for Military Families and Veterans*, <https://www.ed.gov/veterans-and-military-families/information>, for information about educational benefits for service members. Payments for education, training, or subsistence under any law administered by the Department of Veterans Affairs (VA) are tax free. See also IRS Publication 970, *Tax Benefits for Education* (2016).

72 See IRS Publication 525, *Taxable and Nontaxable Income* (2016).

73 Recognizing the special burdens that members of the military may encounter trying to meet their financial obligations while on active duty, Congress passed the Soldiers’ and Sailors’ Civil Relief Act (SSCRA) in 1940. The SCRA was signed into law in 2003, replacing the SSCRA, and is codified at 50 U.S.C. App. 501 *et seq.*

74 See IRS, *Retirement Plans FAQs*, <https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-userra-and-sscra> (last visited Dec. 19, 2017).

75 *C.f.*, Pub.L. 111-275, the Veterans’ Benefits Act of 2010, which makes certain improvements to the SCRA.

76 See H. Rep. 108-81, at 32 (Apr. 30, 2003). See also S. Rept. 108-197, at 9 (Nov. 17, 2003) (stating that the military had activated approximately 300,000 Reserves since September 2001, and that a DOD survey indicated that the self-employed Reservists reported an average \$6,500 in lost income when mobilized or deployed).

77 The SCRA provides a wide range of protections to enable service members to devote their full attention to duty. A few examples of obligations they may be protected against are outstanding credit card debt; mortgage payments; pending trials; taxes; and terminations of leases.

78 See IRS, *Highlights: Military Family Tax Relief Act*, <https://www.irs.gov/newsroom/highlights-military-family-tax-relief-act> (last visited Dec. 19, 2017).

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Very few military tax experts outside the IRS are available to assist the tens of thousands of active and reserve military taxpayers with preparing returns and other tax issues. Additionally, there are no dedicated telephone lines for service members to call the IRS with questions. Instead, the IRS disseminates important tax information to service members via its website, using a broad brush.

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die while on active duty or while serving in certain reserve statuses.<sup>79</sup> The “Miscellaneous Provisions — Combat Zone Service” link on [irs.gov](http://irs.gov) was last updated in 2007.<sup>80</sup> The military information contained on [irs.gov](http://irs.gov) requires a thorough review and update on a regular basis.

The [irs.gov](http://irs.gov) website contains a portal with video and audio presentations on topics of interest to small businesses, individuals and tax professionals, but does not have any presentations on military tax issues. By including specific videos on the various military-specific tax issues, the IRS would be providing another avenue to reach service members around the world.

IRS Publication 3, *Armed Forces Tax Guide*,<sup>81</sup> covers the special tax situations of active members of the U.S. Armed Forces, although it does not cover military pensions or veterans’ benefits, nor does it provide the basic tax rules that apply to all military taxpayers. The IRS could do more by providing easy-to-read information papers explaining the many complex issues facing service members.

### **SPEC Lacks Funding That Would Enable Them to Travel to Overseas Military Locations to Provide Face-to-Face Training for Military VITA Volunteers**

Most large military installations around the world offer service members and their families free income tax filing assistance through the VITA program, managed by SPEC — the outreach and education office of the IRS’s Wage and Investment Division.<sup>82</sup> As stated above, service members have limited options for obtaining assistance with tax filing and rely primarily on military VITA sites where they can speak with a tax preparer knowledgeable about complicated military-specific tax issues in person.<sup>83</sup>

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79 Public Law 109-163 permanently increased the death gratuity from \$12,420 to \$100,000 for all active duty deaths resulting from wounds, injuries, or illnesses that are incurred in the line of duty, not just those occurring in combat-related situations, and was retroactive to September 10, 2001. See NDAA for Fiscal Year 2006, Pub. L. No. 109-163, § 664 (2006). The entire \$100,000 is tax free. See IRC § 134(b)(3)(C). For deaths occurring between October 7, 2001 and January 6, 2006, the law allows the DoD to make retroactive payments of the difference between the original death gratuity survivors received and the new \$100,000 amount. NDAA for FY 2006, Pub. L. No. 109-163, § 664 (2006). An additional death benefit may be possible depending on the circumstances and date of death. See 10 U.S.C. § 1478(d).

80 See IRS, *Miscellaneous Provisions — Combat Zone Service*, <https://www.irs.gov/newsroom/miscellaneous-provisions-combat-zone-service> (last visited Dec. 19, 2017). Shamefully, the most recent information on the page regarding IRA contribution limits is for 2006. The military web page indicates it was reviewed or updated as recently as August 17, 2017, albeit displaying wrong and outdated information.

81 IRS Publication, *Armed Forces’ Tax Guide* (2016).

82 See IRM 22.30.1.1, *What is Stakeholder Partnerships, Education and Communication* (Oct. 1, 2013). See also, IRS, *Free Tax Help Available for the Military*, <https://www.irs.gov/newsroom/free-tax-help-available-for-the-military> (Mar. 23, 2017).

83 Other tax filing options include Military OneSource, a DoD-funded program providing free online tax preparation and tax consultations for military families. Service members from all branches are eligible except for active duty Coast Guard personnel. Service members can file up to three state returns for each federal return and the link to the software is available six months past the April tax deadline — two advantages that Military OneSource has over the VITA program.

In the past, SPEC personnel with knowledge of military tax issues trained volunteers stationed at military bases abroad by using the Link and Learn course for the military certification. However, more and more the IRS is turning to the virtual classroom to train these volunteers.<sup>84</sup> Desperate for in-person training, some overseas installations must procure the expertise of a tax-trained attorney<sup>85</sup> who happens to be stationed in the country or a U.S.-based attorney<sup>86</sup> who travels to the other country to teach tax law. Given that there are only a handful of U.S. military lawyers who are tax law trained,<sup>87</sup> it is simply not feasible to rely on the model of having uniformed lawyers, who happen to be stationed at an overseas installation, provide VITA training.<sup>88</sup>

Overseas military VITA sites need dedicated IRS employees who are trained on the complex issues that service members face year after year. In addition, the IRS should strongly consider hiring veterans who are specifically charged with outreach, education, and training for military taxpayers and the organizations that support them. By providing the necessary training and focusing efforts on outreach, the IRS will be providing essential services to this taxpaying population and honor important taxpayer *rights to be informed, to quality service, to pay no more than the correct amount of tax, and to fair and just tax system.*

### Complex Military Tax Issues Warrant a Dedicated IRS Toll-Free Telephone Line for Service Members and Their Families, Both In and Out of Tax Season

Military OneSource is a DoD-funded program that provides service members and their families free or reduced cost tax filing.<sup>89</sup> In FY 2016, service members and their families filed more than 200,000 federal and state tax returns through Military OneSource.<sup>90</sup> Additionally, Military OneSource tax consultants conducted over 17,000 telephonic tax counseling sessions.<sup>91</sup> One of the most helpful aspects of the program is specialized phone support available to all service members. Consultants are available

84 For the first time in many years, SPEC will not be traveling to South Korea to deliver VITA training for the 2018 tax filing season, citing personal safety concerns for their employees. See email communication to TAS from SPEC Director (Sept. 7, 2017) (on file with TAS); email communication to TAS from SPEC Senior Tax Analyst (Sept. 29, 2017) (on file with TAS). Instead, the IRS will offer webcaster VITA training to personnel in South Korea. See email communication to TAS from Tax Counsel, Under Secretary of Defense (USD), Personnel and Readiness (P&R), Legal Policy, Pentagon (Dec. 15, 2017) (on file with TAS). Notably, there are approximately 20,000 service members and 23,800 U.S. civilians living, at the invitation of the U.S. Government, in South Korea. The DoD, at least currently, is actively assigning and moving these employees and families to South Korea and has deemed it safe to do so. Email communication to TAS from Director, Armed Forces Tax Council, Office of the Secretary of Defense, Department of Defense (Sept. 8, 2017) (on file with TAS).

85 Generally, these are uniformed attorneys, although civilian DoD attorneys working abroad may step in to teach tax law.

86 The U.S. attorneys may be either civilian or military attorneys.

87 Email communication to TAS from Chief, Personnel, Plans & Training Office, Office of the Judge Advocate General, United States Army (Sept. 26, 2017) (on file with TAS).

88 Budget constraints have also made it difficult for the IRS to provide in-person training for military VITA volunteers domestically. As such, SPEC has teamed up with the American Bar Association (ABA) Section of Taxation and law firms in recent years to instruct tax law to military VITA personnel, who prepare returns for other military personnel and their dependents. Although this model appears to work for many installations, the ABA struggles to continually recruit lawyers for these pro bono opportunities. See American Bar Association's description of the Adopt-a-Base Program at [https://www.americanbar.org/groups/taxation/tax\\_pro\\_bono/assist\\_service\\_members.html](https://www.americanbar.org/groups/taxation/tax_pro_bono/assist_service_members.html). See also C. Well Hall, III, *Uncle Sam: We Need a Few Good Tax Lawyers — Military VITA Training Opportunities Through the "Adopt-A-Base" Program*, ABA Section of Taxation NewsQuarterly, 10-12 (Spring 2015).

89 Military OneSource provides a variety of service resources to active-duty service members, to include free federal and state tax preparation through H&R Block software. There are no income nor age restrictions for service members and their families. See IRM 22.30.1.3.1.1.10, *Facilitated Self Assistance Software Programs* (Sept. 26, 2016).

90 Email communication to TAS from Branch Chief, Administration and Communication, Office of the Assistant Secretary of Defense, the office that administers the Military OneSource program (Sept. 11, 2017) (on file with TAS).

91 *Id.*

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Even if service members stationed abroad were some of the lucky 40 percent who got through to the IRS, they cannot be confident the IRS employees on the other end of the line understand their issue.

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January through October. However, these consultants are neither tax attorneys nor tax preparers and can answer only basic procedural questions.

Each year, the IRS receives more than 100 million telephone calls on its toll-free lines, roughly five million taxpayer visits in its taxpayer assistance centers (TACs), and some ten million pieces of correspondence from taxpayers responding to proposed adjustment notices.<sup>92</sup> The IRS received about 8.6 million calls on its “Installment Agreement/Balance Due” line, which taxpayers generally call if they cannot pay their tax liabilities in full and are seeking to arrange a payment plan.<sup>93</sup> The IRS answered 42 percent of these calls during FY 2017 (down from 44 percent in FY 2016), and wait times increased from 22 minutes in FY 2016 to 33 minutes in FY 2017.<sup>94</sup>

Service members face uncommon tax law questions about complex tax issues, including questions associated with return filing, audits, math error adjustments, penalty assessments, and collection issues. Even if service members stationed abroad were some of the lucky 40 percent who got through to the IRS, they cannot be confident the IRS employees on the other end of the line understand their issue. Additionally, military taxpayers stationed abroad generally cannot call U.S. toll-free telephone lines.<sup>95</sup> Moreover, because service members have until June 15 each year to file their tax returns, and IRS employees are prohibited from answering any tax law questions outside the domestic filing season (January 1–April 15), there are two months that service members have nowhere to turn *during the overseas filing season*.<sup>96</sup> This does not even take into account the additional six months outside the filing season, during which they have few tax resources available to them.

## CONCLUSION

Military tax law is a very complicated area of tax law, and members of the military and their families face unusual difficulties in meeting their tax obligations. To better address the complexity of these issues, the IRS should provide accurate, up-to-date information for military taxpayers. Ample funds should be provided to SPEC for the specific purpose of training military tax preparers at overseas locations, as well as hiring veterans who are specifically charged with outreach, education, and training for military taxpayers. There needs to be a dedicated service line for the military, staffed with people familiar with the various provisions, exclusions, and exceptions, who can route the service member taxpayer to the place he or she can go to resolve issues quickly. Additionally, there should be a specific individual in the IRS who is charged with updating the information geared towards service members on irs.gov, to keep it current with developments in this important area of the law. The IRS should strive to be a part of the military community and display a desire to work with and educate service members. By

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92 National Taxpayer Advocate Fiscal Year 2018 Objectives Report to Congress 6-28.

93 IRS, JOC, Snapshot Reports: Product Line Detail Snapshot (week ending Sept. 30, 2017).

94 *Id.*

95 National Taxpayer Advocate Fiscal Year 2018 Objectives Report to Congress 6, 27.

96 Service members stationed abroad for the entire tax year are automatically granted two more months, until June 15, to file their returns. See Treas. Reg. § 1.6081-5(a)(6); see also IRS Pub. 3, *Armed Forces' Tax Guide* (Dec. 2016).

doing so, the IRS will assist a significant number of taxpayers with noteworthy and oftentimes complex tax issues, thereby building trust and improving compliance among this population.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Assign a dedicated IRS employee to routinely update the military information on irs.gov website.
2. Create a special unit of SPEC staffed with veterans whose responsibilities are to develop and conduct outreach, education, and assistance to current military taxpayers, including National Guard and Reservists, and to those organizations that provide tax assistance to these taxpayers.
3. Allocate ample funding for SPEC to provide face-to-face training for military VITA volunteers in overseas locations.
4. Provide a year-round dedicated toll-free telephone line for service members and their families to answer tax law and filing questions, and to resolve their tax account and compliance issues.

**MSP  
#14****SHARING ECONOMY: Participants in the Sharing Economy Lack Adequate Guidance From the IRS****RESPONSIBLE OFFICIAL**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

The “sharing” economy (also known as the gig economy) can be described as “collaborative consumption” or a “peer-to-peer market” that links a willing provider to a consumer of goods or services (coordinated through a community-based online service). Typically, there are three parties involved in a sharing economy transaction. Here, we will refer to them as *service providers* (the freelancers who provide the goods or services), *service recipients* (the consumers of such good or services), and *service coordinators* (the third-party platforms that facilitate the transactions).

A 2016 survey of members of the National Association of the Self-Employed (NASE) revealed that:

- 34 percent of those who reported earning income in the sharing economy did not know they needed to file quarterly estimated tax payments;
- 36 percent did not understand what records they would need to maintain as a small business for tax purposes;
- 43 percent did not set aside money to meet their tax obligations or know how much they owed; and
- 69 percent did not receive any tax information from the sharing economy platform they used to earn their income.<sup>2</sup>

These results demonstrate both the need for guidance from the IRS and the opportunity to create a culture of tax compliance among participants in the sharing economy from the outset. Establishing the tax compliance norms for this emerging sharing economy industry in its infancy will assist the IRS as this segment of taxpayers grows.

1 See Taxpayer Bill of Rights (TBOR), <http://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)).

2 Written statement of Caroline Bruckner, Managing Director, Kogod Tax Policy Center (May 17, 2016). In this survey, 22 percent of respondents reported earning income in the sharing economy. The statistics reported above are percentages of those who reported earning income in the sharing economy. See Caroline Bruckner, *Shortchanged: The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy* (May 2016).

## ANALYSIS OF THE PROBLEM

Proponents of the sharing economy believe it promotes marketplace efficiency by enabling individuals to generate revenue from assets while the assets are not being used personally. For example, a vacation home owner may rent out her home while she is not using it. Peer-to-peer services not only include short-term home rentals (Airbnb) and shared car services (Uber and Lyft), but also:

- Sharing a back seat with strangers (Hitch);
- Short-term car rentals (Relayrides);
- Selling handmade or vintage items (Etsy);
- Providing household errands (TaskRabbit); and
- Providing cleaning and greeting services to Airbnb properties (Happy Host).

Service providers in the sharing economy may not fit the mold of the traditional employee who works “9-to-5” for a singular boss and receives a Form W-2, *Wage and Tax Statement*, from an employer. Rather, they may view themselves as contingent workers or freelancers, serving hundreds of service recipients but with no set schedule. The sharing economy often includes an additional party in transactions — the service coordinator — which may or may not provide a Form 1099-MISC, *Miscellaneous Income*, to the service provider.

### Scope of the Sharing Economy

According to a 2016 Pew Research Center survey, nearly a quarter of the U.S. population earned money from the sharing economy.<sup>3</sup> About eight percent of Americans earned money using digital platforms to perform a job or task; 18 percent earned money selling something online, and one percent rented out properties on a home-sharing site.<sup>4</sup> Revenue from the sharing economy is projected to increase from \$15 billion internationally in 2013 to \$335 billion by 2025.<sup>5</sup>

Although it may be growing at a healthy rate, the sharing economy may not be lucrative for all or most service providers in the sector. On the contrary, data show that the vast majority of gig workers — 85 percent — make less than \$500 per month.<sup>6</sup> When taxpayers take on multiple gigs to help make ends meet, it makes tax compliance even more difficult; they receive information returns from multiple sources, so it may be difficult to track and allocate expenses.

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**Establishing the tax compliance norms for this emerging sharing economy industry in its infancy will assist the IRS as this segment of taxpayers grows.**

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3 Pew Research Center, *Gig Work, Online Selling and Home Sharing* (Nov. 17, 2016), [www.pewinternet.org/2016/11/17/gig-work-online-selling-and-home-sharing/](http://www.pewinternet.org/2016/11/17/gig-work-online-selling-and-home-sharing/).

4 *Id.*

5 Pricewaterhouse Coopers, *The Sharing Economy 14* (2015), <https://www.pwc.com/us/en/technology/publications/assets/pwc-consumer-intelligence-series-the-sharing-economy.pdf>.

6 Washington Post, *Side Hustles Are the New Norm* (July 3, 2017).

There are many reasons why the sharing economy has grown as much as it has.

- **Cost.** It is often less costly for service recipients to use services offered by providers who identify as independent contractors than to use services offered by traditional businesses with employees. Employers are required to pay employment taxes for employees, and many offer costly benefits to full-time employees (such as retirement plans, paid leave, and health insurance). By classifying service providers as independent contractors, service coordinators in the sharing economy can avoid these expenses and pass the savings along to service recipients.
- **Technology.** With mobile networks and smartphone apps, a sharing economy can tap pools of latent labor supply, allowing service providers to deliver in real-time. Service providers in the sharing economy can select engagements based upon how each job fits their own priorities and skills.
- **Lifestyle.** Service providers in a sharing economy enjoy greater flexibility, control, and variety than their full-time employed counterparts. For example, an Uber driver has the ability to work only when it makes sense for his schedule, whereas a full-time taxi driver may have to adhere to rigid schedules set by the employer.

### Participants in the Sharing Economy May Not Fully Understand Their Tax Obligations

Understandably, many of the new service providers in a sharing economy may not fully comprehend their tax filing obligations or have any experience with the requisite tax record-keeping. These new entrants to the sharing economy will need to spend significant time learning about their tax compliance obligations and to devote many hours to recordkeeping. For example, the IRS estimates that it takes taxpayers nearly 40 hours to learn about depreciation methods, keep records, and report the depreciation to the IRS.<sup>7</sup> Yet, according to a recent survey conducted by NASE, 69 percent of entrepreneurs who participate in the sharing economy received absolutely no tax guidance from the companies with which they work.<sup>8</sup>

When looking at noncompliance, it is important to distinguish between the various types of noncompliance the IRS encounters. Not all noncompliant taxpayers are willfully noncompliant; many of them are tripped up by “unknowing” or “lazy” noncompliance.<sup>9</sup> That is, some taxpayers are simply unaware of their tax compliance obligations. The NASE survey results underscore the importance of educating sharing-economy entrepreneurs and merchants that they are operating a self-employed, small business and need to understand certain basic tax obligations (*i.e.*, making required quarterly estimated payments throughout the year to avoid penalties).

Much of the compliance burden can be alleviated if tax is collected by third parties and reported to the IRS and to the service providers. This works well for workers in an employee/employer relationship — the employer withholds income and employment taxes throughout the year and provides a Form W-2 to

7 See 2016 Instructions to Form 4562, *Depreciation and Amortization*. The IRS makes the following estimates for completing this form:

Recordkeeping .....	30 hr., 22 min.
Learning about the law or the form .....	4 hr., 16 min.
Preparing and sending the form to the IRS .....	4 hr., 58 min.

8 National Association of the Self-Employed (NASE), [http://www.nase.org/about-us/Nase\\_News/2016/04/29/nase-releases-new-survey-data-on-sharing-economy](http://www.nase.org/about-us/Nase_News/2016/04/29/nase-releases-new-survey-data-on-sharing-economy). The survey was sent in March 2016 to more than 40,000 small businesses and received over 500 responses, mainly from the self-employed, about their participation in the sharing economy.

9 Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 U. KAN. L. REV. 1145 (2003).



the employer and the IRS after the close of the year. In fact, IRS tax gap data shows that 99 percent of wages subject to withholding and third-party information reporting is reported by taxpayers to the IRS.<sup>10</sup>

For workers who fall outside the parameters of a traditional employee/employer relationship, the process may get more complicated. A driver of a shared car service may receive a Form 1099-MISC in January, reporting the gross amount received in fares for the prior year, but the issuer of the Form 1099-MISC typically has not done any withholding. The service provider may not have been aware of the consequences of being classified as a non-employee and may not have set aside money for self-employment tax or made quarterly estimated payments. Other service providers in a sharing economy may not receive any information reporting from the service coordinators.<sup>11</sup> A 2016 survey found that only 32 percent of sharing economy service providers receive information reporting via Form 1099-K, *Payment Card and Third Party Network Transactions*, or Form 1099-MISC from their service coordinators — perhaps because coordinators are wary of being classified as employers.<sup>12</sup>

### Service Providers in the Sharing Economy Have Turned to Online Forums for Tax Advice

The IRS has not issued industry-specific guidance outlining the common tax issues faced by participants of the sharing economy. Because of this vacuum, many service providers have turned to the internet to ask tax-related questions.

For example, many Uber drivers engage in an online forum where they can share information about or solicit advice on a wide range of topics.<sup>13</sup> There is even a sub-forum dedicated to tax compliance, focused on “1099 income, deductions, and the IRS.”<sup>14</sup> Similarly, Airbnb hosts have created an online forum where hosts can share advice with other hosts, and there is a sub-forum dedicated to “Regulations/Tax Issues.”<sup>15</sup>

There are certain advantages that these online forums enjoy over traditional sources of tax content. First, internet discussion forums can provide a real-time picture of the tax and related issues that concern ridesharing drivers. There is instantaneous reaction to an online post from other forum members who may have had similar experiences. Second, the anonymous nature of these forums may cause forum participants to be more candid and forthright than they might be in face-to-face discussions. Third, the back-and-forth nature of the discussion can flesh out and identify related issues, more so than a static IRS publication could.

However, there are some major risks for service providers in the sharing economy in relying on information or advice gleaned from online forums. The information or advice may be incorrect, yet accepted by the group as correct. This can easily occur when the facts of one taxpayer’s circumstances

10 IRS, *Tax Gap Estimates for Tax Years 2008-2010* (Apr. 2016).

11 The IRS requires payors to issue Form 1099-K, *Payment Card and Third Party Network Transactions*, only when the total number of transactions exceed 200 and the aggregate value exceeds \$20,000 in a calendar year. See IRC § 6050W(e). Senator John Thune recently introduced legislation that would lower the threshold to \$1,000 for payors to report payments on Form 1099-K, while raising the threshold for reporting payments to service providers on Form 1099-MISC to \$1,000 (up from \$600). See New Economy Work to Guarantee Independence and Growth Act of 2017, S. 1549, 115th Cong. (2017).

12 See Caroline Bruckner, *Shortchanged: The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy* 10 (May 2016). The National Taxpayer Advocate has proposed legislative recommendations to allow voluntary withholding on payments made to independent contractors. See Legislative Recommendation: *Amend Internal Revenue Code Section 3402(p) to Allow Voluntary Withholding for Independent Contractors*, *infra*; National Taxpayer Advocate 2007 Annual Report to Congress 493-94; National Taxpayer Advocate 2005 Annual Report to Congress 69.

13 See [www.uberpeople.net](http://www.uberpeople.net) (last visited Nov. 28, 2017).

14 See <http://uberpeople.net/forums/Taxes/> (last visited Nov. 28, 2017).

15 See <http://airhostsforum.com/c/regulations-tax-issues> (last visited Nov. 28, 2017).

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If we operate under the premise that most taxpayers want to comply with the law, the IRS needs to expand its presence within the sharing economy to enable that compliance.

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differ in a slight, but significant, way from the situation discussed in an online forum. Furthermore, anti-government/anti-IRS sentiment may skew the forum discussion, to the point where high-risk tax-avoidance techniques may be accepted as norms.

Rather than ignore the existence of these online forums and the benefits they provide, the IRS should take an active role in such discussions. Certainly, the IRS could not provide specific tax advice through online forums and discussion groups, but it could answer general questions, link to the IRS website for relevant information, and provide the phone number for IRS assistors when appropriate. If the IRS wants to be really bold and proactive, it could designate a representative to respond to questions on a Reddit forum for Airbnb or Uber users. A benefit of these exchanges is that the IRS will learn about specific challenges and issues facing this segment of the economy and thereby do a better job of tailoring its guidance for both taxpayers and IRS employees. It is clear there is a segment of the sharing economy that seeks guidance on how to comply with their tax obligations. By proactively engaging in the discussion, the IRS can positively shape the norm for participants in the sharing economy.

### The IRS Should Expand Its Education and Outreach to Sharing Economy Participants

If we operate under the premise that most taxpayers want to comply with the law, the IRS needs to expand its presence within the sharing economy to enable that compliance. Providers of services want to be educated about what is expected of them. There are many ways the IRS can provide improved taxpayer service to this growing sector.

The IRS could get more creative in repackaging existing content and tailoring it for participants in a sharing economy. For example, the IRS currently releases Publication 527, *Residential Rental Property*,<sup>16</sup> and Publication 463, *Travel, Entertainment, Gift, and Car Expenses*,<sup>17</sup> each year. While these publications contain helpful information, an Airbnb host would have to sift through the 24-page Publication 527, and an Uber driver would have to navigate through the 50-page Publication 463, and they still might not understand how these rules apply to themselves as service providers in a sharing economy.

This new publication for sharing economy participants need not be long and all-encompassing, but it should at a minimum provide a checklist of issues that first-time, self-employed persons participating in the sharing economy should be aware of. For example, this new publication should include information about the need to make estimated payments of income and employment taxes. It should also explain that self-employed persons pay both the employee and employer shares of employment taxes. The new publication should mention that self-employed persons generally need to file a Schedule C and generally may deduct expenses (*e.g.*, actual vehicle expenses for Uber drivers, or a standard vehicle expense based on mileage), provided they keep contemporaneous and accurate records. This new sharing economy publication should cross reference other IRS publications that provide more detail on these and a

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<sup>16</sup> See <https://www.irs.gov/pub/irs-pdf/p527.pdf>.

<sup>17</sup> See <https://www.irs.gov/pub/irs-pdf/p463.pdf>.

few other issues that are relevant to service providers in a sharing economy. To be evenhanded, the publication should also briefly explain the factors underlying worker classification and cross-reference other IRS materials on that topic.

In addition, the IRS should consider developing a one-page brochure that touches on some very basic points relevant to service providers in a shared economy. For example, this brochure can point out the significant difference in tax treatment when a home is rented out for 14 days or less per year versus a home that is rented by an Airbnb host for more than 14 days.<sup>18</sup> This brochure could contain a link to the new publication on the sharing economy. The IRS should require third-party service coordinators to provide this brochure to service providers at the same time they receive the Form W-9, *Request for Taxpayer Identification Number and Certification*, along with the taxpayer identification number from the service provider.

The IRS recently created a dedicated web page containing tax tips for participants in a sharing economy.<sup>19</sup> The IRS could develop a series of webinars on topics of interest to participants in the sharing economy, and host them on the sharing economy web page. The IRS should develop a Frequently Asked Questions (FAQs) section that is updated periodically. The IRS should also designate liaisons to monitor online forums to identify emerging issues for the sharing economy and address them via FAQs while the IRS develops more formal guidance. (FAQs should not be a substitute for formal guidance.)

If the IRS wanted to be even more helpful, it could create and host an online “wizard” — a tool that could be extremely helpful to participants in the sharing economy. TAS is exploring doing just that, but we would welcome IRS involvement. Such an online wizard could walk taxpayers who are newly self-employed through the various steps one needs to take (*e.g.*, obtain an employer identification number, make estimated payments, keep books and records). It could contain a downloadable mileage log app for taxpayers to use, with pre-populated mileage rates for a given year. The IRS could develop a user-friendly calendar function that permits taxpayers to add the estimated tax payment due dates to their smartphone calendars. In past Reports to Congress, we have suggested that the IRS work with the Electronic Federal Tax Payment System to make it more user friendly (*e.g.*, allow taxpayers to schedule estimated tax payments with greater frequency).<sup>20</sup> There are many ways the IRS can embrace technology to deliver services that taxpayers need.

Taxpayers who attempt to reach the IRS with tax law questions should be able to speak to someone about their substantive tax issue. Driving taxpayers to online content may be the desired goal of the IRS’s “Future State” plan, but there are times when a taxpayer needs to speak to a live assistor. Congress needs to provide the resources for the IRS to properly staff its phone lines to achieve an acceptable level of service, and it needs to hold the IRS accountable for answering tax law questions via the phone all

18 For someone using a dwelling unit for both rental and personal purposes, the tax treatment of the rental expenses depends on how many days the dwelling unit was rented out during the year. If the property is rented less than 15 days during the year, income from the rental shall not be included in the gross income of the taxpayer (and rental expenses may not be deducted). See IRC § 280A(g); IRS, Publication 527, *Residential Rental Property* 3.

19 See [www.irs.gov/sharing](http://www.irs.gov/sharing) (last visited Nov. 28, 2017).

20 National Taxpayer Advocate 2007 Annual Report to Congress 43-44.

year round. There should be no reason for such questions to be deemed “out of scope.”<sup>21</sup> We are asking taxpayers to voluntarily comply with their tax obligations, and the IRS should be there to pick up the phone and answer questions.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Develop and publicize new guidance for sharing economy participants that includes a publication and a checklist of issues of which first-time, self-employed persons participating in the sharing economy should be aware.
2. Create a one-page brochure touching on some basic points relevant to service providers in a sharing economy and containing a link to the resources available for sharing economy participants.
3. Require third-party service coordinators to provide the one-page brochure on the service economy to service providers at the same time they receive the Form W-9, *Request for Taxpayer Identification Number and Certification*, from the service provider.
4. Partner with TAS to develop an online wizard for taxpayers in the sharing economy, which may include interactive online tools such as a mileage log app or an estimated tax payment calculator.
5. Designate liaisons to participate in online forums to identify emerging issues for sharing economy participants.

21 Internal Revenue Manual (IRM) 21.1.1, *Accounts Management and Compliance Services Operations, Accounts Management and Compliance Services Overview* (Oct. 1, 2017), provides instructions regarding the kinds of questions IRS customer service representatives may answer. IRM 21.1.1.3.1 (Jan. 15, 2016) provides that “the areas discussed below are beyond the level of service (out of scope) that CAS, Accounts Management will provide:

- ◆ Tax form and schedule preparation
- ◆ Tax planning
- ◆ Legal opinions
- ◆ Highly complex tax issues (limited service).”

Exhibit 21.1.1-1 (Oct. 1, 2017) contains a list of out-of-scope topics and forms. Out-of-scope items include entity classification, e-commerce, depreciation and amortization (including Section 179 deductions), and questions about tax software.

MSP  
#15**INTERNATIONAL: The IRS's Approach to Credit and Refund Claims of Nonresident Aliens Wastes Resources and Burdens Compliant Taxpayers****RESPONSIBLE OFFICIAL**

Douglas W. O'Donnell, Commissioner, Large Business and International Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

Under Internal Revenue Code (IRC) §§ 1441-1443 and 1461-1465 (Chapter 3), the IRS imposes withholding on payments made to nonresident aliens and foreign corporations and allows credits and refunds of the amounts to which these taxpayers are entitled.<sup>2</sup> For many years, the operation of this regime closely paralleled the approach taken by the IRS with respect to domestic withholding under IRC § 31 in that there were no restrictions limiting credits or refunds to the amount of withheld tax actually paid over to the IRS.<sup>3</sup> Based on generalized concerns regarding the potential for fraud and systematic noncompliance, however, in 2015, the IRS altered its administrative policy regarding Chapter 3 refunds.<sup>4</sup> It no longer allows credits and refunds when taxpayers can prove withholding has occurred, as is the practice in the domestic employment tax context. Instead, the IRS now grants credits and refunds only when the information on Forms 1040NR, *U.S. Nonresident Alien Income Tax Return*, substantially matches the information on Forms 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, issued directly to the IRS by withholding agents.<sup>5</sup> (Hereafter, nonresident aliens seeking

- 1 See Taxpayer Bill of Rights (TBOR), <http://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)).
- 2 See Treas. Reg. §§ 1.1441-2; 1.1464-1. Those payors charged with the responsibility of undertaking this withholding are referred to as "withholding agents." Treas. Reg. § 1.1441-7(a). Often, the administrative tasks of withholding and reporting are outsourced to third parties, but ultimate legal responsibility for these duties remains with the individual or company on whose behalf they were undertaken. IRC § 1461.
- 3 For a discussion of prior IRS practice in the processing of Chapter 3 refund claims, see Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2010-40-121, *Improvements Are Needed to Verify Refunds to Nonresident Aliens Before the Refunds are Sent Out of the United States* 6 (Sept. 2010).
- 4 National Taxpayer Advocate 2015 Annual Report to Congress 346-47. Refunds under Chapter 4 (IRC §§ 1471-1474) follow the procedures for such refunds set forth with respect to Chapter 3. See IRC § 1474(b)(1).
- 5 IRM 21.8.1.11.14.3, *FATCA – 1042-S Matching Program – General Information – Identifying Related Letters, Transaction Codes, Reason Codes, 1042-S Data Fields* (Oct. 1, 2017); IRM 21.8.1.11.14.5(4), *FATCA Matching Program Form 1042-S Credit Denials – Accounts Management Telephone/Written Inquiries – Letter 5904C* (Oct. 1, 2017). Note that many of the procedures and some of the concerns discussed in this Most Serious Problem apply equally to foreign corporations filing Forms 1120-F, *U.S. Income Tax Return of a Foreign Corporation*, but these foreign corporations are not the focus of this analysis, as they also present distinct analytical and administrative issues from those arising in the case of individual nonresident aliens.

these credits and refunds associated with Forms 1042-S will be referred to, for simplicity, as “1042-S filers.”)

Without an analytic foundation, the IRS took the drastic step of freezing refund claims of 1042-S filers for up to one year or longer while attempting to match the documentation provided by taxpayers with the documentation provided by withholding agents.<sup>6</sup> The IRS did this even though most 1042-S filers (nearly 80 percent) claim relatively small dollar amounts of withholding (an average of approximately \$1,100).<sup>7</sup> Further, as a group, 1042-S filers appear to be substantially more compliant than a comparable portion of the U.S. taxpayer population.<sup>8</sup> The IRS ultimately released these frozen refunds, which impacted over 100,000 taxpayers, after the systemic matching program yielded so many “false positives” that it proved untenable.<sup>9</sup> The IRS is now redesigning this program.<sup>10</sup> Nevertheless, only the tools and the processes are being revised, while the program’s philosophy remains unchanged and its underlying assumptions unchallenged. The IRS continues to treat 1042-S filers as “tax cheats” anytime a mismatch arises, even if that mismatch is beyond the taxpayer’s control or is based on some other good-faith error.

As a result, the National Taxpayer Advocate is concerned that:

- The IRS’s current approach to 1042-S filers does not appear to be based on analysis of quantitative evidence;
- The IRS is wasting resources and needlessly burdening taxpayers by its undifferentiated approach to 1042-S filers;
- The IRS has demonstrated a reluctance to enforce compliance among Form 1042-S withholding agents, even though it generally has the ability to do so; and
- The IRS position of forcing nonresident taxpayers to shoulder the burden of their withholding agents’ reporting and compliance may be subject to litigation hazards under *Portillo* and other naked assessment cases.

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**The IRS continues to treat 1042-S filers as “tax cheats” anytime a mismatch arises, even if that mismatch is beyond the taxpayer’s control or is based on some other good-faith error.**

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6 National Taxpayer Advocate 2016 Annual Report to Congress 220-29; National Taxpayer Advocate 2015 Annual Report to Congress 346-52.

7 TAS Research, Compliance Data Warehouse (CDW), data drawn Oct. 12, 2017. These numbers represent an annual average derived from the 2013, 2014, and 2015 tax years.

8 *Id.*

9 National Taxpayer Advocate 2016 Annual Report to Congress 221; IRS, *IRS Takes Steps to Help Students; Outlines Interim Process for Obtaining Refunds of Withholding Tax Reported on Form 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding* (June 6, 2016), <https://www.irs.gov/uac/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042s-foreign-persons-us-source-income-subject-to-withholding>.

10 The systemic matching program previously employed by the IRS relied on a semi-automated tool, supplemented by manual review of taxpayer returns and forms where necessary. The systemic matching program was suspended because the semi-automated tool generated a significant false-positive rate, resulting in an overwhelming need for manual review. *Id.* TAS’s understanding is that this manual review is continuing on a more limited basis, but that, as part of its redesigned program, the IRS hopes to reintroduce a mechanism for automated matching.

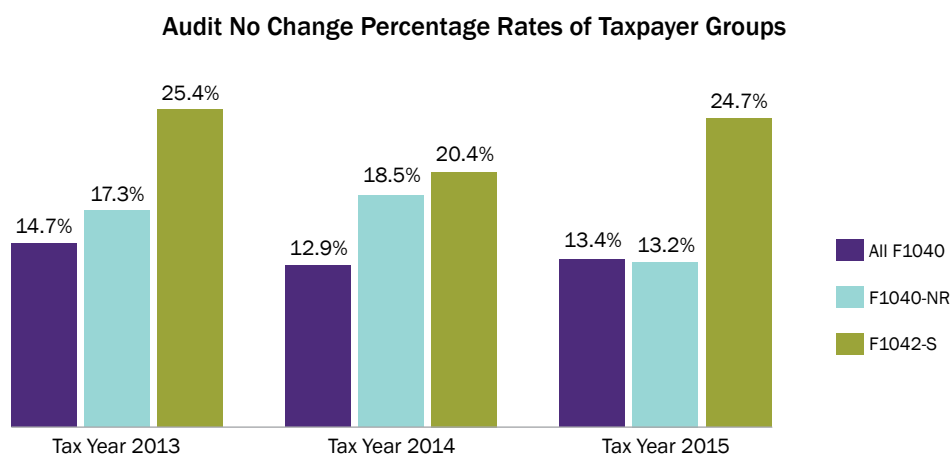
## ANALYSIS OF PROBLEM

### The IRS's Current Approach to 1042-S Filers Does Not Appear to Be Based on Analysis of Quantitative Evidence

The IRS is faced with legitimate challenges regarding information reporting and collection of taxes with respect to nonresident aliens and offshore accounts.<sup>11</sup> Nevertheless, the IRS has not, to TAS's knowledge, yet developed comprehensive statistical data establishing the existence and nature of widespread fraud or noncompliance on the part of 1042-S filers.<sup>12</sup> This lack of information has caused the IRS to adopt a broad-brush approach, which generates tax administration prone to inequities, inefficiencies, and inaccurate assumptions.

In contrast to the blanket fears of the IRS, TAS analysis indicates that the vast majority of taxpayers who file income tax returns associated with a Form 1042-S actually appear to be substantially more compliant than a comparable portion of the overall U.S. taxpayer population. In part, TAS bases this determination on an examination of data relating to reporting compliance. For example, for tax years (TY) 2013, 2014, and 2015, the "no change" rate for cases involving audits of 1042-S filers exceeded the audit "no change" rate for all Form 1040-NR filers as well as for all Form 1040 filers.<sup>13</sup> This comparison can be seen in Figure 1.15.1.

**FIGURE 1.15.1**<sup>14</sup>



11 TIGTA, Ref. No. 2010-40-121, *Improvements Are Needed to Verify Refunds to Non-resident Aliens Before the Refunds Are Sent out of the United States* 6 (Sept. 2010).

12 Large Business & International (LB&I) response to TAS information request (July 5, 2017); LB&I response to TAS information request (Sept. 6, 2016). In its responses, LB&I refers to a TIGTA report from September 2013, which ultimately was determined to be TIGTA Ref. No. 2013-40-083, *Income and Withholding Verification Processes Are Resulting in the Issuance of Potentially Fraudulent Tax Refunds* (Aug. 7, 2013). This report, however, does not address Form 1042-S filers.

13 TAS Research, CDW, data drawn Nov. 1, 2017. The selection criteria used to identify returns for audits sometimes varies across these filing groups. LB&I response to TAS fact check request (Nov. 16, 2017).

14 TAS Research, CDW, data drawn Oct. 16, 2017.

Further, 1042-S filers have a lower percentage of high-scoring Discriminant Index Function (DIF) returns in comparison to filers overall.<sup>15</sup> Since high-scoring DIF returns generally indicate compliance issues, while low-scoring DIF returns signify a more compliant group of taxpayers, this measure likewise furnishes evidence that 1042-S filers as a group are not a high-risk population.

This conclusion is further supported by the circumstance that the increased scrutiny generated by the Form 1042-S systemic matching program does not appear to have resulted in a drop in the number of claims by 1042-S filers. If a significant portion of 1042-S filers had been engaging in fraud or systematic noncompliance, it would follow that the enhanced IRS vigilance in this area would result in a reduced volume of Form 1042-S claims. By contrast, the number of 1042-S filers making credit claims has remained remarkably consistent between processing year (PY) 2013 and PY 2016, the last year for which complete data is available.<sup>16</sup> Indeed, the aggregate dollar value of these claims has increased every year.<sup>17</sup> Figure 1.15.2 elaborates on this claim activity.

**FIGURE 1.15.2, Form 1042-S Claim Activity<sup>18</sup>**

Processing Year	Number of Returns	Aggregate Credits
2013	73,054	\$ 336,803,000
2014	73,038	\$ 384,249,000
2015	73,734	\$ 420,906,000
2016	72,702	\$ 546,167,000

### The IRS Is Wasting Resources and Needlessly Burdening Taxpayers by Its Undifferentiated Approach to 1042-S Filers

As demonstrated above, the majority of 1042-S filers present little risk of noncompliance or revenue loss. As a result, applying a “one-size-fits-all” model of tax administration in this context will continue to disadvantage nonresident taxpayers, poorly allocate scarce funding, and undermine related IRS enforcement efforts.

Instead, the IRS should focus on high-risk taxpayer categories that would benefit from increased scrutiny and enforcement activity.<sup>19</sup> For example, 86 percent of the 1042-S filers in one Total Positive Income (TPI) class show DIF scores that are suggestive of potential noncompliance.<sup>20</sup> On the other hand, only one percent of those in a different TPI class, which encompasses over 80 percent of all 1042-S filers,

15 TAS Research, CDW, data drawn Nov. 1, 2017. These Discriminant Index Function (DIF) scores are for tax year (TY) 2015, which is the last year for which relatively complete data is available. High-scoring DIF returns are generally defined as those falling within the top five percentile.

16 TAS Research, CDW, data drawn Nov. 20, 2017. The term “processing year” denotes all filings made during a given calendar year, regardless of the tax years to which they relate. For instance, processing year 2017 runs from January 1, 2016 through December 31, 2016.

17 TAS Research, CDW, data drawn Nov. 20, 2017.

18 *Id.*

19 This focus could, in part, be pursued by applying an improved version of the Return Integrity and Compliance Services Integrity and Verification Operation, as used in the domestic context. See IRM 25.25.1.1 (Feb. 19, 2015). See also National Taxpayer Advocate 2016 Annual Report to Congress 223; National Taxpayer Advocate 2016 Annual Report to Congress 151-60.

20 Total Positive Income (TPI) class 80. TAS Research, CDW, data drawn Nov. 1, 2017. These DIF scores are for TY 2015, which is the last year for which relatively complete data is available.

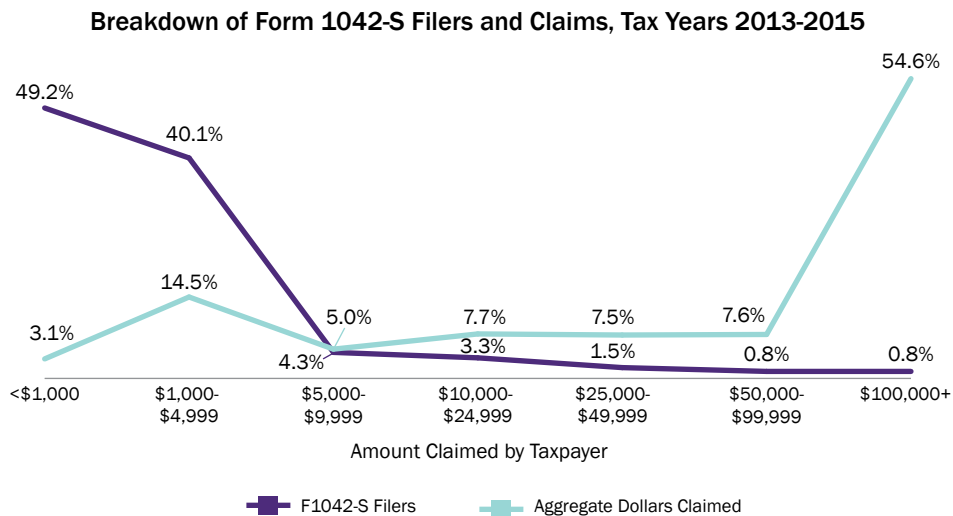


possess a DIF score indicative of noncompliance.<sup>21</sup> While DIF scores are not always conclusive measures of compliance, at a minimum, they provide useful data that the IRS could employ to more efficiently and effectively narrow its oversight efforts.

Also, most 1042-S filers (nearly 80 percent) claim relatively small dollar amounts of withholding (an average of approximately \$1,100).<sup>22</sup> These individual filings can never be completely ignored, as, in the aggregate, they represent a statistically significant portion of the Form 1042-S credits and refunds sought on an annual basis (approximately 11 percent of total dollars).<sup>23</sup> Nevertheless, absent the development of an accurate, timely, and seamless review mechanism, occasional, random examinations of these returns would seem most cost-effective and proportionate, and consistent with sound tax administration practices.

Conversely, a small group of 1042-S filers (less than five percent) claim nearly 74 percent of the credits measured in terms of dollars.<sup>24</sup> The minimal size of this group and the high revenue risk it represents justify more focussed scrutiny. Figure 1.15.3 depicts these relationships.

**FIGURE 1.15.3**<sup>25</sup>



21 TPI class 72. TAS Research, CDW, data drawn Nov. 1, 2017. These DIF scores are for TY 2015, which is the last year for which relatively complete data is available.

22 TAS Research, CDW, data drawn Nov. 1, 2017. These numbers represent an annual average derived from the 2013, 2014, and 2015 tax years.

23 *Id.*

24 *Id.*

25 *Id.*

Moreover, a variety of income sources, ranging from compensation for dependent services to gambling winnings to scholarship and fellowship grants to dividend payments, are associated with significant Form 1042-S credit claims.<sup>26</sup> An analysis aimed at determining the intersection between compliance behavior and revenue risk associated with these income sources could provide some additional insight for fashioning a more tailored oversight regime that is less onerous for taxpayers and more resource-efficient for the government.

### The IRS Has Demonstrated a Reluctance to Enforce Compliance Against Form 1042-S Withholding Agents, Even Though It Generally Has the Ability to Do So

The IRS is primarily concerned that 1042-S filers might attempt to obtain refunds of amounts not remitted to the IRS by withholding agents. This concern has some validity, as approximately \$700 million of taxes for which withholding agents were liable went uncollected by the IRS from both domestic and foreign withholding agents in TY 2015.<sup>27</sup> Figure 1.15.4 details this information.

**FIGURE 1.15.4, Withholding and Remittance Data in Millions of Dollars for Tax Year 2015<sup>28</sup>**

Withholding Agent	Domestic	Foreign	Total
Number	39,963	7,082	47,045
Amount Liability	\$15,859.6	\$8,330.6	\$24,190.3
Amount Remitted	\$15,324.7	\$8,161.4	\$23,486.1
Amount Unremitted	\$534.9	\$169.2	\$704.1
Remittance Percentage	97%	98%	97%

While the need to protect against fraud and systematic noncompliance is understandable, the IRS has so far allocated a disproportionate share of this burden to taxpayers and away from both itself and withholding agents, a step that has only exacerbated the problems caused by the undifferentiated approach adopted by the IRS with respect to 1042-S filers. Current IRS practice is to review certain credit and refund claims of 1042-S filers.<sup>29</sup> Because the IRS's legal position is that it has no obligation to honor Form 1042-S credits or refund claims unless the taxpayer has an accurate Form 1042-S from the withholding agent and the withholding agent has remitted the withholding to the IRS, a mismatch of various data fields will cause the issuance of a preliminary disallowance letter.<sup>30</sup> That letter instructs the taxpayer to contact the withholding agent, figure out the reason for the mismatch, and resolve the issue.<sup>31</sup> If the taxpayer is unable to carry out this instruction, or the withholding agent is unwilling to

26 TAS Research, CDW, data drawn Oct. 12, 2017.

27 LB&I response to TAS fact check request (Nov. 16, 2017).

28 *Id.*

29 IRM 21.8.1.11.14.3 (Oct. 1, 2017).

30 *Id.*; Notice 2015-10, 2015-20 I.R.B. 965. The scope of the fields emphasized by the IRS has varied over time, but currently the IRS looks to the following specific fields: name, taxpayer identification number, federal tax withheld, and escrow. LB&I response to TAS fact check request (Nov. 16, 2017).

31 *Id.*

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Moreover, a variety of income sources, ranging from compensation for dependent services to gambling winnings to scholarship and fellowship grants to dividend payments, are associated with significant Form 1042-S credit claims. An analysis aimed at determining the intersection between compliance behavior and revenue risk associated with these income sources could provide some additional insight for fashioning a more tailored oversight regime that is less onerous for taxpayers and more resource-efficient for the government.

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cooperate, the taxpayer is left with little practical recourse other than to seek redress in the courts, either against the withholding agent or the IRS itself.<sup>32</sup>

This is a step that many taxpayers lack the resources to undertake, as it involves litigating against withholding agents, many of which are large global companies, or against the IRS. Moreover, as the withholding claimed by nearly 80 percent of 1042-S filers averages only about \$1,100 per taxpayer, the cost of litigation for most of these taxpayers would vastly exceed the amounts they are attempting to recover.<sup>33</sup> The IRS has, in effect, shifted the burden of withholding agent noncompliance to these taxpayers, who are comparatively ill-equipped to pursue any remedies in the event that simple reporting inconsistencies cannot be resolved.

By contrast to most taxpayers, the IRS has powerful tools allowing it to directly pursue, and collect from, withholding agents who fail to remit funds.<sup>34</sup> In addition, the IRS can assess assorted failure to pay and failure to file penalties against these withholding agents.<sup>35</sup> Nevertheless, the IRS has shown some reluctance to seek recovery from, and impose sanctions against, noncompliant withholding agents. For example, IRS actions to recover unpaid deposits from withholding agents have dropped from 4,302 for TY 2014 to only 1,139 for TY 2015.<sup>36</sup>

Likewise, the IRS has in its arsenal a number of penalties that can be applied against withholding agents. These penalties, by all appearances, could be employed more vigorously to encourage compliance. Figure 1.15.5 presents IRS penalty activity with respect to withholding agents.

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32 Taxpayers in such situations generally will be entitled to appeal rights. See IRM 21.8.1.11.14.5(4), *FATCA Matching Program Form 1042-S Credit Denials – Accounts Management Telephone/Written Inquiries - Letter 5904C* (Oct. 1, 2017); IRM 21.5.3.4.6.1, *Disallowance and Partial Disallowance Procedures* (Mar. 2, 2017). Nevertheless, given the IRS's current policies precluding credits and refunds in the absence of specified documentation, discussed above, the likelihood of successfully resolving such matters at Appeals remains open to question.

33 TAS Research, CDW, data drawn Oct. 12, 2017. These numbers represent an annual average derived from the 2013, 2014, and 2015 tax years.

34 Treas. Reg. § 1.1461-1(a)(1).

35 Treas. Reg. § 1.1461-1(a)(2); Treas. Reg. § 1.1461-1(h).

36 LB&I response to TAS information request (Oct. 31, 2017). These numbers are based on systemic assessments of the Failure to Pay penalty. LB&I response to TAS fact check request (Nov. 16, 2017). This decrease may be attributable to a variety of factors, including increased compliance by withholding agents, resource constraints on the part of LB&I, or a shift in enforcement emphasis to individual taxpayers.

**FIGURE 1.15.5, Penalties Imposed Against Withholding Agents<sup>37</sup>**

Penalties	2013	2014	2015
IRC § 6656, Failure to make deposit	3,913	3,784	957
IRC § 6672, Failure to collect and pay over, or attempt to evade and defeat tax	0	0	0
IRC § 6651, Failure to file return or pay tax	1,485	1,504	414
IRC § 6662, Accuracy-related penalty	0	1	0
IRC § 6663, Fraud penalty	0	0	0
IRC § 6721, Failure to file correct information returns	0	0	0
IRC § 6722, Failure to furnish correct payee statements	0	0	0
IRC § 6723, Failure to comply with other information reporting requirements	0	0	0

Enforcing compliance on the part of withholding agents will not eliminate all possibility of fraud or noncompliance by individual 1042-S filers. Nevertheless, most large-scale attempts at fraud or noncompliance likely would involve collusion between withholding agents and taxpayers. Since 85 percent of withholding agents are domestic, however, the IRS has direct recourse in the event of fraud or systematic noncompliance in which these withholding agents participate.<sup>38</sup> As a result, the IRS already possesses the ability to guard against and eliminate the majority of the fraud and noncompliance about which it is concerned. The IRS should act assertively on its own behalf and on behalf of taxpayers who are disadvantaged by withholding agent noncompliance. Further, it should consider more efficient ways of discouraging noncompliance by, and collecting unremitted funds from, foreign withholding agents, including exploring cooperative agreements with foreign jurisdictions.

### The IRS Position of Forcing Nonresident Taxpayers to Shoulder the Burden of Their Withholding Agents' Reporting and Compliance May Be Subject to Litigation Hazards Under *Portillo* and Other Naked Assessment Cases

Beyond causing unnecessary taxpayer burden, the Form 1042-S approach could create litigation risks for the IRS. In *Portillo v. Commissioner*, the Fifth Circuit Court of Appeals held that by failing to substantiate a Form 1099, the accuracy of which was challenged by the taxpayer, the IRS made a “naked assessment,” acted arbitrarily, and failed its burden of proof.<sup>39</sup> Courts generally have limited the naked assessment analysis of *Portillo* and similar decisions to unreported income cases arising in the domestic context.<sup>40</sup> Nevertheless, the IRS faces the risk that, in a case involving the creation of a deficiency attributable to a Form 1042-S mismatch, a court could extend *Portillo* and rule that IRS reliance on a withholding agent’s Form 1042-S while rejecting a taxpayer’s sworn Form 1040NR is arbitrary,

37 LB&I response to TAS information request Oct. 31, 2017). LB&I penalty actions and enforcement with respect to withholding agents may be on the increase for the 2016 tax year, although it is still too early to analyze the extent of and reasons for this apparent increase.

38 LB&I response to TAS fact check request (Nov. 16, 2017). Treas. Reg. § 1.1461-1T(c). See also IRC §§ 6601, 6651(a)(2), and 6656. This recourse is sometimes more attenuated in the case of foreign withholding agents and is subject to accessibility constraints, permissions from foreign governments, and provisions of applicable treaties. LB&I response to TAS information request (June 19, 2017).

39 *Portillo v. Comm’r*, 932 F.2d 1128 (5th Cir., 1991). The burden of proof in tax cases generally rests with the taxpayer. In a deficiency proceeding, however, when a taxpayer establishes that an assessment is “arbitrary and erroneous,” the burden shifts to the IRS to prove the correct amount of any taxes owed. *Id.* at 1133.

40 See *U.S. v. Janis*, 428 U.S. 433 (1976); *Jackson v. Comm’r*, 73 T.C. 394 (1979). See also *Parker v. Comm’r*, 117 F.3d 785 (5th Cir. 1997); *Pittman v. Comm’r*, 100 F.3d 1308 (7th Cir., 1996); *Tinsman v. Comm’r*, T.C. Memo. 2000-55.

particularly where the program's false-positive rate is high. Such a finding could result in immediate dismissal of the IRS's case.

Further, even in a refund case, a taxpayer could come before a court and, using any available evidence, demonstrate that the withholding for which the refund is claimed actually occurred. Such a showing would open to judicial scrutiny the IRS's policy of relying solely on withholding agents' Forms 1042-S without any other validation, an approach treated as arbitrary by *Portillo* in the Form 1099 context. Additionally, it would enable a taxpayer to challenge the IRS's current legal view that the IRS has no obligation to provide refunds unless it actually receives full remittances from withholding agents.<sup>41</sup>

## CONCLUSION

The IRS's current approach to 1042-S filers does not appear to be firmly grounded in comprehensive statistical analysis. Rather than using available data to focus compliance and enforcement efforts on high-risk taxpayers, the IRS has adopted an undifferentiated approach to 1042-S filers that wastes resources and needlessly burdens compliant taxpayers. Additionally, the IRS has demonstrated a reluctance to enforce compliance among Form 1042-S withholding agents, even though it generally has the ability to do so.

Instead, the IRS requires taxpayers to do its compliance work with respect to withholding agents, as well as to shoulder the risk that such compliance may not occur. Under current IRS policy, if a withholding agent reports incorrectly or fails to remit, even blameless taxpayers forfeit their credits and refunds while the IRS loses nothing. This allocation of risk and responsibility is not only unfair but inefficient. The IRS has strong tools at its disposal and should energetically use them to obtain increased compliance from withholding agents. This approach, combined with a more precise strategy for addressing potential noncompliance by 1042-S filers, would better protect taxpayer rights and more effectively utilize scarce IRS resources.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Compile and internally publish data relating to the results of manual review of frozen Form 1042-S credits and use this data to better understand and identify the sources and income stratifications generating increased risks of noncompliance.
2. Implement a policy that relies on data as the basis for developing effective programs and systems for validating the credit and refund claims of those relatively few Chapter 3 and Chapter 4 filers for whom such scrutiny is statistically justified.
3. Energetically enforce the withholding, reporting, and remittance obligations of withholding agents, rather than attempting to shift this obligation to nonresident taxpayers in ways that create hazards of litigation.
4. Consider more effective ways of discouraging noncompliance by, and collecting unremitted funds from, foreign withholding agents, including exploring cooperative agreements with foreign jurisdictions.

<sup>41</sup> Notice 2015-10, 2015-20 I.R.B. 965.

**MSP  
#16****INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS (ITINs): The IRS's Failure to Understand and Effectively Communicate With the ITIN Population Imposes Unnecessary Burden and Hinders Compliance****RESPONSIBLE OFFICIALS**

Ken Corbin, Commissioner, Wage & Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

Individual Taxpayer Identification Numbers (ITINs) allow individuals with a tax filing obligation who are ineligible for Social Security numbers (SSNs) to file required returns and pay taxes.<sup>2</sup> IRS administrative policies have made it difficult for taxpayers to apply for and receive ITINs; yet, the IRS has not made necessary changes such as allowing ITIN applications from all applicants year-round and providing adequate alternatives to submitting original documents. These problems have been discussed extensively in past Annual Reports to Congress.<sup>3</sup> The multitude of ITIN problems has many drivers, but two in particular stand out. The IRS fails to adequately:

1. Analyze the characteristics of and understand the ITIN population, including where applicants live, how they file their taxes, what language they speak, and what kind of community resources are available to them; and
2. Communicate with ITIN taxpayers by providing sufficient notices in the taxpayer's language and by conducting outreach through multiple channels to target groups of underserved taxpayers.

These two shortcomings result in a host of negative repercussions, including:

- A substantial decrease in ITIN applications, paired with only 176,000 renewal applications at the close of the filing season and over 152,000 returns with a math error for an expired ITIN, reflects that taxpayers may be unaware of the need to apply for ITINs or are choosing not to.

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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 as IRC § 7803(a)(3)).

2 IRC § 6109; Treas. Reg. § 1.6109-1. Taxpayers who require ITINs include international business persons, foreign students, foreign workers, and any other individual who does not have a Social Security number (SSN). All U.S. citizens and U.S. residents for tax purposes are required to file and pay U.S. taxes on their worldwide income and need a Taxpayer Identification Number (TIN) to do so. See, e.g., IRC § 61. Individuals considered nonresident aliens under the IRC are required to file and pay tax on income derived from sources within the United States. See IRC §§ 1, 2, 871, 7701(b).

3 See e.g., National Taxpayer Advocate 2016 Annual Report to Congress 239-52; National Taxpayer Advocate 2012 Annual Report to Congress 154-179.

- Taxpayers may be unaware of the requirement to have ITINs issued by the tax return due date to claim certain credits, as evidenced by the over 50,000 returns with math errors for failure to have an ITIN issued timely.
- Taxpayers may not receive their original documents or other ITIN correspondence from the IRS, including over five thousand passports that the IRS sent to embassies in 2016 because it could not find a better address to return them to taxpayers.

## ANALYSIS OF PROBLEM

### The IRS Does Not Analyze the Characteristics of the ITIN Population and Fails to Understand Their Needs

The Protecting Americans from Tax Hikes (PATH) Act of 2015 made many changes to the ITIN program, laying out rules for how to apply, when an ITIN must be issued to receive certain credits, and when an ITIN expires.<sup>4</sup> The PATH Act required the IRS to conduct a study on the effectiveness of the ITIN application process.<sup>5</sup> The IRS Research, Applied Analytics, and Statistics office delivered a draft report to internal stakeholders in early 2017. We understand the report addresses many of the issues included in this discussion. However, despite repeated requests, the IRS declined to share the draft report with TAS or even provide high-level information about its scope until December 21, 2017, immediately before the Annual Report to Congress went to press.<sup>6</sup> Accordingly, we have not had sufficient time to evaluate the scope and extent of the IRS's research of the ITIN population that is included in this report. In light of our publication deadline and because the draft report has not been cleared for public release, we do not discuss it here. To the extent that the IRS has addressed the concerns described in this Report, it can identify those efforts in its response to our recommendations. TAS is statutorily required to assist taxpayers in resolving problems with the IRS,<sup>7</sup> and works over a thousand cases related to ITINs each year.<sup>8</sup> TAS also oversees the Low Income Taxpayer Clinics (LITCs), which are statutorily required to conduct outreach and education to taxpayers for whom English is a second language.<sup>9</sup> Excluding TAS from the study team indicates the IRS is not committed to understanding the ITIN population and meeting its needs.

During the last five years, following a 2012 overhaul of ITIN application procedures,<sup>10</sup> the IRS has compiled ITIN data specific to Form W-7, *Application for Individual Taxpayer Identification Number* only one time.<sup>11</sup> This data compilation meets some of the requirements of the PATH Act study, but leaves out key information such as the number of dependents, average refund, withholding, gross income, and

4 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 203(d) (2015) (hereinafter PATH Act).

5 PATH Act § 203(d).

6 IRS response to TAS information request (Oct. 12, 2017).

7 IRC § 7803(c)(2).

8 TAS Inventory Report, Year to Date (YTD) Receipts to Sept. 23, 2017 by Primary Case Issue Code (PCIC) and Special Case Code (Sept. 25, 2017).

9 IRC § 7526(b)(1)(A)(ii)(II).

10 See National Taxpayer Advocate 2013 Annual Report to Congress 214-227 for a discussion of the application changes.

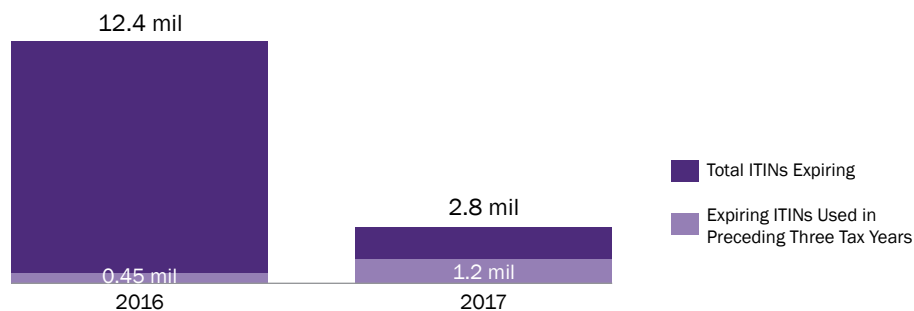
11 IRS response to TAS information request (Oct. 12, 2017). The IRS Research, Applied Analytics, and Statistics office delivered a draft report of the ITIN study required by the PATH Act to internal stakeholders in early 2017. We understand the report addresses many of the issues included in this discussion. However, despite repeated requests, the IRS declined to share the draft report with TAS or even provide high-level information about its scope until December 21, 2017, immediately before the Annual Report to Congress went to press. Accordingly, we have not had sufficient time to evaluate the scope and extent of the IRS's research of the ITIN population that is included in this report. In light of our publication deadline and because the draft report has not been cleared for public release, we do not discuss it here. To the extent that the IRS has addressed the concerns described in this Report, it can identify those efforts in its response to our recommendations.

reason for applying for an ITIN.<sup>12</sup> In addition, it only analyzes a single tax year — 2014 — even though there may be large differences between the activities of taxpayers during the first tax year they needed an ITIN versus a later year. For example, most ITIN taxpayers file a paper return for their first year because the ITIN application must be generally attached to a paper tax return during the filing season, but these taxpayers may prefer to file electronically in subsequent years.

The IRS also analyzed zip code data for taxpayers with expiring ITINs to identify locations for Certified Acceptance Agent (CAA) recruitment based on proximity to existing CAAs and Taxpayer Assistance Centers (TACs) offering ITIN services.<sup>13</sup> This is important because as shown in Figure 1.16.1, even though a smaller number of ITINs will expire at the end of 2017 versus 2016 (2.8 million versus 12.4 million), a greater number of the ITINs expiring at the end of 2017 have been used on a return recently (1.2 million versus 450,000 expiring at the end of 2016), indicating a likely need for them to be renewed.<sup>14</sup>

**FIGURE 1.16.1**<sup>15</sup>

**ITINs Expiring in 2016-2017 Used on a Return in Preceding Three Tax Years**



Between December 2015 and August 2017, the IRS increased the number of CAAs by almost ten percent,<sup>16</sup> but the IRS could do more to recruit CAAs in the most needed areas by compiling and using comprehensive data about ITIN taxpayers, including applicants, current filers, and past filers.<sup>17</sup> TAS

12 The compilation compares mail applications versus applications submitted through a Taxpayer Assistance Center (TAC), Acceptance Agent (AA), or Certifying Acceptance Agent (CAA), and applications submitted before and after the 2012 application changes. These comparisons were requirements of the PATH Act study. PATH Act § 203(d). The compilation also looks at refundable credits and other characteristics that could potentially identify “noncompliant activities.”

13 IRS response to TAS information request (Oct. 12, 2017). CAAs and certain TACs can certify an ITIN applicant’s original documents so the applicant can send in copies instead of original documents to the IRS. IRS, *Instructions for Form W-7* (Nov. 2017).

14 *Id.* ITINs are considered used on a return recently if they have been used on a return for at least one of the last three tax years.

15 *Id.*

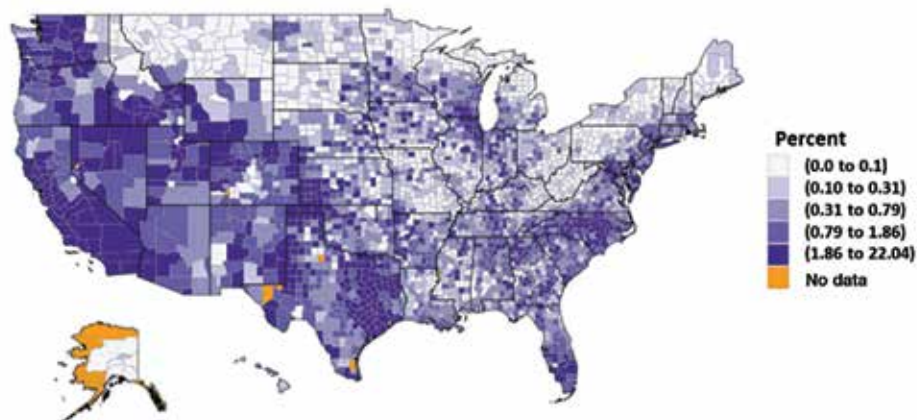
16 As of October 2017, there are 3,676 CAAs. *Id.*

17 The IRS Research, Applied Analytics, and Statistics office delivered a draft report of the ITIN study required by the PATH Act to internal stakeholders in early 2017. We understand the report addresses many of the issues included in this discussion. However, despite repeated requests, the IRS declined to share the draft report with TAS or even provide high-level information about its scope until December 21, 2017, immediately before the Annual Report to Congress went to press. Accordingly, we have not had sufficient time to evaluate the scope and extent of the IRS’s research of the ITIN population that is included in this report. In light of our publication deadline and because the draft report has not been cleared for public release, we do not discuss it here. To the extent that the IRS has addressed the concerns described in this Report, it can identify those efforts in its response to our recommendations.



conducted some preliminary research into the ITIN population. The below map shows the percent of ITIN returns in each county.

**FIGURE 1.16.2, Percent of Tax Returns in U.S. Counties That Include One or More ITINs, Filed in Calendar Year 2017<sup>18</sup>**



Source: Compliance Data Warehouse data retrieved Oct. 19, 2017

Our analysis showed a large number of ITINs in western U.S. counties with a high agricultural output or high proportion of Hispanic individuals. ITIN taxpayers may be underserved in counties with a relatively high number of ITIN returns, few Volunteer Income Tax Assistance (VITA) sites, and high agricultural output.<sup>19</sup> For example, Grant county in east-central Washington, a rural county with a 40 percent Hispanic population<sup>20</sup> and high agricultural output<sup>21</sup> had only two VITA sites. In this county, there were approximately 5,000 ITIN returns, comprising about 13 percent of all returns. Despite the lack of VITA sites, only 63 percent of ITIN returns were prepared by a paid preparer, which is lower than the average for ITIN returns. As depicted on Figure 1.16.3, in the adjacent Douglas county, Washington, there were no VITA sites and only 43 percent of ITIN returns were prepared by a paid preparer.

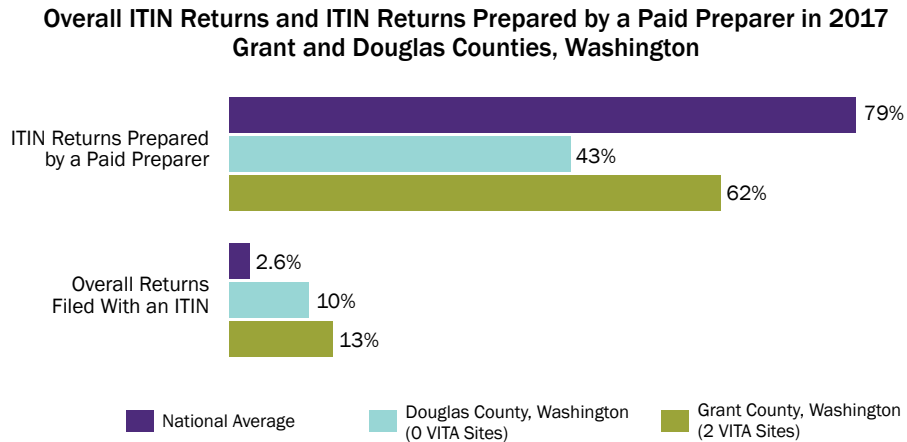
18 TAS Research, Compliance Data Warehouse (CDW) (data drawn Oct. 19, 2017).

19 For a detailed discussion of how the IRS could improve access to the Volunteer Income Tax Assistance (VITA) program, see Most Serious Problem: *VITA/TCE Programs: IRS Restrictions on Volunteer Income Tax Assistance (VITA) and Taxpayer Counseling for the Elderly (TCE) Programs Increase Taxpayer Burden and Adversely Impact Access to Free Tax Preparation for Low Income, Disabled, Rural, and Elderly Taxpayers*, *supra*.

20 United States Census Bureau, <https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmmk>, (data drawn Nov. 08, 2017).

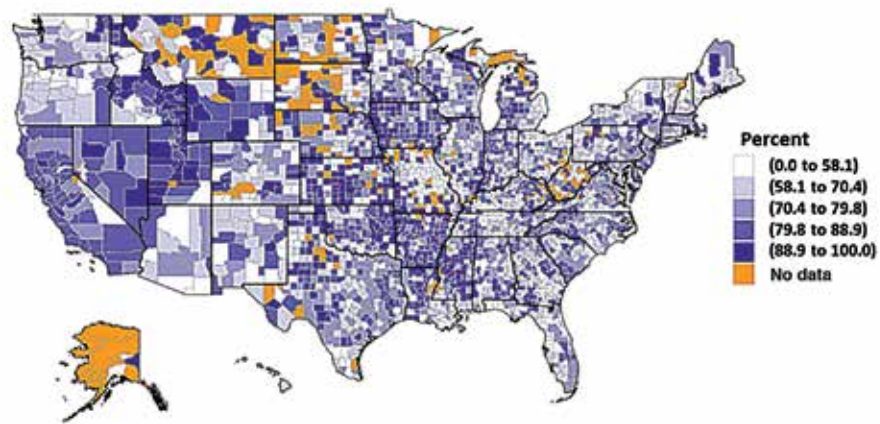
21 Elizabeth Sieverkropp, *2011 Grant County, Washington Irrigated Agriculture: Economic Impact Analysis* (May 1, 2013), <http://www.sieverkroppconsulting.com/wp-content/uploads/2013/04/2011-Irrigated-Agriculture-Report.pdf>.

**FIGURE 1.16.3, Comparison of percent of ITIN returns and ITIN returns prepared by a paid preparer in Grant County, Washington and Douglas County, Washington<sup>22</sup>**



TAS’s research also showed several metropolitan areas such as Los Angeles and Houston with a large Hispanic population, a high ratio of ITIN returns to VITA sites, and a high percentage of ITIN taxpayers using a paid preparer. Using paid preparers may be beneficial to ITIN taxpayers who do not understand the tax system and have limited English proficiency, but it also may signal a lack of access to free tax preparation for low income taxpayers.

**FIGURE 1.16.4, Percent of ITIN Returns Prepared by a Paid Preparer in U.S. Counties, Filed in Calendar Year 2017<sup>23</sup>**



Source: Compliance Data Warehouse data retrieved Oct. 19, 2017

<sup>22</sup> TAS Research, CDW (data drawn Oct. 19, 2017).

<sup>23</sup> *Id.*

The Government Accountability Office calculated the overclaim error rate for ITIN taxpayers claiming the Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC) in 2009-2011 to be 32 percent, versus 10 percent for all claimants.<sup>24</sup> Given the high overclaim rates for ITIN returns claiming refundable credits, and the high percentage of ITIN returns prepared by a paid preparer, it makes sense that the IRS should use this data to identify communities in which to conduct more preparer and taxpayer outreach.<sup>25</sup>

Another area the IRS appears to overlook is language preference or ability. The majority of ITIN taxpayers come from Spanish speaking countries,<sup>26</sup> and over half of Hispanic taxpayers speak exclusively Spanish at home.<sup>27</sup> However, the IRS data compilation on ITIN filers does not include any statistics about language. Furthermore, our analysis showed similar change of address rates for ITIN returns and the individual taxpayer population as a whole.<sup>28</sup> This does not support the IRS's reasoning that it is infeasible to provide notice to all taxpayers with expiring ITINs due to "the transient nature of the ITIN population and our reduced ability to contact them at a last known address."<sup>29</sup>

TAS estimated there were approximately 8,700 expired ITINs at the beginning of 2017 that were not renewed or used on a Form 1040 but were used on a third-party information return, suggesting they may need to be renewed in future years.<sup>30</sup> The IRS could use the addresses of these taxpayers listed on the information returns to directly notify them about the need to renew their ITINs prior to filing an individual return.<sup>31</sup> Although not an exhaustive list, these are examples of helpful data points that could be analyzed in a comprehensive study of ITIN taxpayers.

### The IRS could communicate more effectively with the ITIN population and conduct better outreach

#### *Applying Data to Conduct More Targeted Outreach*

In advance of the mass ITIN deactivations at the end of 2016 and 2017, the IRS launched public outreach campaigns, initially meeting with key stakeholders such as the Congressional Hispanic Caucus,

24 Government Accountability Office, *Refundable Tax Credits: Comprehensive Compliance Strategy and Expanded Use of Data Could Strengthen IRS's Efforts to Address Noncompliance* 16-475, 51 (May 2016).

25 The IRS Research, Applied Analytics, and Statistics office delivered a draft report of the ITIN study required by the PATH Act to internal stakeholders in early 2017. We understand the report addresses many of the issues included in this discussion. However, despite repeated requests, the IRS declined to share the draft report with TAS or even provide high-level information about its scope until December 21, 2017, immediately before the Annual Report to Congress went to press. Accordingly, we have not had sufficient time to evaluate the scope and extent of the IRS's research of the ITIN population that is included in this report. In light of our publication deadline and because the draft report has not been cleared for public release, we do not discuss it here. To the extent that the IRS has addressed the concerns described in this Report, it can identify those efforts in its response to our recommendations.

26 In 2014, 50 percent of ITIN applicants came from Mexico and another seven percent came from Guatemala. National Taxpayer Advocate 2015 Annual Report to Congress 199.

27 Forrester Research, Inc., *The Taxpayer Advocate Service: Hispanic Underserved Analysis*, Q4 2014, 13 (Dec. 2014).

28 TAS Research, CDW (data drawn Nov. 13, 2017). Further research may be necessary to learn whether ITIN taxpayers really are more transient than the general taxpayer population, but are failing to change their addresses with the IRS.

29 IRS response to TAS Information request (Nov. 29, 2016).

30 TAS Research, CDW (data drawn Nov. 2, 2017). ITINs need to be renewed in order to be used on a Form 1040 or other individual return filed by the ITIN holder, but do not need to be renewed if they are only used on information returns filed by third parties.

31 This notification could take the form of an informative bilingual mailer, so there would be no IRC § 6103 disclosure.

La Raza organization, and national English and Spanish media outlets.<sup>32</sup> Between 2016 and Fall 2017, the IRS conducted approximately 250 ITIN outreach events, about 60 percent of which were delivered to practitioners.<sup>33</sup> However, only five outreach events involved community based organizations or nonprofit stakeholders.<sup>34</sup> The IRS conducted only one event for military partners and a single foreign language television broadcast.<sup>35</sup> Despite the prevalence of English as a Second Language (ESL) speakers within the ITIN population, only 10 of the approximately 250 events were delivered to an ESL audience. To its credit, the IRS did prepare helpful materials for stakeholders to share with their communities.<sup>36</sup>

The IRS could create a more targeted outreach strategy and focus on specific areas or populations. For example, Sonoma County in California had over 14,000 ITIN returns filed in 2017, representing about seven percent of all returns in that county, with 88 percent prepared by a paid preparer.<sup>37</sup> Of the approximately 250 ITIN outreach events in the last two years, none were in Sonoma county.<sup>38</sup> Although the IRS provided outreach in the counties with the most ITIN returns, applying data regarding paid preparers and language preferences could help the IRS better reach the population.<sup>39</sup> For example, it could conduct outreach in counties where ITIN returns constitute ten percent or more of the individual tax return population.

### *Communicating ITIN Program Changes*

The IRS made some significant changes to the ITIN program with little publicity. During early 2017, the IRS increased the number of TACs that certify ITINs from 186 to 310 (out of 371 total TACs), but TAS is unaware of any related press releases with this information, leaving taxpayers and practitioners having to frequently visit the IRS's web page that lists the certifying TACs to monitor any changes.<sup>40</sup> The IRS reversed its policy of prohibiting CAAs from assisting taxpayers abroad, but did not include

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- 32 The PATH Act requires ITINs to expire after three years of non-use or on a staggered schedule based on the year they were issued. At the end of 2016, the IRS deactivated approximately 12.4 million ITINs. IRS response to TAS Information request (Nov. 29, 2016). At the end of 2017, the IRS estimates it will expire approximately 2.75 million ITINs. IRS response to TAS information request (Oct. 12, 2017).
- 33 IRS response to TAS information request (Oct. 12, 2017). Although these events include three web conferences held by the IRS's Stakeholder Partnerships, Education and Communication (SPEC) office, there may be additional events held by SPEC partners that focused on ITINs. The IRS does not track specific events that partners conduct. This count also excludes three outreach items described by the IRS as "various methods" and six items described as "emailed accounts" because TAS could not confirm these were actual events. IRS response to TAS fact check (Dec. 22, 2017).
- 34 This count of events excludes three outreach items described by the IRS as "various methods" and five described as "emailed accounts" because we were not able to confirm these were actual events. IRS response to TAS fact check (Dec. 22, 2017).
- 35 IRS response to TAS fact check (Dec. 22, 2017).
- 36 IRS, Pub. 5261 (June 2017).
- 37 TAS Research, CDW (data drawn Oct. 19, 2017).
- 38 This statement refers to the last two calendar years through September 29, 2017. IRS response to TAS information request (Oct. 12, 2017).
- 39 A review of the top ten counties with the most ITIN returns filed in 2017 shows the IRS conducted at least one outreach event in each of these counties during calendar year 2016 or 2017. IRS response to TAS information request (Oct. 12, 2017).
- 40 IRS, *Taxpayer Assistance Center (TAC) Locations Where In-Person Document Review is Provided*, <https://www.irs.gov/help/tac-locations-where-in-person-document-verification-is-provided> (Aug. 11, 2017 and Feb. 1, 2017). Although the IRS did issue a news release, *IRS Now Accepting Renewal Applications for ITINs Set to Expire by End of 2017*, IR-2017-109, (June 21, 2017), this news release only linked to the web page that lists the certifying TACs for each state, and did not inform taxpayers that the IRS had dramatically increased the number of certifying TACs. For a discussion of how TACs are not providing adequate in-person service, see Most Serious Problem: *Taxpayer Assistance Centers (TACs): Cuts to IRS Walk-In Sites Have Left the IRS With a Substantially Reduced Community Presence and Have Impaired the Ability of Taxpayers to Receive In-Person Assistance*, *supra*.

this information on its web page, *New ITIN Acceptance Agent Program Changes*, despite the confusion caused by the PATH Act.<sup>41</sup>

The IRS continues to be vague about the new PATH Act requirement that an ITIN be issued by the tax return due date (including extensions) in order to claim certain refundable credits.<sup>42</sup> The Form W-7 instructions were not updated until nine months after the passage of the PATH Act to state “Failure to timely file the tax return with a complete Form W-7 and required documentation may result in the denial of refundable credits, such as the Child Tax Credit and the American Opportunity Tax Credit.”<sup>43</sup> However, this language is buried on page three and does not indicate that these credits will be permanently denied — even if the taxpayer later receives an ITIN.

### *Reaching ITIN Taxpayers Through Notices*

The IRS failed to reach many ITIN taxpayers when it only sent expiration notices to a limited number of them and in a language they could not understand. In 2016, the IRS only directly notified 450,000 of 12.4 million taxpayers whose ITINs would expire. In 2017, the IRS sent out 874,657 ITIN deactivation notices, but only two were issued in Spanish, despite the prevalence of Spanish speaking taxpayers within the ITIN population.<sup>44</sup> TAS received a complaint on its Systemic Advocacy Management System (SAMS) about the CP 11 Math Error Notice for an expired ITIN not being issued in Spanish.<sup>45</sup> Although the IRS has a Spanish version of the CP 11 notice, it appears it is only issued to taxpayers who file a Form 1040PR, an annual tax return from a Puerto Rico resident.<sup>46</sup> Notices regarding ITIN applications are generated in Spanish if the taxpayer files an ITIN application in Spanish, but if the taxpayer files the English version, the language preference cannot be changed on the ITIN system.<sup>47</sup>

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**In 2017, the IRS sent out 874,657 Individual Taxpayer Identification Number (ITIN) deactivation notices, but only two were issued in Spanish, despite the prevalence of Spanish speaking taxpayers within the ITIN population.**

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41 Applicants abroad can apply by mail or in-person to an IRS employee according to the PATH Act § 203(a). IRS, *New ITIN Acceptance Agent Program Changes*, <https://www.irs.gov/individuals/new-itin-acceptance-agent-program-changes> (June 20, 2017) and (Aug. 29, 2017). The IRS did issue an online news article about this change. IRS, e-News for Tax Professionals, 2017-16 (April 21, 2017). In addition, the web page *Obtaining an ITIN from Abroad* currently states that applicants abroad can use a CAA, although TAS was unable to determine when this information was added. IRS, *Obtaining an ITIN from Abroad* <https://www.irs.gov/individuals/international-taxpayers/obtaining-an-itin-from-abroad> (Dec. 12, 2017). Even though the IRS reversed the foreign CAA policy in April, a discussion on the American Bar Association Low Income Taxpayer Clinic List Serve reveals some practitioners were still not aware of the change as recently as November 2017. See November 2, 2017 post (on file with TAS).

42 PATH Act §§ 205, 206 (codified at IRC §§ 24(e), 25A(i)(6)).

43 IRS, *Instructions for Form W-7* (Sept. 2016).

44 See notes 26 and 27, *supra*. IRS, *Service-wide Notice Information Program (SNIP)* (Nov. 8, 2017).

45 Systemic Advocacy Management System (SAMS) record 36352 (Aug. 14, 2017).

46 IRS, CP 711 - *Spanish Math Error, Balance Due of \$5 or More*. The IRS Service-wide Electronic Research Program, Document 6209, which lists all notices and notice codes describes the CP 711 as “Balance Due on Form 1040PR Math Error.” (June 15, 2017). The IRS has an indicator for limited English proficiency on its system used to manage taxpayer account data known as the Integrated Data Retrieval System (IDRS), but TAS understands that the indicator does not actually generate Spanish notices and only the filing of forms that are specific to taxpayers in certain U.S. territories will generate Spanish notices. Email from Office of Taxpayer Correspondence to TAS (Nov. 6, 2017).

47 IRM 3.21.263.4.9, *ITIN Notices and Forms* (Oct. 1, 2016).

Notwithstanding the language issues, the IRS took positive steps in updating its ITIN suspense, rejection, and assignment notices in early 2017.<sup>48</sup> However, the math error notice for disallowances related to expired ITINs remains problematic because it does not explain why credits or exemptions are disallowed until the third page.<sup>49</sup> Although the second page of the notice does explain that a taxpayer should renew the expired ITIN if that was the reason for the disallowance, taxpayers may not read this last bullet, under the heading “If you disagree with the amount due” because they may agree that the ITIN was expired. Furthermore, the notice gives no deadline for renewing the ITIN, even though it must be renewed within the statutory limitations period for claiming a refund.<sup>50</sup> This notice would be more salient if the IRS were to clearly state on the first page that the credits or exemptions were disallowed due to an expired ITIN and the taxpayer can receive those credits or exemptions if he or she renews the ITIN within the applicable time period explained in the notice.

Finally, the IRS does not leverage partnerships with other federal agencies and state and local governments to share information for immigrant taxpayers. The IRS reported providing materials to organizations such as the Department of State, but it is unclear whether the IRS provided materials to the Department of Homeland Security, U.S. Citizenship and Immigration Services, or any state and local agencies to inform immigrants, temporary workers, or visitors of their tax filing obligations. Working with these agencies is vital because the majority of ITIN applicants reside in the United States.<sup>51</sup>

### **The Failure to Study, Understand, and Communicate with the ITIN Population Increases Taxpayer Burden and May Undermine Compliance and Taxpayer Rights**

*A substantial decrease in ITIN applications, paired with only 176,000 renewal applications at the close of the filing season and over 152,000 returns with a math error for an expired ITIN, reflects that taxpayers may be unaware of the need to apply for an ITIN or are choosing not to.*

Without considering the characteristics of ITIN filers, the IRS maintains policies and procedures that result in taxpayers choosing not to apply for ITINs or being unaware of the need to apply. Additionally, some taxpayers may be unaware of confidentiality protections and fear the IRS will share information with other agencies for immigration purposes.<sup>52</sup> ITIN applications have decreased substantially in recent years, as depicted in Figure 1.16.5 below.

48 See CP 565 - *ITIN Assignment Notice*, CP 566 - *ITIN Suspense Notice*, CP 567 - *ITIN Rejection Notice*. IRS response to TAS information request (Oct. 12, 2017).

49 IRS, CP 11 - *Math Error, Balance Due of \$5 or More*. For a discussion of salience and the behavioral research related to tax compliance, see National Taxpayer Advocate 2016 Annual Report to Congress 50-63. See IRS response to TAS fact check (Dec. 22, 2017) (“Math error notices have a standardized format that drives the location of the taxpayer notice code (TPNC) paragraphs to explain the specific disallowances. This is standard for all math error notices, regardless whether they are issued to an ITIN or an SSN.”).

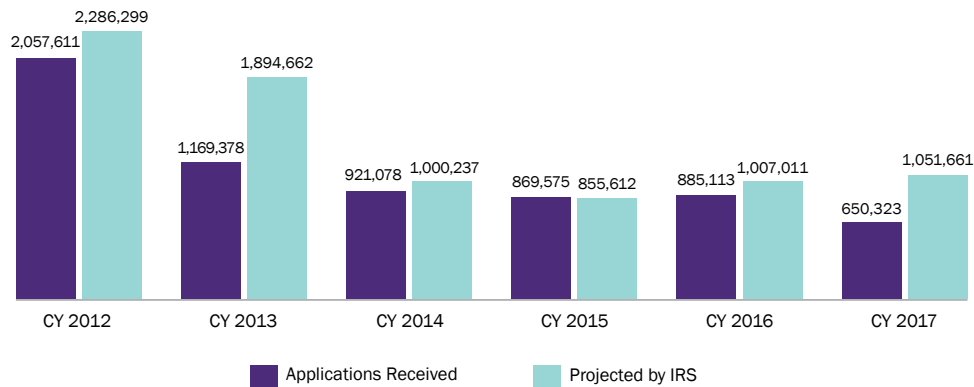
50 Generally, taxpayers must request a refund within three years from the date their return was filed, or two years from the time the tax was paid, whichever occurs later, or, if no return was filed, within two years from the time the tax was paid. IRC § 6511(a).

51 National Taxpayer Advocate 2015 Annual Report to Congress 199.

52 IRC § 6103 provides the general rule that returns and return information shall be kept confidential.

**FIGURE 1.16.5, Number of Returns Including One or More ITINs for Calendar Years 2012–2017<sup>53</sup>**

**ITIN Applications Received vs. ITIN Applications Projected, Calendar Years 2012-2017**



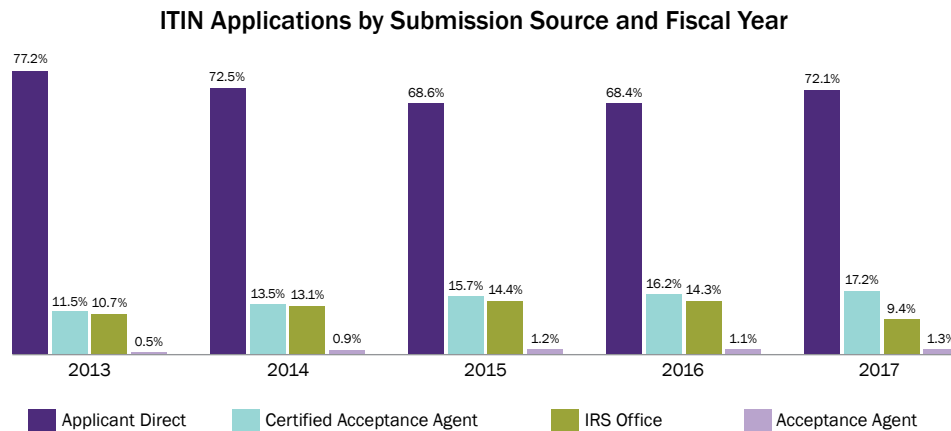
ITIN applications in 2017 were almost 40 percent lower than what the IRS projected.<sup>54</sup> Among other reasons, taxpayers may be failing to apply for ITINs because of the burdensome application procedures. Despite the IRS adding more TACs that can certify documents and permitting CAAs to certify some documents for dependents, the majority of ITIN applicants, approximately 72 percent, continue to mail in original documents or certified copies.<sup>55</sup> As shown in Figure 1.16.6 below, the percentage of applicants who apply by mail actually increased in 2017, indicating either that the IRS's expanded options did not help taxpayers or taxpayers were not aware of them.

53 IRS, ITIN Production Reports (Dec. 29, 2012; Dec. 14, 2013; Dec. 31, 2014; Dec. 30, 2015; Dec. 24, 2016; Nov. 25, 2017).

54 Immigration trends may play a role in the decrease of ITIN applications but are unlikely to account for the entire decrease from 2012 to 2016 because the number of unauthorized immigrants in the United States remained fairly steady during this time period. Because the population of unauthorized immigrants may include a sizable number of new immigrants who are taking the place of those who have left, there may actually be a greater need for new ITINs than would appear so based on just the number of unauthorized immigrants. Pew Research Center, *5 facts about illegal immigration in the U.S. Overall Number of U.S. Unauthorized Immigrants Holds Steady Since 2009*, <http://www.pewresearch.org/fact-tank/2017/04/27/5-facts-about-illegal-immigration-in-the-u-s/> (Apr. 27, 2017) (noting a decrease of about 800,000 unauthorized immigrants from Mexico between 2009 and 2015 and 2016, and rise in unauthorized immigration from other countries that has mostly offset the decrease in unauthorized immigrants from Mexico).

55 TAS Research, CDW (data drawn Oct 26, 2017).

**FIGURE 1.16.6, Number and Submission Source of ITIN Applications from Fiscal Years 2013–2017<sup>56</sup>**



Although the IRS estimated that approximately 450,000 taxpayers would apply to renew ITINs that expired at the beginning of 2017, the IRS had received only about 176,000 renewals at the close of the 2017 filing season.<sup>57</sup> ITIN renewals increased significantly after the IRS issued letters to approximately 1.2 million taxpayers (about 875,000 households) in August 2017.<sup>58</sup> However, between the beginning of August and mid-October, the IRS received less than 100,000 renewal applications, representing less than ten percent of the ITINs that would be expiring at the end of the year and which had been used recently (suggesting they may need to be renewed).<sup>59</sup> This trend is shown in Figure 1.16.7 below.

<sup>56</sup> TAS Research, CDW (data drawn Oct 26, 2017).

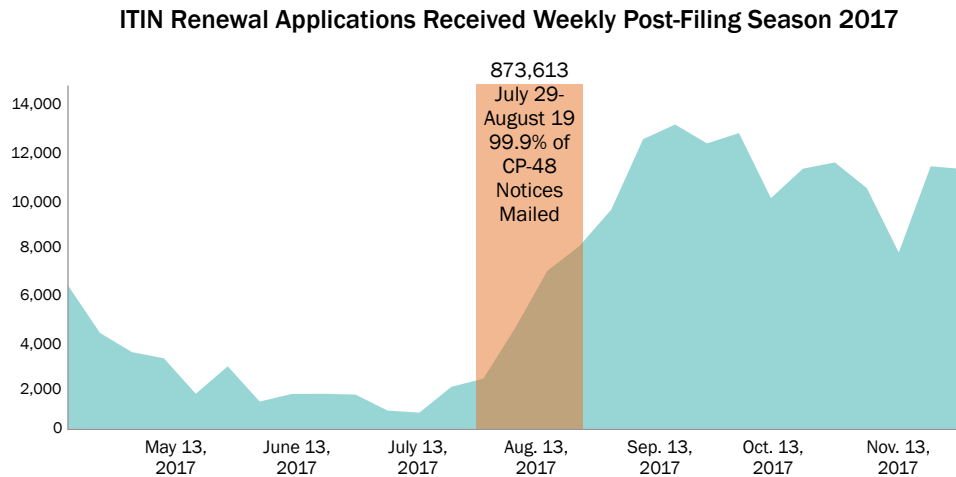
<sup>57</sup> IRS response to TAS information request (Nov. 29, 2016). IRS, Submission Processing (SP), Program Management/Process Assurance (PMPA) Branch, *Filing Season Statistics Report for Week Ending April 22, 2017*, 10. The 176,000 renewal applications received by the end of the filing season is based on the traditional filing season, which ended the week of April 17. Taxpayers living abroad receive an automatic two-month extension to file, and all taxpayers may request an extension until October 15. IRS, Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return* (Nov. 2017). However, because the majority of ITIN holders reside in the United States, and because we were not able to determine whether renewals received during the fall were for already expired ITINs or ones that would expire as part of the next batch at the end of the year, we only looked at the traditional filing season. National Taxpayer Advocate 2015 Annual Report to Congress 199.

<sup>58</sup> IRS response to TAS information request (Oct. 12, 2017).

<sup>59</sup> IRS, Submission Processing (SP), Program Management/Process Assurance (PMPA) Branch, *Filing Season Statistics Reports for Week Ending August 15, 2017 through Week Ending October 14, 2017*. IRS response to TAS information request (Oct. 12, 2017).



**FIGURE 1.16.7, Number of ITIN Renewal Applications Received Weekly Post-Filing Season 2017<sup>60</sup>**



In calendar year 2017, there have been over 152,000 tax returns with at least one math error for an expired ITIN.<sup>61</sup> Of these tax returns filed with expired ITINs, the IRS mailed an expiration notice to approximately one fifth of them, reflecting that the notices either did not reach taxpayers or were not effective. Furthermore, the math error notices themselves may have been ineffective because of the 152,000 tax returns that received a math error for an expired ITIN, taxpayers subsequently renewed the expired ITINs for only 33,056 (22 percent) of these returns.<sup>62</sup>

*Taxpayers may be unaware of the requirement to have ITINs issued by the tax return due date to claim certain credits, as evidenced by the more than 50,000 returns with math errors for failure to have an ITIN issued timely.*

As explained above, the IRS does not adequately notify taxpayers about the requirement to have an ITIN issued by the tax return due date. As of November 14, 2017, there were approximately 51,000 tax returns with at least one math error for failure to have an ITIN issued by the tax return due date in order to claim the CTC or American Opportunity Tax Credit.<sup>63</sup> Because the tax return due date for the purposes of having an ITIN issued includes extensions, these taxpayers may have been able to request an extension and obtain an ITIN by the extended due date, had they been aware of the requirement and this option. Unlike math errors for expired ITINs, where a taxpayer can remedy the problem by renewing an ITIN, taxpayers who did not have an ITIN issued by the tax return due date or extended due date have no options once the date has passed.

60 IRS response to TAS fact check (Dec. 22, 2017).

61 TAS Research, CDW (data drawn Nov. 14, 2017).

62 To determine these numbers, TAS assumed a successful renewal occurred if the renewed ITIN was issued in the same or later month when the math error notice was generated. TAS Research, CDW (data drawn Nov. 14, 2017).

63 *Id.*

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Unlike math errors for expired Individual Taxpayer Identification Numbers (ITINs), where a taxpayer can remedy the problem by renewing an ITIN, taxpayers who did not have an ITIN issued by the tax return due date or extended due date have no options once the date has passed.

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*Taxpayers may not receive their original documents or other ITIN correspondence from the IRS, including over five thousand passports that the IRS sent to embassies in 2016 because it could not find a better address to return them to taxpayers.*

The IRS's lack of understanding of ITIN taxpayers, combined with its failure to effectively promote alternatives to sending in original documents such as passports and national I.D. cards, leads to delays in returning these documents to taxpayers, or worse, the permanent loss of these documents. The IRS Submission Processing and Lean Six Sigma Organization collaborated on a pilot to improve quality, fraud detection, and the handling of original identification documents. While this pilot was reported to reduce the risk of misplacing documents, it is difficult to gauge improvement because the IRS does not track the number of missing document requests.<sup>64</sup>

From June 1, 2017 to September 15, 2017, the IRS was able to find a better address and return to taxpayers approximately 2,300 original documents that had been sent to the address listed on the ITIN application but were returned to the IRS as undelivered.<sup>65</sup> Nonetheless, the IRS returned about 5,400 passports to embassies in 2016 because it was not able to find a better address for the taxpayer.<sup>66</sup> For non-passport original documents, the IRS actually *destroys* these documents within six months if a better address is not found.<sup>67</sup> The IRS cited a study as the basis for its decision to retain documents for six months instead of the prior policy of a year, but provided TAS with no data in response to our request for information about the study.<sup>68</sup> Better communication with ITIN taxpayers could emphasize the importance of changing their addresses on file with the IRS, avoiding common address errors, or providing a pre-paid express envelope to receive their documents back.<sup>69</sup> To prevent the problems of lost documents to begin with, the IRS should adopt a more proactive approach by encouraging applicants to use alternatives to mailing original documents.

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64 IRS response to TAS information request (Oct. 12, 2017).

65 *Id.*

66 In these cases, the taxpayer may have moved before the Form W-7 was processed. IRS response to TAS information request (Oct. 12, 2017); IRS response to TAS fact check (Dec. 22, 2017).

67 *Id.*

68 *Id.*

69 See IRS, *Instructions for Form W-7* (Sept. 2016).

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The IRS returned about 5,400 passports to embassies in 2016 because it was not able to find a better address for the taxpayer. For non-passport original documents, the IRS actually *destroys* these documents within six months if a better address is not found.

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## CONCLUSION

In response to the PATH Act as well as a general need to improve the ITIN process, the IRS frequently makes changes to the ITIN program. However, without first understanding the ITIN population — who they are, where they live, what language they speak, what their needs are — the IRS will continue to overlook necessary changes and make others that create obstacles for taxpayers obtaining ITINs, filing their returns, and receiving tax benefits to which they may be entitled. Furthermore, without using its understanding of the ITIN population when developing its communication strategy, the IRS risks any positive changes not being effective because taxpayers do not understand or are not aware of them.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. In collaboration with TAS, conduct a comprehensive study of ITIN taxpayers that includes data such as geographical location, distance to a CAA, TAC, or VITA site, country of origin, language usage, paid preparer usage, and filing characteristics over multiple years.
2. Create a comprehensive outreach plan that includes materials to distribute to preparers; local community organizations; non-profit organizations; and local, state, and federal government agencies, with a particular focus on communities where there are high concentrations of ITIN filers.
3. Use data regarding the geographic location of ITIN taxpayers to create a list of underserved communities in need of greater CAA, TAC, and VITA sites and apply resources to recruit and add more CAAs, VITA sites, and certifying TACs in these locations.
4. Use data regarding ITIN taxpayers who incorrectly claimed refundable credits via a paid preparer to provide targeted outreach to segments of the preparer community.
5. Update its systems to provide that when a limited English proficiency indicator is placed on a taxpayer's account, all IRS notices will be issued in the taxpayer's preferred language when available.
6. Update Form W-7 instructions and CAA outreach materials to emphasize the importance of informing the IRS about a change of address.
7. Update Form W-7 instructions to explain on the first page the requirement to apply for an ITIN by the tax return due date in order to receive certain refundable credits.
8. Develop a system for tracking missing document requests and the actions the IRS has taken to address the missing document.

**MSP  
#17****APPEALS: The IRS Office of Appeals Imposes Unreasonable Restrictions on In-Person Conferences for Campus Cases, Even As It Is Making Such Conferences More Available for Field Cases****RESPONSIBLE OFFICIALS**

Donna C. Hansberry, Chief, Appeals

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

In October 2016, the IRS Office of Appeals (Appeals) formally changed its position regarding the availability of in-person Appeals conferences. Under this policy, the default rule became telephone conferences with in-person conferences only being available in cases meeting certain criteria and where the Appeals Team Manager approved.<sup>2</sup> Although Appeals offered reassurance that “the changes are not intended to shift the paradigm away from in-person conferences as a resolution tool,” many taxpayers and their representatives viewed the IRS’s new approach as “a major change in long-standing policy that protects taxpayer rights.”<sup>3</sup> This perspective is understandable, given that the number of in-person Appeals conferences has dropped by 61 percent between fiscal year (FY) 2013 and FY 2017, while Appeals case receipts have fallen by only 16 percent during this same period.<sup>4</sup>

The shrinking availability of in-person Appeals conferences is problematic because a face-to-face meeting is sometimes essential to properly explaining and settling a controversy.<sup>5</sup> For example, as one tax practitioner has explained, “An experienced advocate will generally adjust his or her presentation based on how it is being received. A look of doubt by the IRS Appeals Officer would generally cause the taxpayer’s representative to explain things in a different manner.”<sup>6</sup> In particular, cases that involve substantial factual or legal complexity, or that pose significant hazards of litigation to the government, are difficult to adequately communicate remotely.

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).
- 2 Internal Revenue Manual (IRM) 8.6.1.4.1. *Conference Practice* (Oct. 1, 2016).
- 3 Open letter from Kirsten Wielobob, Chief, Appeals (Nov. 16, 2016); Letter from Texas Soc’y of Cert. Pub. Accts. to John Koskinen, Comm’r of IRS (Jan. 24, 2017), 2017 TNT 16-16.
- 4 Appeals response to TAS information request (Oct. 25, 2017).
- 5 Lisa Zarlenga, Robert Kovacev, Cameron Arterton and Caitlin Tharp, *Changes to IRS Appeals May Cause Problems for Taxpayers*, LAW360 (Oct. 26, 2016), <https://www.law360.com/articles/856147/changes-to-irs-appeals-may-create-problems-for-taxpayers>.
- 6 Kevin Johnson, *Face-to-Face Conferences with IRS Appeals Should Be a Taxpayer Right*, Forbes (Mar. 5, 2017). See also National Taxpayer Advocate 2016 Annual Report to Congress 64-71.

As observed by the American Bar Association Section of Taxation, “In order for taxpayers to be amenable to the administrative Appeals process, they must feel that their legal arguments and perspective on an issue have been heard — and for that, there is no substitute for a face-to-face conference.”<sup>7</sup> If access to an in-person conference is denied to taxpayers and their representatives when they believe this interaction to be crucial for resolving their case, the result is likely to be disillusionment, less long-term compliance, and a willingness on the part of taxpayers to more quickly seek recourse in the federal courts.<sup>8</sup>

In response to objections from a range of stakeholders, Appeals issued guidance to employees “informing them that Appeals will return to allowing taxpayers to have in-person Appeals conferences in field cases.”<sup>9</sup> The National Taxpayer Advocate commends Appeals for its responsiveness to stakeholder concerns and its quick modification of its position. Nevertheless, the ultimate benefit of this new guidance remains uncertain as, rather than formally committing to honor good-faith requests for in-person conferences, Appeals pledges only to use its “best efforts” in this regard.<sup>10</sup> Further, a return to the pre-October 2016 status quo leaves a variety of underlying issues unaddressed. For example, the existing policy continues the prohibition against in-person conferences for Campus Appeals, which raises serious equity and due process concerns, as many Campus cases involve lower-income and unrepresented taxpayers. One of the hallmarks of top-quality customer service is choice, and the choice regarding an in-person conference should be made available to taxpayers regardless of whether their case is assigned to a Campus or Field office.

As a result, the National Taxpayer Advocate remains concerned that:

- The limitations on in-person conferences continue, particularly with respect to Campus cases, even though existing trends indicate these steps to be unnecessary;
- The availability of conference options that often represent unsatisfactory alternatives sometimes obscures the importance of in-person Appeals conferences;<sup>11</sup> and
- The existing restrictions on in-person conferences could harm both taxpayers and the government in the long run.

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**One of the hallmarks of top-quality customer service is choice, and the choice regarding an in-person conference should be made available to taxpayers regardless of whether their case is assigned to a Campus or Field office.**

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<sup>7</sup> ABA Members Comment on Recent Appeals Division Practice Changes, 2017 TNT 89-10 (May 10, 2017).

<sup>8</sup> Letter from American College of Tax Counsel to Kirsten Wielobob, Chief, Appeals (Oct. 10, 2016), 2016 TNT 197-16; ERICH KIRCHLER, THE ECONOMIC PSYCHOLOGY OF TAX BEHAVIOR (2007).

<sup>9</sup> Stephanie Cumings, *IRS Appeals Moving Back to In-Person Conferences*, 2017 TNT 179-4 (Sept. 18, 2017); IRS, Interim Guidance Memorandum (IGM) AP-08-1017-0017, *Appeals Conference Procedures*, (Oct. 13, 2017).

<sup>10</sup> IRS, IGM AP-08-1017-0017, *Appeals Conference Procedures*, (Oct. 13, 2017).

<sup>11</sup> These alternatives include teleconferences, virtual service delivery (VSD), the newly implemented case assistor program, and the WebEx program, which is currently being piloted.

## ANALYSIS OF PROBLEM

### The Limitations on In-Person Conferences Continue, Particularly With Respect to Campus Cases, Even Though Existing Trends Indicate These Steps to Be Unnecessary

With the October 2016 revisions to the Internal Revenue Manual (IRM), Appeals attempted to alter the playing field regarding in-person Appeals conferences. As Appeals explained, “By putting in place business rules around when Appeals provides in-person conferences, the changes shift the decision from the taxpayer to Appeals.”<sup>12</sup> Simply returning to the pre-existing policy regarding Field cases, however, will not necessarily make in-person Appeals conferences significantly more available to good-faith taxpayers than has recently been the case.

For example, Appeals does not offer in-person conferences for Campus Appeals, which can be especially burdensome for low income taxpayers, whose testimony and credibility may be particularly important in the case of missing records or the lack of representation.<sup>13</sup> Further, Appeals will no longer allow taxpayers to seek transfer of a case from the Campus to the Field, one mechanism that previously enabled taxpayers to obtain an in-person conference.<sup>14</sup> Thus, in its effort to reduce the number of in-person conferences, Appeals continues to substantially limit taxpayers’ choices and options, not just with respect to these conferences, but also regarding transfers to the Field, which sometimes are based on the reasonable desire of taxpayers to obtain an Appeals Officer with more topical experience or better regional understanding.<sup>15</sup>

These steps, however, appear to be largely unnecessary, given the long-term trends prevailing with respect to in-person conferences. In-person Appeals conferences have dropped by 61 percent between FY 2013 and FY 2017, and requests to transfer cases out of Campuses in order to obtain an in-person Appeals conference have fallen by 58 percent during this same period. These trends are illustrated in Figure 1.17.1.<sup>16</sup>

**FIGURE 1.17.1, In-Person Conference Trends**

	FY 2013	FY 2017	Percentage change
Total Appeals receipts	123,113	103,574	-16%
Total in-person conferences	14,986	5,832	-61%
Case transfers due to in-person request	5,853	2,461	-58%
Case transfers due to in-person request resulting in in-person conference	2,626	983	-63%

12 Open letter from Kirsten Wielobob, Chief, Appeals (Nov. 16, 2016).

13 This testimony provides the evidentiary basis for application of the *Cohan* rule, developed in the case of *Cohan v. Comm’r*, 39 F.2d 540 (2d Cir. 1930), which allows the decisionmaker to estimate allowable deductions.

14 *Id.*

15 National Taxpayer Advocate 2016 Annual Report to Congress 204-08.

16 Appeals response to TAS information request (Oct. 25, 2017).

Since taxpayers have already been requesting fewer in-person conferences, the motivation for Appeals' new policy restricting taxpayers' right to an in-person conference is unclear. Appeals has in part justified its approach by explaining that taxpayers prefer telephone conferences and that "the overwhelming majority of [Appeals'] cases — more than 87 percent — are effectively handled by phone."<sup>17</sup> If this is so, however, then along with existing data trends, it would argue even more powerfully in favor of allowing taxpayers the maximum range of conference options and reducing the number of in-person conferences by increasing the desirability of alternatives.

Other taxing authorities have concluded that better results are achieved when taxpayers are not forced to pursue pre-selected channels of tax administration or case resolution.<sup>18</sup> Given this reality and the existing data indicating that Appeals is in no danger of being overwhelmed by in-person conferences, Appeals has the opportunity to substantially improve taxpayer service. For example, Appeals could, using attrition from the Campuses, increase staffing in local field offices with Hearing Officers of various grades and designations such that the office could cover cases ranging from the Earned Income Tax Credit (EITC) to itemized deductions to Schedule C controversies. This step would not only expand Appeals' geographic footprint and facilitate the accessibility of in-person Appeals to taxpayers, but would allow Appeals to implement the call for an Appeals Officer and Settlement Officer permanently located in every state, the District of Columbia, and Puerto Rico currently proposed in the Grassley-Thune bill, a policy which the National Taxpayer Advocate has long recommended.<sup>19</sup>

### The Availability of Conference Options That Often Represent Unsatisfactory Alternatives Sometimes Obscures the Importance of In-Person Appeals Conferences

Appeals seeks to allay concerns regarding potential limitations on the availability of in-person conferences by reassuring taxpayers that they will still have a range of conference options, including virtual service delivery (VSD), telephone conferences, and the case assistor program.<sup>20</sup> Nevertheless, these alternatives often do not live up to their billing and fail to meet the needs of taxpayers and their representatives.

For example, the IRM paints a rosy picture of VSD, a "teleconferencing technology that permits parties to conduct virtual face-to-face conferences from remote locations." It "is installed in a number of IRS locations known as VSD 'support' sites, including all six Appeals Campus locations... VSD technology is also installed in a number of 'customer-facing' sites, where taxpayers and representatives can go to conduct VSD conferences."<sup>21</sup>

Nevertheless, the reality surrounding Appeals' use of VSD does not measure up to its portrayal. Currently, there are only ten customer-facing VSD locations available to taxpayers and their representatives around the country.<sup>22</sup> Further, there was just one Appeals conference held using VSD throughout all of FY 2017.<sup>23</sup> Outside commentators have noted the limited nature of VSD, as has Kirsten Wielobob, the former Chief of Appeals, who has said, "My personal feeling is that until we can

17 Letter from Kirsten Wielobob, Chief, Appeals, to Tax Analysts (June 23, 2016), 2016 TNT 123-13.

18 National Taxpayer Advocate 2016 Annual Report to Congress 70.

19 Taxpayer Bill of Rights Enhancement Act of 2017, S. 1793, 115th Congress. National Taxpayer Advocate 2014 Annual Report to Congress 46-54; National Taxpayer Advocate 2014 Annual Report to Congress 311-14.

20 Open letter from Kirsten Wielobob, Chief, Appeals (Nov. 16, 2016).

21 IRM 8.6.1.4.5(1), *Virtual Service Delivery* (Oct. 1, 2016).

22 Appeals response to TAS information request (Oct. 25, 2017).

23 *Id.*

use Skype or something like that that's more commonly available to everyone, we're probably not going to get widespread adoption."<sup>24</sup>

Appeals recently announced a new WebEx pilot program in which taxpayers and Appeals Officers would communicate using WebEx meeting software on their own computers.<sup>25</sup> Taxpayers would also have the ability to use their smart devices for such conferences.<sup>26</sup> WebEx is a promising development and has a number of potential benefits for both taxpayers and Appeals. Nevertheless, the WebEx pilot is still in its formative stages and should be treated by Appeals as an additional means of expanding conference options for taxpayers, not as a further mechanism for limiting taxpayers' right to an in-person conference.

Further, Appeals has evidenced a strong desire to shift taxpayers from in-person conferences to telephone interactions, establishing the latter as the default method in the October 2016 guidance. Although Appeals has now abandoned the "default" language, the extent to which it will continue to push the telephone option on potentially unwilling taxpayers remains an open question. Appeals has expressed the view that 87 percent of its cases "are effectively handled by phone."<sup>27</sup> Many of the potential explanations for this large percentage, however, do not support Appeals' implication that telephone contact can effectively replace the availability of in-person conferences. For example, the Texas Society of Certified Public Accountants has observed that "[e]fficient resolution could very easily include prompt denial of the relief the taxpayer was seeking."<sup>28</sup> In particular, telephone conferences can sometimes present additional obstacles to the ability of low income or unsophisticated self-represented taxpayers to fully understand and adequately present their case.

Additionally, the 87 percent number cited by Appeals may be somewhat misleading given that many cases appropriate for resolution over the phone, by their very nature, include less complex factual and legal controversies than cases involving in-person appeals.<sup>29</sup> Likewise, some taxpayers who may be eligible for an in-person conference may feel compelled to accept a telephone conference simply to obtain timely resolution of their case. For FY 2017, average cycle time was 189 days for cases with telephone conferences, as compared with an average cycle time of 372 days for cases involving an in-person Appeals conference.<sup>30</sup>

As a third alternative, Appeals has developed a new procedure primarily for Campus cases, which are disqualified from eligibility for in-person Appeals conferences.<sup>31</sup> This procedure, known as the case assistor program, teams the assigned Appeals Officer with a local Appeals Officer. The taxpayer travels to the local Appeals office and together with the local Appeals Officer telephones the assigned Appeals Officer to consider the case. Thereafter, the two Appeals Officers discuss proceedings, and the assigned Appeals Officer reaches a decision.

24 Amy S. Elliot, *IRS Appeals to End Case Reassignment Strategy*, 2016 TNT 172-5 (Sep. 16, 2016).

25 Matthew R. Madara, *IRS Addressing Concerns Over Appeals Conference Pilot Program*, 2017 TNT 114-3 (June 15, 2017).

26 Appeals response to TAS fact check request (Nov. 13, 2017).

27 Letter from Kirsten Wielobob, Chief, Appeals, to Tax Analysts (June 23, 2016), 2016 TNT 123-13.

28 Letter from Texas Soc'y of Cert. Pub. Accts. to John Koskinen, Comm'r of IRS (Jan. 24, 2017), 2017 TNT 16-16.

29 *Id.*

30 Appeals response to TAS information request (Oct. 25, 2017). In this context, the term "cycle time" is defined as the period between when a non-docketed case is received by Appeals and closed by Appeals.

31 IRM 8.6.1.4.1.1, *In-Person Conferences: Case Assistance* (Oct. 1, 2016).



The IRS has described this mechanism somewhat confusingly as “in-person conferences: case assistance.”<sup>32</sup> This program, however, combines the effort of travel to the Appeals office with the limitations inherent in a telephone conference, discussed above. Moreover, using two Appeals Officers for every case assistor conference will not only create an odd dynamic among the participants, but also seems to be an inefficient use of Appeals’ dwindling personnel. The attractiveness of this option to taxpayers and their representatives remains an open question, as only 15 cases were closed using the case assistor program during FY 2017.<sup>33</sup>

One of the hallmarks of top-quality customer service is choice. The case assistor program, along with telephone conferences and VSD, have their place and can be beneficial in certain situations. They should not, however, be forced on taxpayers as a replacement for in-person Appeals conferences. As stated by one witness in hearings held before the Oversight Subcommittee of the House Committee on Ways and Means, “We believe that taxpayers, if willing to incur the time and cost, should have a fundamental right to meet Appeals face to face.”<sup>34</sup>

### The Existing Restrictions on In-Person Conferences Could Harm Both Taxpayers and the Government in the Long Run

Several taxpayer representative groups came forward to express disagreement with the October 2016 restrictions on in-person conferences. Many of these objections continue to be applicable, however, as they speak to the importance of in-person conferences as a means of resolving cases, particularly those involving factual or legal complexity, credibility of witnesses, or hazards of litigation settlements. “Our tax system has grown exponentially more complicated since RRA ‘98 [the IRS Restructuring and Reform Act of 1998], making the historical policy of allowing an in-person conference all the more important in facilitating clear communications between taxpayers and Appeals, allowing resolution of factual misunderstandings, and facilitating prompt resolution of tax disputes.”<sup>35</sup>

Restricting the ability of good-faith taxpayers to obtain an in-person conference reduces Appeals’ effectiveness and runs counter to Appeals’ mission of achieving fair and equitable negotiated settlements. It increases the risk that the parties will fail to adequately understand one another’s positions and decreases the likelihood that a fair and equitable settlement will be reached. Further, increasing the availability of in-person conferences in Field cases while continuing the prohibition against such conferences for Campus cases, many of which involve lower income taxpayers, raises serious equity and due process concerns.

As explained by another witness in the hearing held by the Oversight Subcommittee of the House Ways and Means Committee,

For many taxpayers, the first opportunity to meet someone and talk about their case is at Appeals... In these cases, Appeals is the first opportunity they have to present their case

<sup>32</sup> IRM 8.6.1.4.1.1, *In-Person Conferences: Case Assistance* (Oct. 1, 2016).

<sup>33</sup> Appeals response to TAS information request (Oct. 25, 2017).

<sup>34</sup> *IRS Reform: Resolving Taxpayer Disputes: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 225th Cong. (2017) (statement of Kathy Petronchak, Director, alliantgroup LP) 5.

<sup>35</sup> Letter from American College of Tax Counsel to Kirsten Wielobob, Chief, Appeals (Oct. 10, 2016), 2016 TNT 197-16. See also Letter from Texas Soc’y of Cert. Pub. Accts. to John Koskinen, Comm’r of IRS (Jan. 24, 2017), 2017 TNT 16-16; *ABA Members Comment on Recent Appeals Division Practice Changes*, 2017 TNT 89-10 (May 10, 2017).

and have a discussion about their particular situation. By limiting face-to-face conferences, taxpayers lose the sense that their tax positions and perspectives are considered impartially.<sup>36</sup>

Many taxpayer representatives have expressed concern that unnecessary restrictions on in-person access could lead to expanded litigation, which would be costly for taxpayers, wasteful for the government, and burdensome for all concerned. “[W]e suspect that if practitioners perceive that Appeals loses its attractiveness as the next step after a revenue agent’s report, recourse to a Tax Court filing with the use of Appeals as a part of that procedure may become more the norm.”<sup>37</sup>

A mechanism for resolving disputes that taxpayers view as equitable gives taxpayers a greater stake in the outcomes of their cases and encourages long-term fealty to the tax system.<sup>38</sup> The quality of the contact between taxpayers and the taxing authority correlates closely with long-term trust in that authority and acceptance of its determinations.<sup>39</sup> A program such as Appeals that purports to be impartial for everyone and committed to making “a high quality decision in each case” runs a substantial risk of fostering disillusionment by limiting taxpayers’ options for true in-person contact with the organization when taxpayers believe such contact to be essential to the resolution of their cases.<sup>40</sup>

## CONCLUSION

Appeals’ 2016 policies that established a default telephone conference rule, removed taxpayers’ right to choose an in-person conference, and restricted the circumstances under which an Appeals Officer could elect to hold such a conference were puzzling and troubling. After an outcry from stakeholders, Appeals announced that it would return to making in-person Appeals available in Field cases, a step which the National Taxpayer Advocate applauds. Nevertheless, the scope and parameters of this availability remain to be seen, and a number of important restrictions on in-person conferences are still in place, such as in the context of Campus Appeals.

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**The number of in-person Appeals conferences has dropped by 61 percent between FY 2013 and FY 2017, while Appeals’ case receipts have fallen by only 16 percent during this same period. Given this trend, the sheer passage of time and some much-needed improvements to in-person alternatives likely would achieve Appeals’ goals in a taxpayer-friendly manner.**

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36 *IRS Reform: Resolving Taxpayer Disputes: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means, 225th Cong. (2017)* (statement of Chastity K. Wilson, Am. Inst. Cert. Pub. Accts.).

37 Letter from Texas Soc’y of Cert. Pub. Accts. to John Koskinen, Comm’r of IRS (Jan. 24, 2017), 2017 TNT 16-16. See also Letter from California Soc’y of Cert. Pub. Accts. to John Koskinen, Comm’r of IRS (Mar. 8, 2017); Letter from American College of Tax Counsel to Kirsten Wielobob, Chief, Appeals (Oct. 10, 2016), 2016 TNT 197-16.

38 See generally Tonya M. Scherer, *Alternative Dispute Resolution in the Federal Tax Arena: The Internal Revenue Service Opens Its Doors to Mediation*, 2 J. OF DISP. RESOL. 215 (1997); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138-71; National Taxpayer Advocate 2016 Annual Report to Congress 214.

39 See generally Melinda Jone and Andrew J. Maples, *Mediation as an Alternative Option in Australia’s Tax Disputes Resolution Procedures*, 27 AUSTRAL. TAX F. 525, 528, 531 (2012).

40 IRM 8.1.1.1(2)(c), *Accomplishing the Appeals Mission* (Oct. 1, 2016).

The number of in-person Appeals conferences has dropped by 61 percent between FY 2013 and FY 2017, while Appeals' case receipts have fallen by only 16 percent during this same period.<sup>41</sup> Given this trend, the sheer passage of time and some much-needed improvements to in-person alternatives likely would achieve Appeals' goals in a taxpayer-friendly manner.

Nevertheless, taxpayers and their representatives still are left with significant concerns regarding their ability to effectively present and resolve their cases. The alternatives to in-person conferences touted by Appeals (VSD, telephone conferences, and the case assistor program) do not measure up to Appeals' optimistic descriptions. Further, in-person conferences are particularly important for some types of cases, such as those involving factual or legal complexity, or those implicating a hazards of litigation settlement. Restrictions, be they procedural or practical, on the ability of good-faith taxpayers to obtain in-person conferences may well lead to increased litigation, which is costly and inefficient for both parties. Additionally, such limitations run counter to the mission of Appeals and could diminish long-term tax compliance, an unintended consequence that would harm the government and taxpayers.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Honor all good-faith requests for an in-person Appeals conference.
2. Continue improving VSD (or its successor) and telephone conferences so that taxpayers have access to a range of quality options for interacting with Appeals.
3. Through the use of attrition and other strategies, staff local Appeals offices so as to have a permanent Appeals office in every state, the District of Columbia, and Puerto Rico that provides effective in-person coverage for the full range of Appeals cases.

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<sup>41</sup> Appeals response to TAS information request (Oct. 25, 2017).

**MSP  
#18****APPEALS: The IRS's Decision to Expand the Participation of Counsel and Compliance Personnel in Appeals Conferences Alters the Nature of Those Conferences and Will Likely Reduce the Number of Agreed Case Resolutions****RESPONSIBLE OFFICIALS**

Donna C. Hansberry, Chief, Appeals

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

Effective October 2016, Appeals implemented a number of changes to its conference procedures. Among other things, Appeals revised the Internal Revenue Manual (IRM) to allow Hearing Officers to invite Counsel and/or Compliance to participate in Appeals conferences.<sup>2</sup> The ability to invite these additional participants exists regardless of whether taxpayers agree or object to their inclusion.

Appeals' option to involve Counsel and Compliance in such conferences has historically existed and occasionally has been used in selected cases by Hearing Officers.<sup>3</sup> Appeals, however, views the IRM changes as part of a new and concerted trend toward expanded participation in Appeals proceedings by IRS personnel.<sup>4</sup> As one example, effective May 1, 2017, Appeals began a pilot initiative designed to make the inclusion of representatives from the Large Business and International (LB&I) examination audit team a matter of "routine."<sup>5</sup> Donna Hansberry, Chief of Appeals, has stated that "the purpose of having both parties in the room is to aid case resolution."<sup>6</sup> Appeals further explains, "The goals for this initiative are to improve conference efficiency, reach case resolution sooner, and offer earlier certainty for issues in future years."<sup>7</sup>

Nevertheless, this change in conference procedures could have far-reaching negative consequences for Appeals' effectiveness in resolving cases with taxpayers. This potential downside is why a number of tax practitioner groups have expressed opposition to such a policy: "There should be a clean break between

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).

2 Internal Revenue Manual (IRM) 8.6.1.4.4, *Participation in Conferences by IRS Employees* (Oct. 1, 2016).

3 Chelsea Looper-Stockwell, *Sitting Down with Appeals Chief, Donna Hansberry*, APPEALS QUARTERLY NEWSLETTER VOL. 3, ISSUE 1 1-2 (Feb. 2017).

4 *Id.*

5 *Appeals Team Cases: All Parties Conferences*, <https://www.irs.gov/pub/irs-utl/atclfaqs.pdf> (last visited Apr. 17, 2017).

6 *IRS Appeals Conference Procedure Change Follows Prior Guidance*, 2017 TNT 53-4 (Mar. 20, 2017).

7 *Id.*

Compliance and Appeals.”<sup>8</sup> Appeals runs the risk that Hearing Officers could be perceived as part of a contingent representing the IRS in a “quasi-judicial” regime that fosters distrust and litigation, rather than negotiation and case resolution.

Specifically, the National Taxpayer Advocate is concerned that Appeals’ emphasis on expanding participation of Counsel and Compliance in Appeals conferences will:

- Fundamentally change the nature of Appeals conferences in which this approach is adopted;
- Jeopardize Appeals’ independence, both real and perceived; and
- Generate additional costs for the government and taxpayers in the form of fewer case resolutions, additional litigation, and reduced long-term compliance.

## ANALYSIS

### Background

Most cases brought by taxpayers to Appeals come directly from Compliance after taxpayers and Compliance reach an impasse.<sup>9</sup> In these cases, the Hearing Officer receives the administrative file, which includes the taxpayer’s protest, the revenue agent’s report, and a transmittal memorandum prepared by Compliance.<sup>10</sup> Upon receipt, Appeals reviews the administrative file to ensure completeness and to determine whether the case has been sufficiently prepared for potential disposition. If it has not, the case is to be returned to Compliance for further development under the terms of the Appeals Judicial Approach and Culture (AJAC) Project adopted in 2014.<sup>11</sup>

Assuming that the case is ready for Appeals’ consideration, the Hearing Officer can invite Compliance and the taxpayer to a pre-conference meeting. The purpose of such a meeting is to discuss the issues of the case, the taxpayer’s protest, and the rebuttal prepared by Compliance.<sup>12</sup> Pre-conferences generally are used in more complex cases.<sup>13</sup>

Once a pre-conference is held or bypassed, the Appeals conference itself is scheduled. The conference is conducted informally and, in practice, is often conducted in stages.<sup>14</sup> Taxpayers present their case, enter into dialogue with the Hearing Officer, and eventually commence settlement negotiations.<sup>15</sup> Although Appeals strives to resolve cases after a single conference, additional conferences can be conducted where necessary.<sup>16</sup>

As the final administrative stop for most taxpayers within the IRS, Appeals’ role is to negotiate settlements with taxpayers in light of existing hazards of litigation to the government.<sup>17</sup> This function, in which

<sup>8</sup> ABA Members Comment on Recent Appeals Division Practice Changes, 2017 TNT 89-10 (May 10, 2017).

<sup>9</sup> Appeals response to TAS information request (June 9, 2017), Tab 3. This category of cases is known as nondocketed Appeals. The other category, docketed Appeals, consists of cases that bypass Appeals on their way to the U.S. Tax Court and then are remanded to Appeals for further consideration.

<sup>10</sup> MICHAEL I. SALTZMAN & LESLIE BOOK, IRS PRACTICE AND PROCEDURE 9.06 (2016).

<sup>11</sup> *Id.*

<sup>12</sup> IRM 8.7.11.8.1, *Purpose of Pre-Conference Meeting* (Mar. 16, 2015).

<sup>13</sup> IRM 8.7.4.5, *Pre-Conferences in Estate and Gift Tax Cases* (Aug. 18, 2014).

<sup>14</sup> IRM 8.6.1.4(5), *Conference Techniques used by Appeals Technical Employees (ATEs)* (Oct. 1, 2016).

<sup>15</sup> MICHAEL I. SALTZMAN & LESLIE BOOK, IRS PRACTICE AND PROCEDURE 9.06 (2016).

<sup>16</sup> *Id.*

<sup>17</sup> IRM 8.6.2.6.4.2, *Resolved Based on Hazards of Litigation* (Oct. 18, 2007).

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**By definition, if taxpayers had been able to reach agreement with Counsel and Compliance, the case would not have been elevated to Appeals in the first place.**

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Appeals serves as the ultimate decision-maker, is different from mediation and similar types of alternative dispute resolution (ADR) in which an independent third party seeks to facilitate an agreement between adversaries with opposing positions.<sup>18</sup> For example, in IRS mediation, which is voluntary, Compliance has a seat at the table, and Appeals attempts to facilitate a resolution that becomes binding only if Compliance and the taxpayer agree.<sup>19</sup>

By contrast, prior to Appeals' 2016 guidance changes, Counsel and Compliance generally did not attend Appeals conferences, although the IRS always had the right to include them.<sup>20</sup> Counsel and Compliance typically were granted their say via the case file and the pre-conference, if held. Thereafter, the Appeals conference itself generally was devoted to presentation of the taxpayer's case and settlement negotiations between the taxpayer and the Hearing Officer.

The manner in which Appeals will implement its new emphasis on including Counsel and Compliance in conferences is still somewhat vague. TAS has been assured that neither Counsel nor Compliance will be present during settlement negotiations between Hearing Officers and taxpayers.<sup>21</sup> Nevertheless, in her comments before the U.S. House Ways and Means Committee, Subcommittee on Oversight, one practitioner testified as follows:

In a recent settlement conference with my client, the Appeals personnel openly asked Compliance what they thought was a fair settlement before reaching a final decision. After the conference, the taxpayer asked how it was possible for Appeals to maintain independence when they were seeking the opinion of the Compliance team.<sup>22</sup>

### **Participation of Additional IRS Personnel Will Fundamentally Change the Nature of Appeals Conferences**

The expansion of Appeals conferences to routinely involve Counsel and Compliance alters the relationship between the taxpayer and the Hearing Officer and makes interactions less negotiation-based.

By definition, if taxpayers had been able to reach agreement with Counsel and Compliance, the case would not have been elevated to Appeals in the first place. The inclusion of these now-contentious parties in an Appeals proceeding likely will create a dynamic in which the opposing sides present their arguments and then await the ruling of the Hearing Officer. While this model may well move closer to the

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18 For an in-depth discussion of alternative dispute resolution (ADR) within the IRS, see National Taxpayer Advocate 2016 Annual Report to Congress 211-19.

19 IRM 8.26.3.1, *Objective and Authority for Fast Track Mediation* (Dec. 5, 2014); IRM 8.26.3.2, *Collaborative Dispute Resolution Process* (Dec. 5, 2014).

20 Chelsea Looper-Stockwell, *Sitting Down with Appeals Chief, Donna Hansberry*, APPEALS QUARTERLY NEWSLETTER VOL. 3, ISSUE 1 1-2 (Feb. 2017).

21 Appeals response to TAS fact check request (Nov. 13, 2017).

22 *IRS Reform: Resolving Taxpayer Disputes: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 225th Cong. (2017) (statement of Chastity K. Wilson, Am. Inst. Cert. Pub. Accts.).

“quasi-judicial” role for Hearing Officers envisioned by AJAC, it is neither an effective means of reaching a settlement in a particular case, nor of pursuing administrative dispute resolution on a broader scale.

Appeals should be sitting across the table from taxpayers with a complete file, based on which administrative case resolution can be sought. Anything that Compliance would have to say at that point would be redundant or, if new, would contradict the principles of AJAC. If Appeals is receiving incomplete case files, the solution is to insist on better case development from Compliance, not to expand its participation in Appeals conferences so that it can present verbally what should already have been provided in writing. Rather than confronting and resolving this issue directly, Appeals’ new approach simply creates more problems.

For example, this change, which allows Counsel and Compliance to reiterate their positions, converts Appeals to a more adversarial forum, and will limit negotiation between taxpayers and Hearing Officers. “Adding IRS employees to the Appeals conference turns the Appeals conference into more of a trial setting as opposed to the historic conduct of most Appeals conferences.”<sup>23</sup>

As discussed above, the National Taxpayer Advocate has been assured by the Chief of Appeals that Counsel and Compliance will not be a party to the settlement discussions, which theoretically would occur later in the conference.<sup>24</sup> Even if that is the case, the entire Appeals conference can be accurately characterized as a settlement negotiation in which taxpayers and their representatives are attempting to establish a rapport with their Hearing Officer from which resolution of their case can be mutually explored.

When Counsel and Compliance are given a second opportunity and essentially allowed to present an oral argument setting forth their case, of which the Hearing Officer should already be aware, this in turn drives taxpayers and their representatives to present their own oral arguments. Aspects of the case in which the parties could reach agreement should previously have been addressed in the examination or even uncovered at an Appeals pre-conference. Including Counsel and Compliance in the Appeals conference itself deters, and runs the risk of poisoning the environment for, the meaningful dialogue between taxpayers, representatives, and the Hearing Officer, based on which resolution can occur.

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<sup>23</sup> Marie Sapirie, *IRS Appeals Chief Clarifies Policy Changes in Open Letter*, 2016 TNT 215-5 (Nov. 14, 2016).

<sup>24</sup> National Taxpayer Advocate Blog, *Appeals Should Facilitate Mutual Respect and Trust by Allowing Taxpayers a Choice in the Expanded Participation of Counsel and Compliance in Appeals Conferences* (June 21, 2017), <https://taxpayeradvocate.irs.gov/news/appeals-should-facilitate-mutual-respect-and-trust-by-allowing-taxpayers-a-choice-in-the-expanded-participation-of-counsel-and-compliance-in-appeals-conferences?category=Tax%20News>.

### Expanding Conferences Will Jeopardize Appeals' Independence, Both Real and Perceived

Appeals recognizes that the achievement of its mission statement depends on resolving tax controversies on a basis that is fair and impartial to both the government and the taxpayer and in a manner that will enhance public confidence in the integrity and efficiency of the IRS.<sup>25</sup> Nevertheless, this initiative fundamentally imperils Appeals' ability to fulfill its mission and equitably settle cases.

Inviting Counsel and Compliance to attend conferences will make it difficult for Appeals to serve as an unbiased participant in the case resolution process. Compliance will be in a position to put pressure on Hearing Officers to adopt and sustain the prior asserted outcome and will have the opportunity to directly counter the arguments of taxpayers. As a practical matter, Compliance presumably will be granted a much broader latitude for extending arguments in person beyond the parameters existing within the four corners of the case file.

Where the views of Counsel are concerned, Revenue Procedure 2012-18 provides Appeals with the discretion to override Counsel. In reality, however, Hearing Officers may well be reluctant to do so when Counsel actually has a seat at the table.<sup>26</sup> A Hearing Officer may lack the personal confidence or the institutional support necessary to stand firm in exercising independent judgment in the face of opposition from Compliance regarding the factual strengths and weaknesses or the assessment of Counsel regarding hazards of litigation.<sup>27</sup> By inviting these parties to conferences as a routine matter, Appeals is undermining its own independent mechanisms for case resolution.

As has the National Taxpayer Advocate, the American Bar Association Section of Taxation has expressed concerns that "Appeals' independence is impaired by permitting, encouraging, or mandating that all three parties (Appeals employees, the taxpayer, and Compliance/Counsel personnel) attend all conferences with Appeals. Moreover, such a significant change in conference procedures could interfere with the ability of Appeals to conduct its traditional role of settling the case based on hazards of litigation."<sup>28</sup>

Including all three parties in the Appeals conference may appear sensible, and tax practitioners sometimes find this approach to be helpful in resolving cases.<sup>29</sup> Mandating this inclusion, however, fundamentally disregards the very purpose of the Appeals conference, which is neither to give Compliance another bite at the apple nor to transform Appeals into a mediation forum. Instead, the credibility of Appeals hinges on its ability to undertake direct and independent settlement negotiations with taxpayers and their representatives.

Even if Appeals is able to generate case resolutions that are unbiased, the necessary perception of independence will inevitably be compromised by Appeals' new approach. Additional IRS participants cannot help but alter taxpayers' perception of the proceedings and the fairness of the outcomes. Taxpayers will not feel they are going before an independent and objective party to seek a resolution to their cases; instead, taxpayers will feel they are simply continuing their disagreements with the IRS as an institution,

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

26 Rev. Proc. 2012-18, § 2.02(3)(b), 2012-10 I.R.B. 455.

27 The National Taxpayer Advocate has previously suggested steps that would enhance Appeals' independence, such as locating at least one Appeals Officer and Settlement Officer in every state, the District of Columbia, and Puerto Rico, and maintaining separate office space and communication facilities from other IRS personnel. National Taxpayer Advocate 2009 Annual Report to Congress 348. This independence could be further strengthened if, as also recommended by TAS, Appeals were provided with an independent Counsel to help Appeals evaluate positions adopted by IRS Counsel. National Taxpayer Advocate 2002 Annual Report to Congress 198.

28 *ABA Members Comment on Recent Appeals Division Practice Changes*, 2017 TNT 89-10, May 10, 2017.

29 TAS conference call with National Association of Enrolled Agents (NAEA) (Aug. 24, 2017).



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Taxpayers will not feel they are going before an independent and objective party to seek a resolution to their cases; instead, taxpayers will feel they are simply continuing their disagreements with the IRS as an institution, this time with an extra party or two added to the conversation — perhaps as overseers.

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this time with an extra party or two added to the conversation — perhaps as overseers. Such an appearance is a far cry from the independent arbiter envisioned by the IRS Restructuring and Reform Act of 1998.<sup>30</sup> “With this legislation, we require the agency to establish an independent Office of Appeals — one that may not be influenced by tax collection employees or auditors.”<sup>31</sup>

Other federal agencies likewise place a premium on the independence of their appeals process. Most of these agencies establish appeal to an Administrative Law Judge, or the equivalent, as the final stage in their administrative case resolution structure. Although negotiation is less of a central element in these disputes than in the context of IRS controversies, it is significant that, as far as TAS can determine, the agencies conducting large numbers of case appeals culminate their processes with proceedings in which claimants and their representatives can independently present their case to a final decision-maker without the presence of anyone from the agency who was involved in previous aspects of the case.<sup>32</sup>

### **Adding Counsel and Compliance to Appeals Conferences Will Generate Additional Costs for the Government and Taxpayers in the Form of Fewer Case Resolutions, Additional Litigation, and Reduced Long-Term Compliance**

As the American Bar Association has observed, “Taxpayers who choose traditional Appeals have chosen not to mediate, based at least in part on an assessment that the inclusion of Compliance could be counterproductive.”<sup>33</sup> To the extent that Appeals’ independence, either in reality or appearance, is diminished by mandating the presence of adversarial IRS personnel, taxpayers will be less likely to value and respect the outcome of Appeals proceedings. On the other hand, when people feel that a dispute resolution mechanism represents a fair and just process, they are highly likely to accept it. For example, one ADR survey found that over 90 percent of parties involved in arbitration voluntarily comply with the outcome.<sup>34</sup>

By contrast, taxpayers who believe that Appeals has not made an objective, good-faith effort to resolve their cases will be much more likely to turn to the courts to obtain the independent review they are denied within the IRS. The National Taxpayer Advocate continues to note with concern that the proportion of docketed Appeals cases (which, by definition, require judicial involvement) in comparison to non-docketed Appeals cases has remained at over 40 percent between fiscal year (FY) 2013 and

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30 The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, Title III, Subtitle E, § 3465 (b) (July 22, 1998).

31 144 CONG. REC. S7622 (1998) (statement of Sen. Roth).

32 See, e.g., Board of Veterans Appeals, *How Do I Appeal?*, VA Pamphlet 01-15-02B 10-11 (May 2015), <https://www.bva.va.gov/docs/Pamphlets/How-Do-I-Appeal-Booklet-508Compliance.pdf>; Social Security Administration, *About Appeals*, Pub. No. 05-10041 (Jan. 2017).

33 *ABA Members Comment on Recent Appeals Division Practice Changes*, 2017 TNT 89-10 (May 10, 2017).

34 ABA, Sec. of Disp. Resol., *Benefits of Arbitration for Commercial Disputes*, [http://www.americanbar.org/content/dam/aba/events/dispute\\_resolution/committees/arbitration/arbitrationguide.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/events/dispute_resolution/committees/arbitration/arbitrationguide.authcheckdam.pdf) (last visited Apr. 18, 2017).

FY 2017.<sup>35</sup> This undesirable level of litigation activity, which may well be attributable to a growing alienation between taxpayers and Appeals, likely is perpetuated by a series of Appeals initiatives, including the AJAC project, the limitations placed on in-person conferences, and now the push to involve Counsel and Compliance in conferences regardless of taxpayers' views.<sup>36</sup>

This troubling trend could be exacerbated by the possibility that, given the potential presence of Counsel, taxpayers and their representatives may decide to forego Appeals altogether out of concerns that Counsel will simply use the conference as a means of gathering insight regarding taxpayers' litigation strategies. Fewer resolutions in Appeals means more of a resource burden for taxpayers and the government on account of litigation, which forces taxpayers to incur extra expense, subjects them to tremendous personal stress, and wastes ever-dwindling government funds.

Appeals, administered with a careful eye toward taxpayer attitudes, can help generate the types of interactions and perceptions that will perpetuate the compliant behavior necessary to the success of the voluntary tax system.<sup>37</sup> Conversely, the implementation of procedures that allow for the addition of participants to conferences against taxpayers' wishes will likely foster disenfranchisement, litigation, and long-term noncompliance.

In many cases, the involvement of Counsel and Compliance in conferences may well generate the outcomes desired by Appeals. These beneficial results, however, will only occur where the participation of Counsel and Compliance is agreed to by taxpayers and their representatives, not where it is unilaterally mandated by Appeals. In order to facilitate short-term case resolutions and long-term tax compliance, Appeals should foster mutual respect and trust by allowing taxpayers a choice in the expanded participation of Counsel and Compliance in Appeals conferences.

## CONCLUSION

Effective October 2016, Appeals implemented a number of changes to its conference procedures, including guidance in its IRM explicitly allowing Hearing Officers to invite Counsel and Compliance to participate in Appeals conferences. This step, however, may well have far-reaching negative consequences for Appeals' effectiveness in resolving cases with taxpayers. Among other things, Appeals' emphasis on expanding participation of Counsel and Compliance in conferences will fundamentally change the nature of conferences in which this approach is adopted and will jeopardize both the real and perceived independence of Appeals.

By allowing Hearing Officers the discretion to invite Counsel and Compliance personnel to join Appeals conferences, Appeals is altering the power dynamic between Hearing Officers and taxpayers. As a result, taxpayers are less likely to feel that their case has been fully heard, that they have been treated fairly, and

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- 35 National Taxpayer Advocate 2016 Annual Report to Congress 205. Examination-based cases represent the best data set for observing trends in this context, as Collection-based cases overwhelmingly give rise to non-docketed appeals (approximately 99.9 percent). Appeals response to TAS information request (Oct. 25, 2017). A docketed case arises when a taxpayer files a valid petition for review in the U.S. Tax Court and the case is referred back to Appeals for possible settlement. A prerequisite for this reassignment is that a taxpayer has not previously had an opportunity to present the case to Appeals. See IRM 8.4.1.4(1), *Appeals Authority Over Docketed Cases* (Oct. 26, 2016).
- 36 National Taxpayer Advocate 2017 Annual Report to Congress (Most Serious Problem: *The IRS Office of Appeals Imposes Unreasonable Restrictions on In-Person Conferences for Campus Cases, Even As It Is Making Such Conferences More Available for Field Cases*), *supra*; National Taxpayer Advocate 2016 Annual Report to Congress 203-10; National Taxpayer Advocate 2015 Annual Report to Congress 82-90.
- 37 Melinda Jone and Andrew J. Maples, *Mediation as an Alternative Option in Australia's Tax Disputes Resolution Procedures*, 27 AUSTL. TAX F. 525, 528 (2012); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138-71.

that the outcome of the proceeding should be respected. Instead, more litigation and less long-term tax compliance likely will be the unintended consequences of such an initiative. The IRS has acknowledged many of these issues, but has not yet committed to make any meaningful changes in the policy it has adopted.<sup>38</sup>

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Preserve its actual and perceived independence by adopting IRM procedures that separate Counsel and Compliance from Appeals conferences unless their inclusion is mutually agreeable to the taxpayer and Hearing Officer involved.
2. Continue to involve Counsel and Compliance in pre-conference hearings and if, after the Appeals conference itself is complete, additional information from Counsel and Compliance proves necessary, explain the need to taxpayers and convene a post-conference call or meeting in conformity with *ex parte* rules.
3. Track and analyze data relating to cycle times, outcomes, and subsequent litigation activity regarding conferences in which Counsel and Compliance participate so as to provide quantitative insight into the impact of such participation on Appeals proceedings.
4. Seek and carefully consider comments from tax practitioners and other stakeholders regarding when, and to what extent, the participation of additional IRS personnel in Appeals proceedings would contribute to case resolution.

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38 Matthew R. Madara, *IRS Addressing Concerns Over Appeals Conference Pilot Program*, 2017 TNT 114-3 (June 15, 2017).

**MSP  
#19****IDENTITY THEFT: As Tax-Related Identity Theft Schemes Evolve, the IRS Must Continually Assess and Modify Its Victim Assistance Procedures****RESPONSIBLE OFFICIAL**

Kenneth Corbin, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Quality Service*
- *The Right to Finality*

**DEFINITION OF PROBLEM**

Tax-related identity theft is an invasive crime that has significant impact on its victims and the IRS. Since 2004, the National Taxpayer Advocate has highlighted the need for the IRS to establish or improve procedures to assist victims of identity theft.<sup>2</sup> The IRS has gradually adopted many of our recommendations over the years. For example, one such change involved centralizing its identity theft victim assistance units, something for which TAS has long advocated.<sup>3</sup>

The IRS has made significant strides in revamping its identity theft victim assistance procedures. However, problems remain as cyber criminals continually evolve their schemes. In our review of the IRS response to identity theft, we found that:

- although identity theft case receipts are on the decline, there remains a significant inventory of unresolved identity theft cases;
- the IRS has adopted a centralized approach to identity theft victim assistance, including assignment of a sole contact person for certain victims;
- automated identity theft filters are still over-inclusive; and
- the IRS must be nimble as it counteracts emerging identity theft schemes, such as employer identity theft.

1 See Taxpayer Bill of Rights (TBOR), <http://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)).

2 See National Taxpayer Advocate 2015 Annual Report to Congress 180-87; National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 44-90; National Taxpayer Advocate 2013 Annual Report to Congress 75-83; National Taxpayer Advocate 2012 Annual Report to Congress 42-67; National Taxpayer Advocate 2011 Annual Report to Congress 48-73; National Taxpayer Advocate 2009 Annual Report to Congress 307-17; National Taxpayer Advocate 2008 Annual Report to Congress 79-94; National Taxpayer Advocate 2007 Annual Report to Congress 96-115; National Taxpayer Advocate 2005 Annual Report to Congress 180-91; National Taxpayer Advocate 2004 Annual Report to Congress 133-36.

3 See National Taxpayer Advocate 2007 Annual Report to Congress 115.

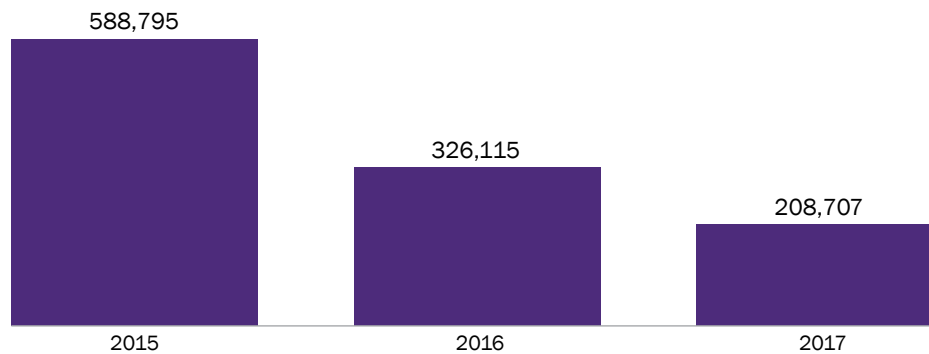
## ANALYSIS OF PROBLEM

### Although Identity Theft Case Receipts Are on the Decline, There Remains a Significant Inventory of Unresolved Identity Theft Cases

While still pervasive and having significant impact to victims, tax-related identity theft has been on the decline in recent years. There has been a downward trend in identity theft case receipts IRS-wide from 2015.

**FIGURE 1.19.1**<sup>4</sup>

**IRS Identity Theft Receipts, January 1-September 30, 2015-2017**



Through September 30, 2017, there has been a 36 percent drop in identity theft case receipts compared to the prior year, and a 65 percent drop compared to 2015.<sup>5</sup>

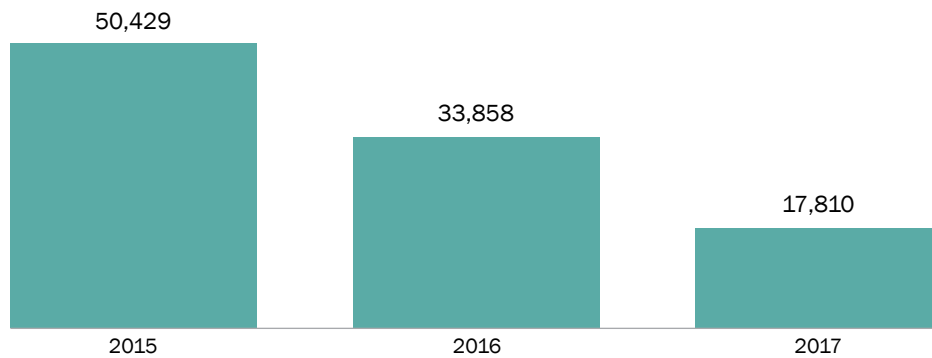
Within TAS, we have experienced a similar decline in our identity theft case receipts over the past year, which is a reversal of the upward trend in previous years.

<sup>4</sup> IRS, *Global Identity Theft Report* (Sept. 2017). Identity Theft Victim Assistance (IDTVA) accounts for the majority of the cases, but the inventory also includes a small amount from Small Business/Self-Employed (SB/SE) (Field Exam), Large Business and International (LB&I), and Appeals.

<sup>5</sup> Note that the 2015 and 2016 data in the table does not include inventories for Business Master File and Compliance Designated Identity Theft Adjustment, which are included in 2017 inventory.

FIGURE 1.19.2<sup>6</sup>

## TAS Identity Theft Receipts, January 1-September 30, 2015-2017



It is not clear what the primary driver of the reversal is that caused the downward trend of identity theft case receipts. However, we believe that improvements to the IRS's identity theft filters and earlier access to information return data, has led to the decline in identity theft case receipts.

We also believe that part of the decline may be attributable to the way the IRS calculates identity theft case receipts. When the IRS revised the layout this year of the Global Identity Theft Report that is distributed monthly to its executives, it does not include all identity theft cases worked outside of the Identity Theft Victim Assistance (IDTVA) unit in Victim Assistance Servicewide Inventory. For example, identity theft cases may be worked by the Return Integrity & Compliance Services (RICS) and Submission Processing (SP) functions, but are not included in the roll-up of victim assistance identity theft case receipts reported in the Global Report.<sup>7</sup>

To get a sense of the volume of open identity theft cases, TAS Research conducted a query of unique taxpayers with unreversed open identity theft claim markers input during calendar years 2014–2016 and through April 1, 2017.<sup>8</sup> TAS Research looked for identity theft cases that have been open for more than the 180-day normal processing time that have not had an identity theft closing marker. There are more than 178,000 such taxpayers, substantially more than the inventory of 36,333 identity theft cases reported by the IRS in the IRS Global Identity Theft Report for the corresponding period.<sup>9</sup>

6 Data obtained from Taxpayer Advocate Management Information System (TAMIS) (Jan. 1, 2015, Jan. 1, 2016, Jan. 1, 2017; Oct. 1, 2015, Oct. 1, 2016, and Oct. 1, 2017).

7 IRM 25.23.2.21(1), *IMF Identity Theft Worked by Functions Outside Accounts Management IDTVA* (Oct. 13, 2016): "The re-engineering effort brought accounts management and certain compliance functions under the Accounts Management Identity Theft Victim Assistance Organization. There are pockets of employees outside the new organization who will be working ID theft related issues identified using systemic applications and other applications and methods."; IRS, *Global Identity Theft Report* (Sept. 2017) (With Identity Theft Victim Assistance (IDTVA) making up the majority of the cases, the inventory also includes a small amount from SB/SE (Field Exam), LB&I, and Appeals).

8 IRS, Compliance Data Warehouse (CDW), Individual Master File (IMF), Transaction History table. Taxpayers are only counted once per year, but may be included more than once if their identity theft case spans multiple years. IRS did not provide information to confirm or disprove the figures during the TAS fact check process.

9 IRS, *Global Identity Theft Report* (Sept. 2017). This does not necessarily mean that the taxpayer's primary identity theft issue has not been resolved, but it does mean that the IRS has not taken all actions to protect the taxpayer from further harm — for example, a closing marker is required for a taxpayer to be eligible to receive an Identity Protection Personal Identification Number (IP PIN).

The analysis completed by TAS Research yielded cases with unresolved identity theft markers servicewide, regardless of which IRS function controlled the case. In contrast, the IRS Global Identity Theft Report omitted identity theft case receipts worked by some functions, such as RICS or SP. By opting to include only a portion of its identity theft case receipts, the IRS does not provide a complete perspective and may undermine its case for sufficient funding to prevent identify theft and assist victims. While the IRS has improved its fraud detection measures and streamlined its processing of identity theft cases in certain situations, the overall problem is more pervasive than the IRS “Global” report suggests. When funding decisions are made, it would do a disservice to taxpayers if Congress were to rely on incomplete data as evidence that identity theft is no longer a serious problem for tax administration.

### **The IRS Has Adopted a Centralized Approach to Identity Theft Victim Assistance, Including Assignment of a Sole Contact Person for Victims**

In addition to improved identity theft filters, the IRS recently overhauled its approach to identity theft victim assistance. In July 2015, the IRS established the IDTVA unit, centralizing victim assistance functions under one umbrella within the Wage and Investment (W&I) division.<sup>10</sup> In this centralized model, there is a core group of employees who receive specialized training in working identity theft cases.

Recently — for cases that do not require interaction with other IRS functions (such as RICS and SP) — IDTVA changed its procedures to designate a single employee as the sole contact person for an identity theft victim, from beginning to end.<sup>11</sup> The IDTVA assistor will provide the taxpayer with his or her name, direct phone extension, and tour of duty.<sup>12</sup> While we applaud the decision to provide a sole contact person — something the National Taxpayer Advocate has recommended since 2012<sup>13</sup> — we urge the IRS to extend this privilege to identity theft victims facing multiple issues and dealing with multiple IRS functions; these are the taxpayers most likely to have their cases fall between the cracks.

Shortly after standup in 2015, IDTVA convened a team (comprised of members from across various IRS organizations, including TAS) to overhaul the identity theft victim assistance procedures. This Identity Theft Re-engineering Team made many recommendations that allow the IRS to provide better service

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**For cases that do not require interaction with other IRS functions, Identity Theft Victim Assistance changed its procedures to designate a single employee as the sole contact person for an identity theft victim, from beginning to end — something the National Taxpayer Advocate has recommended since 2012.**

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10 While the IRS centralized most functions under IDTVA, some functions (such as Return Integrity & Compliance Services and Submission Processing) continue to work identity theft cases outside of IDTVA.

11 IRM Exhibit 25.23.4-6, *IDTVA Routing Matrix* (Oct. 1, 2017) (“With IDT, in most cases, there should be one single point of contact for a taxpayer.”).

12 IRM 25.23.4.18, *Telephone Contact Procedures for IDTVA Paper Employees Only* (Oct. 27, 2017) (“Upon receiving those calls, the employee should try to answer the taxpayer’s questions.... Provide the taxpayer the toll-free number, employee’s name extension and Tour of Duty (TOD) when available based on the TP’s time zone.”).

13 See National Taxpayer Advocate 2012 Annual Report to Congress 67.

to victims of identity theft. For example, the team strengthened the global account review procedures to ensure all actions are taken prior to closing an identity theft case. The re-engineering team also expanded the role and scope of the Identity Protection Specialized Unit (IPSU), enabling certain types of identity theft cases to be addressed by IPSU employees. The Taxpayer Protection Program (TPP) End-to-End (E2E) Improvement Team improved the taxpayer's experience by making several process improvements, which includes updating TPP letters to encourage taxpayer response, creating an internal TPP website to shorten average handle time, and improve taxpayer authentication.

One preventive measure the IRS continues to use is the Identity Protection Personal Identification Number (IP PIN). This IP PIN is a unique number assigned to victims of identity theft to use in conjunction with their tax identification number (TIN, usually a Social Security number) when filing tax returns in future years, after their account issues have been fully resolved and their identity and address have been verified. Once the IRS assigns an IP PIN to a taxpayer, it will not accept an e-filed tax return without this IP PIN and paper return processing will be delayed by a manual review to verify the taxpayer's identity. The IRS issued 3.5 million IP PINs for use in the 2017 filing season.<sup>14</sup> Since the IRS began using IP PINs in 2011, it has been a very effective safeguard that prevents fraud from recurring.

### Automated Identity Theft Filters Are Still Over-Inclusive

As tax-related identity theft refund fraud schemes become more sophisticated, the IRS continues to evolve its various filters, rules, and data mining models to combat these schemes. For example, the TPP is a process where the IRS uses a series of filters to stop certain tax returns it suspects are filed by an identity thief. TPP filters can be adjusted during the filing season if the data suggests that either the filters are too sensitive or not sensitive enough.<sup>15</sup> The IRS will not issue a refund for a return flagged by the TPP until the taxpayer can verify his or her identity by calling the TPP toll-free phone line and answering certain "high risk authentication" questions.<sup>16</sup>

As of September 30, 1.9 million suspicious tax returns were selected by the TPP identity theft filters in calendar year (CY) 2017.<sup>17</sup> In past years, we have had concerns regarding the high false detection rate.<sup>18</sup> High false detection rates can lead to significant downstream consequences for both the IRS and taxpayers. When legitimate taxpayers are ensnared in an over-reaching IRS fraud detection mechanism, they may experience protracted refund delays as they navigate the authentication processes to prove they are the true tax return filers.

In CY 2016, the false detection rate for TPP identity theft filters was 53 percent, which means that of all returns flagged as potentially fraudulent, more than half turned out to be legitimate.<sup>19</sup> In CY 2017 through September 30, the false detection rate for identity theft filters overall increased to 62 percent.<sup>20</sup>

14 IRM 25.23.2.20, *Identity Protection Personal Identification Number (IP PIN)* (Sept. 15, 2017); IRS, *Global ID Theft Report* (Aug. 2017).

15 IRS response to TAS information request (Nov. 6, 2017).

16 For taxpayers failing oral authentication with a phone assistor or for taxpayers deemed at high risk for identity impersonation (i.e., data breach victims), the only option is to visit a Taxpayer Assistance Center (TAC). IRM 25.25.6.3.2, *Referring the Caller to the Taxpayer Assistance Center (TAC) - Taxpayer Protection Program (TPP) Toll Free Assistors* (July 14, 2017).

17 IRS response to TAS information request (Nov. 6, 2017).

18 National Taxpayer Advocate 2016 Annual Report to Congress 151-60 (Most Serious Problem: *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*).

19 IRS Wage & Investment Division, *Business Performance Review 9* (Feb. 9, 2017).

20 *Id.*



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In calendar year 2017 through September 30, the false detection rate for identity theft filters overall increased to 62 percent. The IRS asserts that the identity theft filter false detection rate was a result of several large-scale data breach incidents from external organizations, which made it easier for identity thieves to access sensitive taxpayer information and more difficult for the IRS to create filters that can differentiate between legitimate and illegitimate tax returns.

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RICS, the function that is in charge of the TPP, asserts that the identity theft filter false detection rate was a result of several large scale data breach incidents from external organizations (see discussion below), which made it easier for identity thieves to access sensitive taxpayer information and more difficult for the IRS to create filters that can differentiate between legitimate and illegitimate tax returns.

### **The IRS Must Be Nimble As It Counteracts Emerging Identity Theft Schemes, Such As Employer Identity Theft**

As the IRS gets more adept at detecting identity theft, fraudsters get more sophisticated in their schemes. The IRS needs the ability to quickly identify and react to new schemes. It cannot afford to let months or even weeks go by without plugging a vulnerability in their filters.

One emerging identity theft scheme involves the reporting of false data that is filed on stolen employer identification numbers (EINs) or tax returns. Criminals have long used stolen EINs to perpetrate tax fraud by creating falsified Forms W-2, *Wage and Tax Statement* or Forms 1099, *Miscellaneous Income*, but in the past couple of years there has been an increase in the filing of fraudulent business tax returns.<sup>21</sup> The IRS is aware of these types of schemes and has created a team to respond to employer identity theft issues.

Return preparer misconduct (RPM) is another type of refund fraud scheme that, like employer identity theft, is likely to bypass traditional identity theft filters because the perpetrator has access to the legitimate filer's tax return information. The IRS began tracking return preparer misconduct cases in 2014.<sup>22</sup> While the raw number of RPM cases may be relatively low, this type of fraud is particularly traumatic because taxpayers are being victimized by people they entrusted with their very personal information.

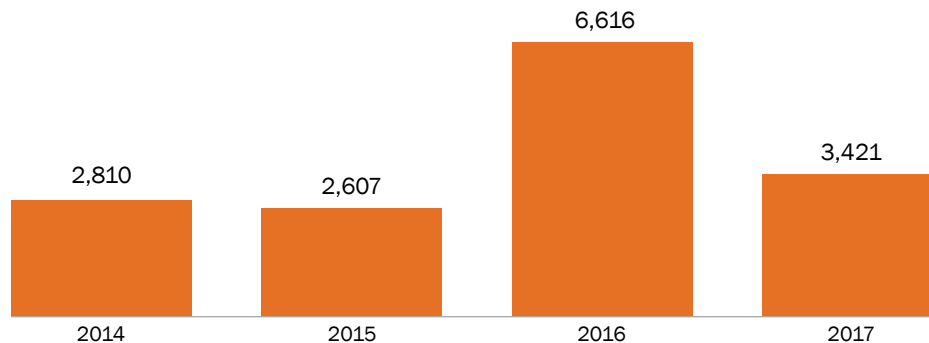
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21 See IRS, FS-2017-10, *Information on Identity Theft for Business, Partnerships and Estate and Trusts* (July 25, 2017).

22 IRM 25.23.2.19.1.2, *TC 971 AC 504 - Miscellaneous Field Code SPCL1, SPCL2, RPM1, RPM2, RPM3, RPM4, and EAFail* (Sept. 15, 2017).

FIGURE 1.19.3<sup>23</sup>

### Accounts Management Return Preparer Misconduct Receipts January 1-September 30, 2014-2017



### Large Scale Data Breaches May Cause a Reversal in the Downward Trend of Identity Theft Case Receipts

The IRS must also develop procedures to assist victims of new schemes in a timely manner. Recent schemes have targeted businesses and other large organizations to gain access to personal information of their employees or customers. For example, the sensitive personal information of over 145 million American consumers was exposed in a data breach at Equifax, one of the nation's three major credit reporting agencies.<sup>24</sup> The IRS must assess how best to assist victims of these large-scale data breaches. With so many taxpayers made vulnerable by having their personal identifying information available to hackers, we can expect that tax-related identity theft will ramp up. Taxpayer personal information may include their full name, Social Security number, address, and even information from their last filed return or Form W-2, *Wage and Tax Statement*.

Given the risk that an identity thief could have full access to an individual's personal information, the IRS may need to reconsider how secure allowing online or phone authentication will be. The IRS will need to consider alternative methods of validating a taxpayer's identity.

In the past, we recommended that the IRS expand the use of IP PINs to allow taxpayers in every state the ability to receive an IP PIN to protect their accounts.<sup>25</sup> There was concern about the cost of administering the IP PIN program (new IP PINs must be generated each year, and phone lines must be staffed to assist the percentage of taxpayers who will invariably misplace the IP PIN) and the IRS did not adopt our recommendation.<sup>26</sup> We recognize that there is a cost to providing an IP PIN, but we also know that there is a considerable cost to **not** protecting taxpayer accounts from fraud.

23 IRS response to TAS information request (Nov. 6, 2017).

24 See Equifax, <http://www.prnewswire.com/news-releases/equifax-announces-cybersecurity-firm-has-concluded-forensic-investigation-of-cybersecurity-incident-300529345.html>.

25 See National Taxpayer Advocate 2015 Annual Report to Congress 187.

26 See National Taxpayer Advocate 2016 Objectives Report vol. 2, 105 (*IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in the 2015 Annual Report to Congress*).

If the IRS finds it too cost-prohibitive to expand the IP PIN program under its current budget constraints, it should explore other ways to fund the cost. When a company is at fault for allowing a large-scale data breach, it often offers to pay for credit monitoring service for impacted individuals. The IRS should enter into similar agreements with these companies and have them pay for the cost of the IRS issuing IP PINs to impacted individuals.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Include identity theft case receipts received IRS-wide — including RICS and SP receipts — in its Global Identity Theft Report.
2. Expand its procedures so that all identity theft victims — including those with multiple tax issues and needing to interact with IRS functions outside of the Identity Theft Victim Assistance function — are assigned a sole contact person to assist them until all identity theft-related issues are resolved.
3. Set a limit of 35 percent for the false detection rate for its Taxpayer Protection Program identity theft filters for 2018 and 20 percent for 2019 and thereafter.
4. Expand the IP PIN program by offering it to all taxpayers to proactively protect their tax accounts against tax related identity theft.
5. Develop procedures to address large scale data breaches while minimizing the burden on victims.

**MSP  
#20****FRAUD DETECTION: The IRS Has Made Improvements to Its Fraud Detection Systems, But a Significant Number of Legitimate Taxpayers Are Still Being Improperly Selected by These Systems, Resulting in Refund Delays****RESPONSIBLE OFFICIALS**

Kenneth Corbin, Commissioner, Wage & Investment Division  
John D. (Don) Fort, Chief, Criminal Investigation

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

The IRS uses a series of complex screening processes to detect and prevent tax refund fraud.<sup>2</sup> When a return is flagged by the IRS's fraud detection system that scrutinizes returns for characteristics of refund fraud, the refund is held until the information on the return can be verified.<sup>3</sup> Although the IRS fraud detection system identifies illegitimate returns and prevents improper refunds from being issued, it also remains highly inaccurate, which results in unnecessary refund delays and negatively impacts taxpayers' voluntary compliance.

The National Taxpayer Advocate recognizes the need to detect and prevent refunds resulting from fraud or identity theft from being issued. However, TAS remains concerned about taxpayers whose legitimate refunds have been unreasonably delayed by the IRS. The IRS Return Review Program (RRP), the system used to detect fraud, selected 90,410 returns between January 1, 2017 and September 30, 2017, a decrease of about 25 percent from 120,884 returns selected during the same time period in 2016.<sup>4</sup> This may be explained in part by the availability of third-party reporting information (Forms W-2 and Forms 1099-MISC-Nonemployee Compensation) before or on January 31; thus, providing the IRS more time to match the wage and tax information reported on the taxpayer's return against the information

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).

2 The IRS Return Integrity & Compliance Services (RICS) uses the Return Review Program (RRP) to identify returns when it suspects that the return is fraudulent.

3 The IRS has distinct screening processes for identity theft and refund fraud. For purposes of this report, we will refer to refund fraud including certain instances that have elements of identity theft but are processed in the refund fraud units. See Most Serious Problem: *Identity Theft: As Tax-Related Identity Theft Schemes Evolve, the IRS Must Continually Assess and Modify Its Victim Assistance Procedures*, *supra* MSP 19.

4 IRS response to TAS's information request (Oct. 19, 2017).

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Despite the decline in the number of returns selected, the false positive rate went up from 54 percent for January 1, 2016 through September 30, 2016, to 66 percent for the same time period for 2017.

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submitted by third parties.<sup>5</sup> Despite the decline in the number of returns selected, the false positive rate (FPR) went up from 54 percent for January 1, 2016 through September 30, 2016, to 66 percent for the same time period for 2017.<sup>6</sup>

Over the past 14 years, the National Taxpayer Advocate has consistently advocated for taxpayers whose legitimate refunds have been unreasonably delayed by the IRS, and recommended improvements to reduce taxpayer burden while preventing refund fraud.<sup>7</sup> Despite some improvements to the IRS's fraud detection system, the following issues remain:

- Many legitimate returns are improperly selected as possibly fraudulent because fraud detection filters are too broad, lack exactness, and are not adjusted during filing season despite the functionality to do so. The IRS has worked with other agencies to establish best practices for preventing and detecting fraud, but could benefit from broadening the types of partners it collaborates with.
- Improperly selected returns caused tens of thousands of refunds to be delayed for up to 11 weeks. TAS Research and Analysis analyzed tax year 2016 cases from the 2017 filing season, the latest data available. The analysis shows the IRS's pre-refund Income Wage Verification (IWV) Program selected approximately 65,700 tax returns where taxpayers ultimately received their refunds, but the refunds of more than 37 percent, or approximately 24,400 taxpayers, were delayed 11 weeks or beyond.<sup>8</sup>
- Since 2014, about 24,000 refunds were held where refund fraud was suspected and a notice of disallowance was sent to the taxpayer.<sup>9</sup> These refunds were held for months — and in some

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<sup>5</sup> IRS response to TAS information request (Oct. 19, 2017). Section 201 of the Protecting Americans From Tax Hikes (PATH) Act of 2015 amended IRC § 6071 to require that certain information returns be filed by January 31, generally the same date as the due date for employee and payee statements, and are no longer eligible for the extended filing date for electronically filed returns under IRC § 6071(b). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 201 (2015).

<sup>6</sup> A false positive occurs when a system selects a legitimate return and delays the refund past the prescribed review period. IRS response to TAS information request (Oct. 19, 2017). The IRS commonly refers to this as a “false detection rate” (FDR); however, throughout this Most Serious Problem, we will be using the term “false positive rate” (FPR). IRS response to TAS fact check (Dec. 26, 2017).

<sup>7</sup> See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress, 45-55, 180-87; National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 44-90; National Taxpayer Advocate 2013 Annual Report to Congress 75-83; National Taxpayer Advocate 2012 Annual Report to Congress 42-67, 95-110; National Taxpayer Advocate 2011 Annual Report to Congress 48-73; National Taxpayer Advocate 2009 Annual Report to Congress 307-17; National Taxpayer Advocate 2008 Annual Report to Congress 79-94; National Taxpayer Advocate 2007 Annual Report to Congress 96-115; National Taxpayer Advocate 2005 Annual Report to Congress 25-54, 180-91; National Taxpayer Advocate 2004 Annual Report to Congress 133-36; and National Taxpayer Advocate 2003 Annual Report to Congress 175-81.

<sup>8</sup> TAS Research and Analysis, IRS Compliance Data Warehouse (CDW), Individual Master File (IMF) Transaction History Table and Individual Returns Transaction File Table for tax module 2016. See also footnote 30, *infra*.

<sup>9</sup> TAS Research and Analysis, IRS CDW, IMF Transaction History Table, Individual Returns Transaction File Table and Notice Delivery System Notice Table for Calendar Years (CYs) 2014-2017. See also footnote 31, *infra*.

cases, even years — before the notice of disallowance was issued to the taxpayer.<sup>10</sup> On average, the notice of disallowance was sent to the taxpayer about 31 weeks after the refund was held by the IWV Program.<sup>11</sup> Further, since 2014, about 5,800 refunds have been held and no notice of disallowance has ever been issued to the taxpayer.<sup>12</sup>

- Legitimate taxpayers who get entangled in the IRS refund fraud filters are subjected to poor customer service. For example, when the taxpayer reaches an IRS employee to inquire about his or her refund, he or she will find the customer service representative (CSR) does not have access to the case history which is stored on the IRS's Electronic Fraud Detection System (EFDS), and therefore cannot give specific responses to taxpayer inquiries.<sup>13</sup>

## ANALYSIS OF PROBLEM

### Background

In an effort to combat refund fraud, the IRS uses pre-refund IWV to freeze a taxpayer's refund when it detects potentially false income or withholding. The Return Integrity & Compliance Services (RICS) Integrity & Verification Operation (IVO) — a part of the Wage and Investment (W&I) Division — uses data mining models and manual reviews to identify potentially false returns, usually through income documents reported by third parties.<sup>14</sup> The system that is primarily used for detecting possible refund fraud is the RRP.<sup>15</sup>

The IRS's EFDS was previously used to detect possible refund fraud. However, for over a decade the IRS has been attempting to retire this system because of its limitations and it is now largely used as a case management system.<sup>16</sup> The retirement of EFDS for detecting possible refund fraud and the implementation of RRP has allowed the IRS to modernize its fraud detection program by enhancing its ability to create custom inquiries and modify models, which should improve stability if all the capabilities of the RRP system are properly used.

The IRS has taken other steps to improve its fraud detection and prevention, including:

- establishing the Security Summit to collaborate with other government agencies and the private sector to identify the best techniques to detect, prevent, and anticipate identity theft fraud activity; and
- comparing third-party documentation prior to releasing a refund, ensuring the information matches what is reported on the return.

10 The IRS uses different types of notices, some of which are required by statute, to tell taxpayers their claims are disallowed. If the IRS disallows any portion of a claim for refund or credit of an overpayment, IRC § 6532(a) requires it to mail to the taxpayer, by certified or registered mail, a notice of claim disallowance in order to commence the two-year statute of limitations on filing suit to challenge the disallowance in a United States District Court or the Court of Federal Claims. For more information on notices of disallowance, see National Taxpayer Advocate 2014 Annual Report to Congress, 172-84 (Most Serious Problem: *Notices: Refund Disallowance Notices Do Not Provide Adequate Explanations*).

11 TAS Research and Analysis, IRS CDW, IMF Transaction History Table, Individual Returns Transaction File Table and Notice Delivery System Notice Table for CYs 2014-2017. See also footnote 31, *infra*.

12 *Id.*

13 Internal Revenue Manual (IRM) 21.5.6.4.35.3 (Oct. 1, 2015).

14 IRM 25.25.1.1(1), *Revenue Protection, Return Integrity and Verification Revenue Protection Programs, Overview* (Feb. 19, 2015); IRM 25.25.2.1(1), *Program Scope and Objectives* (Mar. 29, 2017).

15 IRM 25.25.2.1(1) (Mar. 29, 2017).

16 Wage and Investment (W&I), *Business Performance Review (BPR) 21* (May 11, 2017). Currently, the IRS's RRP program is the system used for detecting possible fraudulent returns.

TAS's inventory of IVO cases indicates that taxpayers come to TAS more often for pre-refund wage verification than for any other issue except identity theft. For Fiscal Year (FY) 2017, TAS closed 20,238 IVO cases and of those, 77 percent received full or partial relief.<sup>17</sup>

### **Despite Improvements to Its Fraud Detection System, the IRS's Processes for Revising Filters Do Not Sufficiently Minimize Harm to Legitimate Taxpayers**

The IRS has accepted high FPRs of 50 percent or more, rather than leveraging the full capacity of its fraud detection system. In October 2016, the case selection functionality of EFDS was replaced by the RRP, which is a real-time application, and has the flexibility to allow the IRS to adjust filters virtually in real-time. Changes to the filters that do not require new code to be written can typically be implemented within 48 hours from the time the change was approved. Changes that require new code to be written typically take up to three weeks.<sup>18</sup> Notably, the IRS did not make any fraud filter changes between January 1, 2017 and September 30, 2017.<sup>19</sup>

In contrast, fraud detection systems used by tax administration agencies in several states are nimble and are regularly adjusted. For example, the Iowa Department of Revenue (DOR) has developed a fraud detection system with filters and models that are adjusted spontaneously, even in the midst of the filing season.<sup>20</sup> The Maryland DOR introduced a new set of algorithms that proved successful in identifying 65 to 70 percent of fraudulent returns last year — a significant increase from the 55 percent success rate in 2015.<sup>21</sup> The success was largely due to shifting from an algorithm that proved too far-reaching and overwhelmed fraud analysts to a more narrow and refined model that could better zero in on instances of fraud.<sup>22</sup>

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**The IRS has accepted high false positive rates of 50 percent or more, rather than leveraging the full capacity of its fraud detection system.**

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### *The IRS Has Worked With Other Agencies to Establish Best Practices for Preventing and Detecting Refund Fraud, But Should Expand the Types of Agencies It Consults With*

In recognition of escalating challenges related to identity (ID) theft refund fraud, the Commissioner of Internal Revenue convened a Security Summit meeting in Washington, D.C. on March 19, 2015. IRS officials and state tax administrators came together with the chief executive officers of the leading tax preparation firms, software developers, and payroll and tax financial product processors, to discuss common challenges and ways to leverage collective resources and efforts.

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17 Data obtained from Taxpayer Advocate Management System (TAMIS) (Oct. 1, 2017).

18 IRS response to TAS information request (May 23, 2017).

19 IRS response to TAS information request (Oct. 19, 2017). The IRS does have an annual meeting prior to the upcoming filing season in which it reviews prior year filters and discusses possible modifications to the filters for the upcoming filing season.

20 Meeting between TAS, Joshua R. Beck, Senior Advisor to the Executive Director of Systemic Advocacy, and Iowa Department of Revenue, Courtney M. Kay-Decker, Director (Aug. 29, 2017).

21 Juliet Van Wagenen, *How States are Using Tech to Stop Tax Fraud*, STATETECH MAGAZINE (March 24, 2017), <https://statetechmagazine.com/article/2017/03/how-states-are-using-tech-spot-tax-fraud>.

22 *Id.*

Although the Security Summit is primarily focused on ID theft, it is concerned with reducing refund fraud generally. The National Taxpayer Advocate, along with the Electronic Tax Administration Advisory Committee (ETAAC), recommended that the Security Summit broaden the types of partners to include entities from:

- the financial sector;
- the banking sector;
- the commercial sector; and
- the consumer and privacy advocate sectors.<sup>23</sup>

Expanding the Security Summit to include these partners will ensure it is aware of the most advanced tactics being used to detect and prevent ID theft and fraud in all sectors. Further, the Security Summit should consider amending its charter to reflect its interest in reducing all refund fraud and not just ID theft related refund fraud.

### The IRS's Fraud Detection System Still Has a High False Positive Rate (FPR) and a Number of Legitimate Refunds Are Delayed for an Excessive Period of Time

The National Taxpayer Advocate is pleased that the IRS is now conducting monthly tracking of FPRs, and has decided to reverse its earlier position and set aspirational FPR goals for both its ID theft and refund fraud filters.<sup>24</sup> The IRS has set an FPR goal for its ID theft filters of 50 percent, but has not yet set any goals for its refund fraud filters, stating that it is waiting for a full year of data from its RRP

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**When and if the IRS does set goals for its non-ID theft filters, it should consider a more ambitious goal than the 50 percent false positive rate set for its identity theft filters.**

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23 See National Taxpayer Advocate 2016 Annual Report to Congress 151-60 (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*); Electronic Tax Administration Advisory Committee (ETAAC) 2017 Annual Report to Congress (June 2017), <https://www.irs.gov/pub/irs-pdf/p3415.pdf>. See also National Taxpayer Advocate Fiscal Year 2018 Objectives Report to Congress, vol. 2, 82. Security Summit's efforts were institutionalized through the auspices of the ETAAC in 2016 when an amendment to ETAAC's charter expanded its scope to include identity theft. On an ongoing basis, ETAAC engages with the Security Summit through the attendance and participation of its members in work group activities. Additionally, ETAAC members proactively engage with Security Summit work group co-leads to keep abreast of Security Summit initiatives and Identity Theft Tax Refund Fraud (IDTTRF) developments.

24 The National Taxpayer Advocate recommended establishing target false positive rates for each process and filter. National Taxpayer Advocate 2015 Annual Report to Congress 45-55. The IRS did not initially adopt this recommendation: "The establishment of precise target false detection rates per Fraud Model ("Non-Identity Theft Model") would be challenging to implement because specific FDR are typically not available until several months into the filing season." National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress, vol. 2, 18, 20 (*IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in the 2015 Annual Report to Congress*). However, the IRS reversed course in 2017: "The FDR goal for the 2017 processing year is 49% for the identity theft (IDT) filters. Due to a change from moving non-IDT filters from the Electronic Fraud Detection System (EFDS) to the Return Review Program (RRP), we are baselining the FDR for non-IDT for 2017." National Taxpayer Advocate Fiscal Year 2018 Objectives Report to Congress, vol. 2, 78-81 (*IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in the 2015 Annual Report to Congress*).



system from which it will base its goal.<sup>25</sup> When and if the IRS does set goals for its non-ID theft filters, it should consider a more ambitious goal than the 50 percent FPR set for its ID theft filters.<sup>26</sup>

As stated above, FPRs for fraud detection rose from 54 to 66 percent for the period from January 1, 2017 through September 30, 2017, compared to the same period in 2016.<sup>27</sup> This means that 66 percent or about 60,000 out of the 90,410 returns selected by the system were legitimate returns.<sup>28</sup> Despite the RRP selecting two thirds of its IWV inventory in error, the IRS RRP monthly report stated, “All Filters are operating as expected; No filter changes are recommended at this time.”<sup>29</sup>

High FPRs result in many legitimate taxpayers having their refunds held unnecessarily. As noted earlier, TAS Research analyzed tax year 2016 returns from the 2017 filing season, the latest data available. Of the about 65,700 returns selected for IVO review in which taxpayers ultimately received their refunds, nearly 63 percent took ten or fewer weeks to process, but about 37 percent of these refunds were held 11 weeks or longer.<sup>30</sup> Prior to October 2015, the IRS was required to take action, such as manually freezing or releasing a refund, if it was to hold refunds beyond 11 weeks. However, after October 2015, the IRS changed its policy, holding all refunds indefinitely until a determination is made.

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**Despite the Return Review Program selecting two thirds of its Income Wage Verification inventory in error, the IRS Return Review Program monthly report stated, “All Filters are operating as expected; No filter changes are recommended at this time.”**

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### **The IRS Holds Refunds for Months Before Issuing a Notice of Disallowance, and in Some Cases, a Notice of Disallowance Has Never Been Issued**

Since 2014 through September 30, 2017, the IRS held about 24,000 refunds for which a notice of disallowance was sent to the taxpayer on average 31 weeks after the return was selected by the IWV program (this is about 20 weeks beyond an 11-week time period in which the IRS previously had to

25 National Taxpayer Advocate Fiscal Year 2018 Objectives Report to Congress, vol. 2, 82.

26 *See Id.*

27 IRS response to TAS information request (Oct. 19, 2017).

28 *Id.*

29 IRS, Identify Theft (IDT) & Integrity & Verification Operation (IVO) Selections Performance Report, PowerPoint slide 5, (Sept. 6, 2017).

30 TAS Research and Analysis, IRS CDW IMF Transaction History Table and Individual Returns Transaction File Table for tax module 2016. The computation of these numbers is based on a population of IVO returns that were identified by having an initial IVO posting transaction code and action code and having a refund due. Then these returns were filtered to exclude any returns with reversed credit for withheld taxes, any returns with additional tax assessment or carryback allowance or carryback disallowance, any returns with overpayment interest transfer, and any returns with posted duplicate return or posted amended return, posted consolidated generated amended return, late reply, or Department of Labor referral.

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**Holding refunds for an extended period of time before sending a notice of disallowance, or holding the refund and never sending a notice of disallowance, resembles the practices under the highly criticized IRS Questionable Refund Program and raises significant taxpayer rights and due process concerns.**

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either release the refund or take action on the return).<sup>31</sup> For about 5,800 refunds held during the same period the IRS has not yet issued a notice of disallowance.<sup>32</sup> Holding refunds for an extended period of time before sending a notice of disallowance, or holding the refund and never sending a notice of disallowance, resembles the practices under the highly criticized IRS Questionable Refund Program (QRP) and raises significant taxpayer rights and due process concerns.<sup>33</sup> To avoid the problems experienced as a result of the QRP, it is essential that the IRS reinstate the 11-week limitation on holding refunds, which required the IRS to either release the refund after 11 weeks or take action on it.<sup>34</sup> This would properly observe the taxpayer's *right to finality* and the taxpayer's *right to challenge the IRS's position and be heard*.

### **Legitimate Taxpayers Who Get Entangled in the IRS Refund Fraud Filters Are Subjected to Poor Customer Service**

Nearly sixty thousand taxpayers with legitimate returns who ultimately received their refunds were subjected to a frustrating and often elusive process when attempting to determine the cause of their refund delay.<sup>35</sup> If the IRS is scrutinizing the return for possible refund fraud, the taxpayer will be instructed to contact the IRS's general Accounts Management (AM) Customer Service line, which did not answer about one out of every four calls during FY 2017.<sup>36</sup>

When taxpayers reach a CSR, he or she will find the CSR does not have access to the case history which is stored on the IRS's EFDS system, and therefore cannot give specific responses to taxpayer inquiries.<sup>37</sup> CSRs take down information and refer it to the IWV group in IVO. IVO, however, does not call back

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31 TAS Research and Analysis, IRS CDW, IMF Transaction History Table, Individual Returns Transaction File Table and Notice Delivery System Notice Table for CYs 2014-2017. The computation of these numbers is based on a population of IVO returns that were identified by having an initial IVO posting transaction code and action code and having a refund due and a subsequent posting of transaction code and action code for identified to meet OMM criteria or identified to be potentially fraudulent or identified to need additional time to complete the review. These returns were filtered to exclude any returns receiving refunds, any returns with additional tax assessment or carryback allowance or carryback disallowance, and any returns with posted duplicate return or posted amended return, posted consolidated generated amended return, late reply, or Department of Labor referral. These filtered returns were matched to the notice file with disallowance letters and any unmatched returns were excluded. Weeks of delay measured from date of initial IVO posting transaction code and action code to date of disallowance letter.

32 TAS Research and Analysis, IRS CDW IMF Transaction History Table, Individual Returns Transaction File Table and Notice Delivery System Notice Table for CYs 2014-2017. See also footnote 31, *supra*.

33 National Taxpayer Advocate 2005 Annual Report to Congress 25-54.

34 IRM 25.25.11.2, *Wage/Withholding Only (WOW) (Notice CP05A) Overview* (Oct. 10, 2017). The IRS may send the taxpayer a notice requesting additional information regarding their withholdings. However, this notice is not necessarily sent within an 11-week time period from when the return was selected by the Income Wage Verification (IWV) Program, and does not provide any information regarding the taxpayer's right to file a refund suit in federal court.

35 IRS response to TAS information request (Oct. 19, 2017).

36 W&I, *BPR* (Nov. 9, 2017).

37 IRM 21.5.6.4.35.3 (Oct. 1, 2015).

or correspond with a taxpayer based on the referral from a CSR. If the information forwarded by the CSR is not verifiable, IVO will simply close out the referral on an Account Management Services (AMS) application, without contacting the taxpayer.<sup>38</sup> If a taxpayer tries to get information from the “Where’s My Refund” application, he or she will receive a generic message prompting a call to the IRS. As we previously recommended, the IRS should establish a direct line to reach IVO so that affected taxpayers can resolve refund issues with an employee knowledgeable of his or her return issues. This would decrease resolution time and save resources downstream since the taxpayer would not need to call the general AM line.

## CONCLUSION

The National Taxpayer Advocate recognizes the need to detect and prevent refunds resulting from fraud from being issued, and acknowledges the important steps the IRS has taken to improve its fraud detection program. However, reducing fraud must be accomplished while respecting and protecting the taxpayer’s right to a *fair and just tax system*. This means the IRS is obligated to design and implement systems that impact as few legitimate taxpayers as possible and allow legitimate taxpayers to reach an IRS employee to resolve any discrepancies, thereby avoiding unnecessary and prolonged refund delays.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Expand the Security Summit by including participants from the financial sector, the banking sector, the commercial sector, and consumer and privacy advocate sectors.
2. Revise the Security Summit’s charter to broaden its scope to include non-identity theft refund fraud.
3. Reinstate the 11-week process thereby requiring the IRS to either release the refund or to take some other action on the account, such as requesting additional information from the taxpayer or sending a notice of disallowance.
4. Establish a direct phone line to the IVO unit and provide information via “Where is my Refund” application to those taxpayers whose refunds are held because of suspected fraud.

38 IVO does not correspond with a taxpayer based on a referral from a customer service representative (CSR). To the contrary, if it is just a refund status inquiry not associated with any verifiable information, IVO employees will just close out the referral on Account Management Services (AMS). IRM 25.25.5.2 (May 17, 2016); IRM 25.25.5.4 (Dec. 10, 2015); IRM 25.25.5.4.1 (May 17, 2016).

**MSP  
#21****REFUND ANTICIPATION LOANS: Increased Demand for Refund Anticipation Loans Coincides with Delays in the Issuance of Refunds****RESPONSIBLE OFFICIALS**

Kenneth Corbin, Commissioner, Wage and Investment Division  
John D. (Don) Fort, Chief, Criminal Investigation

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**DEFINITION OF PROBLEM**

Demand for refund anticipation loans (RALs) has more than tripled over the past year.<sup>2</sup> Over 90 percent of the returns filed with RAL indicators were filed by February 15.<sup>3</sup> This substantial increase in demand coincides with the effective date of the provision in Internal Revenue Code (IRC) § 201 of the Protecting Americans from Tax Hikes Act of 2015 (PATH Act) that requires the IRS to hold all refunds that include Earned Income Tax Credit (EITC) and Additional Child Tax Credit (ACTC) until February 15.<sup>4</sup> While the IRS is statutorily required to delay refund issuance, such delay improves tax administration by allowing the IRS to match return information with information reporting documents. However, in the process, taxpayers are absorbing the costs of these short-term loans and, in many cases, they might not even realize the true cost due to the hidden nature of the indirect fees.<sup>5</sup>

**ANALYSIS OF PROBLEM****Background***The Demand for Refund Anticipation Loans*

Taxpayers have various refund delivery options, of which the most popular is direct deposit into the taxpayer's bank account. Eight out of ten refunds are delivered through direct deposit, which is a no

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://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)).
- 2 As of May 23, 2017, the IRS accepted over 1.7 million returns with refund anticipation loan (RAL) indicators, up from 468,330 in the same time period in 2016. Returns with refund anticipation check (RAC) indicators decreased during this period with about 21.5 million in 2016 and over 20.2 million in 2017. IRS, *Daily E-File at a Glance*, U.S. Totals for Individual Returns, Nationwide (May 24, 2017).
- 3 IRS, *Daily E-File at a Glance*, U.S. Totals for Individual Returns, Nationwide (Feb. 15, 2017). As of February 15, 2017, the IRS accepted over 1.56 million returns with RAL indicators, up from 437,245 in the same time period in 2016. Therefore, approximately 90 percent of the total 1.7 million RAL returns filed (as of Aug. 23, 2017) were filed by Feb. 15, 2017.
- 4 Protecting Americans from Tax Hikes Act of 2015 (the PATH Act), enacted as part of the Consolidated Appropriations Act, 2016, Division Q, Pub. L. No. 114-113, 129 Stat. 2242 (Dec. 18, 2015); See, e.g., Jackson Hewitt, *How Fast Will You Get Your Tax Refund This Year?*, <https://www.jacksonhewitt.com/Resource-Center/Your-Tax-Refund/> (last visited Sept. 8, 2017).
- 5 Chi Chi Wu (National Consumer Law Center) and Michael Best (Consumer Federation of America), *Big Changes Burden Taxpayers: New Law Delays Refunds, Drives Demand for Loans; Immigrant Taxpayers Face Challenges* 3-4 (Mar. 2017).

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**Demand for refund anticipation loans (RALs) has more than tripled over the past year. Over 90 percent of the returns filed with RAL indicators were filed by February 15.**

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cost option. When combined with e-filing, this method is the quickest way for taxpayers to receive refunds, with more than nine out of ten direct deposit refunds delivered within 21 days.<sup>6</sup> However, direct deposit is not available to unbanked taxpayers.<sup>7</sup> Unbanked taxpayers can choose to receive a paper check, which takes up to six weeks and may involve check cashing fees, or purchase a commercial product that may reduce the wait but typically involves high fees. Such commercial products include RALs, refund anticipation checks (RACs and also known as refund transfers), and debit cards.<sup>8</sup> These products also provide a mechanism by which the taxpayer can pay tax preparation fees with the anticipated tax refund.<sup>9</sup>

RALs are short term interest-bearing loans secured by the taxpayer's expected refund. The loans are made by financial institutions, facilitated by tax preparers and tax preparation software, and enable taxpayers to receive advances of a portion of their refund (typically an amount up to \$1,300). The taxpayer contracts with the financial institution for the loan and receives the funds a day or two after applying. The refund is then sent to an account held by the financial institution, which offsets the refund with the amount of the loan, and then disburses the remaining balance, if any, to the taxpayer.<sup>10</sup>

### *The History of Refund Anticipation Loans*

RALs were introduced in the tax preparation market in 1987. In 2000, the IRS instated the Debt Indicator (DI) to provide information on refund offsets.<sup>11</sup> The National Taxpayer Advocate has raised

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6 IRS, *Direct Deposit Your Refund* (Mar. 27, 2017). As of Aug. 18, 2017, almost 88 million refunds were delivered by direct deposit out of a total of over 108 million refunds issued to individual taxpayers. The number of direct deposit refunds increased by one percent from the same time in 2016. *IRS Filing Season Statistics, Cumulative Individual Income Tax Returns*, (Aug. 18, 2017).

7 Unbanked taxpayers are taxpayers with no bank accounts.

8 RALs are loans secured by a taxpayer's anticipated tax refund. RACs are temporary bank accounts established on behalf of a taxpayer into which the IRS can direct deposit a refund and out of which a bank typically issues a payment to the taxpayer. For more information on RALs and RACs, see National Taxpayer Advocate Fiscal Year 2007 Objectives Report to Congress, vol. 2, 2-18 (Study: *The Role of the IRS In the Refund Anticipation Loan Industry*). In addition, some financial institutions offer pay stub loans, also known as holiday loans, in which the tax preparer prepares an estimated return based on the last pay stub, because the taxpayer does not yet have a W-2. The lender advances a small portion of the refund with the pay stub loan and the remainder of the refund is available after the preparer prepares and files the return once the W-2 is available. The IRS does not track pay stub loans specifically. However, it is possible that these loans are included in the RAL data because the tax return would likely list the taxpayer's temporary bank account associated with these loans. An example of a pay stub loan is the Express Refund Advance by MetaBank. See <https://www.jacksonhewitt.com/file-taxes-last-pay-stub/> (last visited on Nov. 14, 2017).

9 Urban Institute and Internal Revenue Service, *Characteristics of Users of Refund Anticipation Loans and Refund Anticipation Checks* 33 (2010); IRS Working Group on Refund Anticipation Loans and Other Refund Settlement Products, *Background Information* 8 (Mar. 2010).

10 See Urban Institute and Internal Revenue Service, *Characteristics of Users of Refund Anticipation Loans and Refund Anticipation Checks* (2010); Karen Masken, Mark Mazur, Joanne Meikle, and Roy Nord, IRS Office of Research, Analysis, and Statistics, *Do Products Offering Expedited Refunds Increase Tax Compliance?* (Nov. 2007).

11 The Debt Indicator (DI) was used as an underwriting tool for RALs. The DI was included in the acknowledge file for electronically filed returns and indicated whether the individual taxpayer would have any portion of the refund offset for delinquent tax or other debts, such as unpaid child support or delinquent federally funded student loans. RAL lenders used the DI to gauge whether the taxpayer's entire anticipated refund would be released by the IRS. IRS, *IRS Removes Debt Indicator for 2011 Tax Filing Season*, IR-2010-89 (Aug. 5, 2010); Urban Institute and Internal Revenue Service, *Characteristics of Users of Refund Anticipation Loans and Refund Anticipation Checks* 12 (2010).

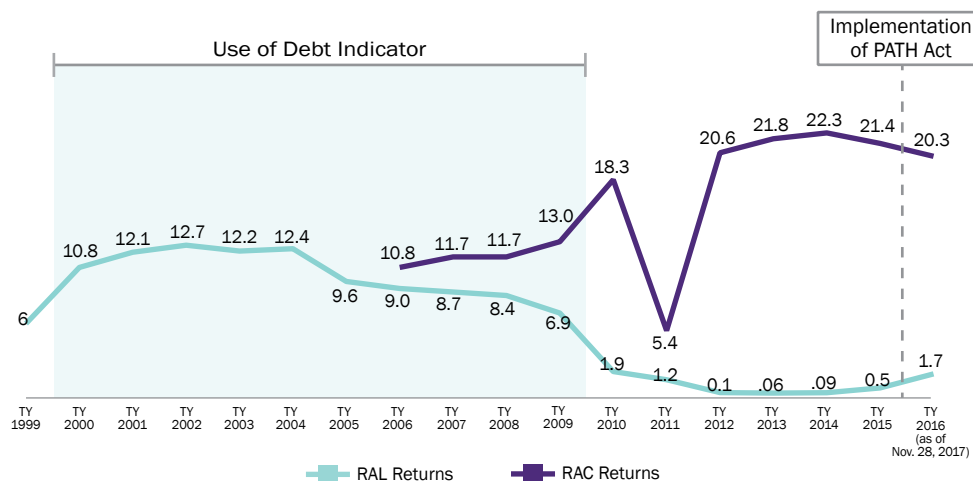
concerns about the high costs as well as compliance risks associated with these products since 2005.<sup>12</sup> The IRS stopped providing the DI to the financial institutions beginning in Filing Season (FS) 2011 and, as a result, most banks exited the RAL market by 2012.

### A Spike in RAL Demand Coincides with the Effective Date of the PATH Act

Beginning in FS 2017, RALs have reemerged in the refund product market. The increase in demand coincided with the effective date of the provisions in the PATH Act preventing the IRS to release EITC or ACTC refunds before February 15.<sup>13</sup> The demand for RALs spiked significantly in FS 2017.<sup>14</sup> The chart below shows the demand for RALs and RACs from Tax Year (TY) 1999 to 2016.

FIGURE 1.21.1<sup>15</sup>

Refund Anticipation Loan (RAL) and Refund Anticipation Check (RAC)  
Demand From Tax Years (TYs) 1999 to 2016 (in millions)



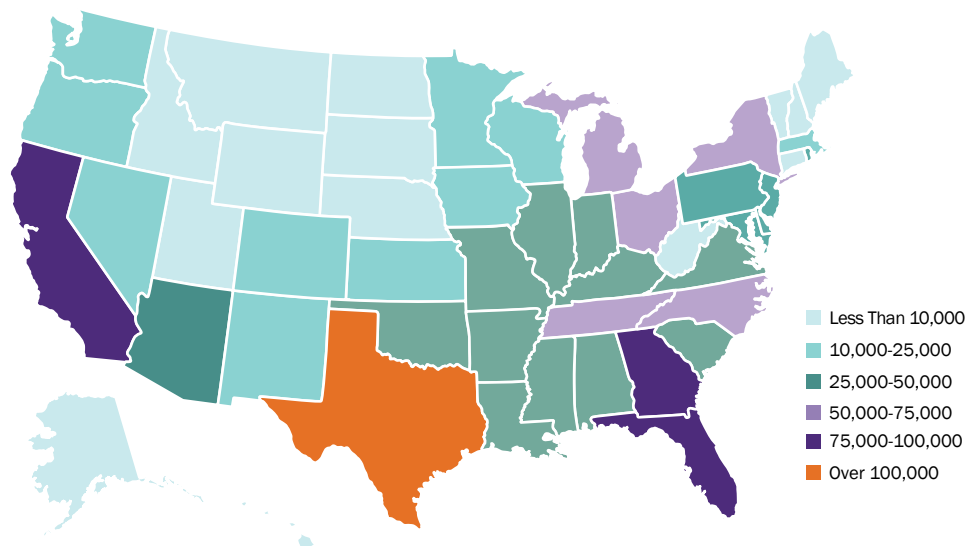
- 12 National Taxpayer Advocate 2011 Annual Report to Congress 404-419; National Taxpayer Advocate 2008 Annual Report to Congress 427; National Taxpayer Advocate Fiscal Year 2007 Objectives Report to Congress, *The Role of the IRS in the Refund Anticipation Loan Industry, Vol. II* (June 30, 2006); *Tax Return Preparation Options for Taxpayers: Hearing Before S. Comm. On Finance, 109th Cong.* (Apr. 4, 2006) 1-5 (statement of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate 2005 Annual Report to Congress 162-79; *Fraud in Income Tax Return Preparation: Hearing Before Subcomm. on Oversight, H. Comm. on Ways & Means, 109th Cong.* (July 20, 2005) (statement of Nina E. Olson, National Taxpayer Advocate).
- 13 To address the EITC improper payment rate, Congress included a directive in the PATH Act that requires the IRS to delay payment of any refund that includes the EITC or the refundable portion of the Child Tax Credit (CTC) until February 15 of each filing year. The freeze on refunds involving EITC or the refundable portion of the CTC applies to refunds made after December 31, 2016. Protecting Americans from Tax Hikes (PATH) Act of 2015, Pub. L. No. 114-113, Division Q, Title II, § 201(b), 129 Stat. 2242, 3076 (2015) (codified at IRC § 6402(m)).
- 14 IRS, *IRS Removes Debt Indicator for 2011 Tax Filing Season*, IR-2010-89 (Aug. 5, 2010); Chi Chi Wu and Chantal Hernandez, National Consumer Law Center, *Minefield of Risks: Taxpayers Face Perils from Unregulated Preparers, Lack of Fee Disclosure, and Tax-Time Financial Products* 7 (Mar. 2016).
- 15 Counts from Urban Institute and Internal Revenue Service, *Characteristics of Users of Refund Anticipation Loans and Refund Anticipation Checks* (2010) for tax years 1999 through 2007 and from Compliance Data Warehouse (CDW) for tax years 2008 through 2016 (as of Aug. 29, 2017). The IRS did not provide information to confirm or disprove the figures during the TAS Fact Check process.

There was a 72 percent *decrease* in demand after TY 2009 when the IRS discontinued the DI and a significant *increase* in demand during FS 2017. More importantly, 90 percent of returns filed with RAL indicators were filed on or before February 15.<sup>16</sup> This substantial increase in demand coincides with the effective date of the provision in the PATH Act requiring the IRS to delay the issuance of refunds with EITC and ACTC until February 15.<sup>17</sup> Taxpayers who are facing financial hardship and need the money before February 15 to pay bills may be willing to incur the additional costs.

The map below illustrates the number of RAL filers across the continental United States.

**FIGURE 1.21.2, TY 2016 RAL Filings Through Feb. 15, 2017**

**Refund Anticipation Loans, Tax Year 2016 (through February)**



Texas had the most filings, with approximately 156,000 RAL returns, or 10.6 percent of the total, almost twice that of Florida and California. Larger representation was also noted for states such as Georgia, North Carolina and Ohio.<sup>18</sup>

**The Compliance Risk Associated with RALs**

The National Taxpayer Advocate is particularly concerned about the rate of noncompliance for returns with RALs. For filings through February 15, 2017, 83 percent included EITC claims and the median Adjusted Gross Income (AGI) was \$20,600 (average AGI was \$24,800).<sup>19</sup> The following chart provides the number of RAL returns in which the taxpayer received their expected refund, less than

16 IRS, *Daily E-File at a Glance*, U.S. Totals for Individual Returns, Nationwide (Feb. 15, 2017).

17 See, e.g., Jackson Hewitt, *How Fast Will You Get Your Tax Refund This Year?*, <https://www.jacksonhewitt.com/Resource-Center/Your-Tax-Refund/> (last visited Sept. 8, 2017).

18 State counts of RAL filings are from IRS, CDW, Individual Returns Transaction File (IRTF), Form 1040. Data represents tax year 2016 returns filed with a RAL indicator through February 15. The IRS did not provide information to confirm or disprove the figures during the TAS Fact Check process.

19 EITC, Adjusted Gross Income (AGI) and RAL counts are from IRS, CDW, IRTF, Form 1040. Data represents tax year 2016 returns filed with a RAL indicator through February 15. The IRS did not provide information to confirm or disprove the figures during the TAS Fact Check process.

the anticipated refund, or no refund. The chart also indicates if the refund was subject to an offset (indicating either no offset, partial offset of the refund, or full offset of the refund). In the chart, when a TY 2016 refund is offset either partially or fully in FS 2017, it is used to repay a federal tax debt from a prior tax year.<sup>20</sup> Therefore, an offset, whether partial or full, that occurs in FS 2017 does not indicate TY 2016 noncompliance.

**FIGURE 1.21.3, FS 2017 RAL Return Refunds, Filed by Feb. 15, 2017 (counts rounded to nearest hundred)<sup>21</sup>**

Refund Status	Count	No Offset	Partial Offset	Full Offset
Expected Refund Received	1,398,000			
Percent of Total	95.3%			
Less Refund Received	54,900	7,900	47,000	
Percent of Total	3.7%	0.5%	3.2%	
No Refund Received	13,300	5,000	400	7,800
Percent of Total	0.9%	0.3%	0.03%	0.5%
<b>Total</b>	<b>1,466,200</b>			

Therefore, the above chart indicates that the IRS did not issue the entire claimed refund for reasons other than refund offsets on less than one percent of the RAL returns. A subset of this population was subject to a refund hold due to issues including Income Wage Verification, Taxpayer Protection Program Identity Theft filters and similar programs. The following chart illustrates the number of RAL returns filed during FS 2017 with refund holds, also indicating whether or not the refund was subject to offset:

**FIGURE 1.21.4, FS 2017 Refund Holds for RAL Returns (counts rounded to nearest hundred)<sup>22</sup>**

Refund Status	Count	No Offset	Partial Offset	Full Offset
Less Refund Received	2,300	1,000	1,300	
No Refund Received	4,000	3,600	100	300
<b>Total</b>	<b>6,300</b>			
<b>Percent of Total RALs</b>	<b>0.4%</b>			

20 Internal Revenue Manual (IRM) 21.4.6.2, *What is a Refund Offset* (Sept. 22, 2017). IRC § 6402 provides authority for the Treasury Secretary to apply a taxpayer's refund to any outstanding federal tax debt, child support obligation, other federal agency debt, state income tax debt, or unemployment compensation debt prior to crediting the overpayment to a future tax year or issuing a refund. The offsets in the chart only include offsets for past due federal tax debts.

21 IRS, CDW, IRTF, Form 1040, and Individual Master File (IMF) Transaction History for individuals filing returns through Feb. 15, 2017 for the tax year ending Dec. 31, 2016. Totals were compiled for returns with a RAL indicator. The IRS did not provide information to confirm or disprove the figures during the TAS Fact Check process.

22 IRS, CDW, IRTF, Form 1040, and IMF Transaction History for individuals filing returns through Feb. 15, 2017 for the tax year ending Dec. 31, 2016. Totals were compiled for returns with a RAL indicator and for all returns. The IRS did not provide information to confirm or disprove the figures during the TAS Fact Check process.



While the initial noncompliance rate for RAL returns appears low, it is higher than the rate for overall individual returns filed in the same time period.<sup>23</sup> The Taxpayer Advocate Service will evaluate the compliance rates of RAL returns into the future as awareness of and demand for the product continues to increase. Our concern stems from past noncompliance associated with these products. For example, a 2007 study conducted by IRS Research found a significant correlation between taxpayers using RALs and noncompliance. In fact, the study found that RAL users are 27 percent to 36 percent more noncompliant than taxpayers who do not use a bank product.<sup>24</sup>

### Taxpayers Still Pay for “No-Fee RALs”

In the wake of the PATH Act, some lenders are now offering “no-fee” RALs.<sup>25</sup> For FS 2017, the loans were limited to amounts up to \$1,300, depending on the lender. With no-fee RALs, the taxpayer does not directly pay a fee or incur any interest charges for the loan. The preparer pays the loan fee to the financial institution.<sup>26</sup> The no-fee RAL differs from those offered in the past as they are now nonrecourse loans, meaning that the taxpayer is not liable if the IRS does not release the entire anticipated refund in a timely manner.<sup>27</sup> In addition, at least one of the lenders provided that there is no negative credit reporting of the taxpayer in such a case.<sup>28</sup> On its face, it appears that the financial institution takes the greatest risk with this new refund product. However, the taxpayer does not necessarily walk away from the deal without any consequences if the IRS fails to release part or all of the refund, because the taxpayer may be subject to taxation on cancellation of debt income.<sup>29</sup>

While the taxpayer does not directly pay any fees when purchasing a no-fee RAL, it is inevitable that the banks and preparers are recouping the costs indirectly. Banks often charge preparers a fee for the RAL. In addition, banks can also recoup the costs of providing RALs through indirect means. For example, during FS 2017, River City Bank required RAL customers to also purchase a RAC (also known as a refund transfer) at a cost of \$44.95. If the taxpayer decided against purchasing a RAL and only

23 While approximately 95 percent of all RAL returns received their expected refund, 96 percent of all individual TY 2016 returns filed through Feb. 15, 2017 received their expected refund. Further, while 0.4 percent of RAL returns were subject to a refund hold, 0.2 percent of all individual returns filed through Feb. 15, 2017 were subject to refund holds. Therefore, the initial no-fee RAL data appears to show low noncompliance but, when compared to overall individual returns filed in the same time period, it may signal potential noncompliance issues. IRS, CDW, IRTF, Form 1040, and IMF Transaction History for individuals filing returns through Feb. 15, 2017 for the tax year ending Dec. 31, 2016. Totals were compiled for returns with a RAL indicator and for all returns. The IRS did not provide information to confirm or disprove the figures during the TAS Fact Check process.

24 Karen Masken, Mark Mazur, Joanne Meikle, and Roy Nord, IRS Office of Research, Analysis, and Statistics, *Do Products Offering Expedited Refunds Increase Tax Compliance?* 19 (Nov. 2007).

25 Some of the financial institutions that offered “no-fee” RALs during FS 2017 include: MetaBank (lender for H&R Block through FS 2017 and Jackson Hewitt), Santa Barbara Tax Products Group, Republic Bank & Trust (lender for Liberty Tax), and River City Bank. Chi Chi Wu, National Consumer Law Center, and Michael Best, Consumer Federation of America, *Big Changes Burden Taxpayers: New Law Delays Refunds, Drives Demand for Loans; Immigrant Taxpayers Face Challenges* 3-4 (Mar. 2017).

26 Chi Chi Wu, National Consumer Law Center, and Michael Best, Consumer Federation of America, *Big Changes Burden Taxpayers: New Law Delays Refunds, Drives Demand for Loans; Immigrant Taxpayers Face Challenges* 3-4 (Mar. 2017); Chi Chi Wu and Chantal Hernandez, National Consumer Law Center, *Minfield of Risks: Taxpayers Face Perils from Unregulated Preparers, Lack of Fee Disclosure, and Tax-Time Financial Products* 7 (Mar. 2016); See, e.g., Republic Bancorp, Inc., Form 10-K for year which ended on December Dec. 31, 2016 at 12.

27 Chi Chi Wu (National Consumer Law Center) and Michael Best (Consumer Federation of America), *Big Changes Burden Taxpayers: New Law Delays Refunds, Drives Demand for Loans; Immigrant Taxpayers Face Challenges* 3 (Mar. 2017).

28 Republic Bancorp, Inc., Form 10-K for year ending Dec. 31, 2016 at 12.

29 See IRC § 61(a)(12); Rev. Rul. 91-31, 1991-1 CB 19 (1991). Depending on the amount of the debt discharge, the lender may be subject to reporting requirements, in which case the lender issues to the taxpayer IRS Form 1099-C. IRC § 6050P. For detailed explanation of the taxation of, as well as exceptions for and exclusions from cancellation of debt income, see IRS Pub. 4681, *Canceled Debts, Foreclosures, Repossessions, and Abandonments (For Individuals)*.

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Because tax preparers directly incur the refund anticipation loan fees, the IRS should require Electronic Return Originators to prepare a “truth-in-lending” statement if they are offering a Refund Anticipation Loan product. This statement would incorporate clear language and design to help the taxpayer better understand the terms of the loan product, including any “hidden” or indirect costs of the loan product.

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purchased a RAC, the RAC fee would be \$29.95.<sup>30</sup> Therefore, there is a \$15 price difference in the RAC depending on whether the taxpayer also purchased a RAL. Other lenders directly charge preparers a fee for the RAL.<sup>31</sup>

Preparers can also recoup the costs they incur to offer no-fee RALs to their clients by increasing return preparation fees. Due to the lack of transparency in preparation fees charged by many preparers, the hidden fees may be difficult to identify. To prevent this, at least one no-fee RAL bank prohibits preparers from passing this cost along to taxpayers by padding fees.<sup>32</sup> Some preparers may be willing to incur the RAL fee as a marketing expense to get clients in the door.<sup>33</sup>

While some taxpayers facing an immediate financial hardship may be willing to incur any additional costs associated with RALs, all taxpayers would benefit from a detailed breakdown of fees incurred. Because tax preparers directly incur the RAL fees, the IRS should require Electronic Return Originators (EROs) to prepare a “truth-in-lending” statement if they are offering a RAL product.<sup>34</sup> This statement would incorporate clear language and design to help the taxpayer better understand the terms of the loan product, including any “hidden” or indirect costs of the loan product. Working with the industry and consumer advocates, the IRS could develop and require a standard form for disclosures. The IRS could enforce this requirement through its e-file monitoring authority.<sup>35</sup>

In addition, as the demand for no-fee RALs continues to increase, it is incumbent on the IRS to conduct a consumer education campaign before the filing season about RALs and the hidden costs associated with these loan products. The campaign should warn taxpayers to carefully review the accuracy of their returns, especially if they purchase a RAL.

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30 River City Bank, *2017 Freedom to Choose Pricing Tiers*, <http://www.rcbtaxdivision.com/pricing.aspx> (last visited Aug. 18, 2017).

31 Chi Chi Wu (National Consumer Law Center) and Michael Best (Consumer Federation of America), *Big Changes Burden Taxpayers: New Law Delays Refunds, Drives Demand for Loans; Immigrant Taxpayers Face Challenges* 3-4 (Mar. 2017).

32 *Id.* at 4-5; See, e.g., Republic Bancorp, Inc., Form 10-K for the fiscal year which ended on Dec. 31, 2016, at 12 (“All fees for the product were paid by the Tax Providers with a restriction prohibiting the Tax Providers from passing along the fees to the taxpayer customer.”).

33 Stacy Cowley, *Tax Refund Loans Are Revamped and Resurrected*, THE NEW YORK TIMES (Jan. 15, 2017).

34 Truth-in-Lending disclosures are now termed “Loan Estimates” for mortgage applications submitted before Oct. 3, 2015. The Loan Estimate provides the applicant with important information about estimated interest rate, monthly payments, and total closing costs for the loan. It also informs the applicant about estimated tax and insurance costs, any anticipated changes in interest rate, penalties, and a negative amortization feature, if applicable. Consumer Financial Protection Bureau, *What is a Loan Estimate?* (Aug. 4, 2017).

35 See IRS Pub 3112, *IRS e-file Application and Participation*; IRS Publication 1345, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns* Rev. Proc. 2007-40, 2007-26 I.R.B. (June 25, 2007).

## CONCLUSION

Demand for RALs substantially increased in FS 2017, likely due to the PATH Act's required delay in the issuance of EITC and ACTC refunds. The private industry accommodated this demand by offering no-fee RALs. While the tax preparation industry and financial institutions are claiming to absorb the costs associated with these refund products, the IRS should survey the products currently available on the market and evaluate the impact on taxpayers as well as tax administration. Finally, regardless of which party absorbs the costs of these refund products, taxpayers will benefit from better consumer education about these products and a clear disclosure of all fees and terms associated with the product.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Survey the RAL products currently on the market, including detailed analysis of direct and indirect fees, to understand how taxpayers and tax administration are impacted.
2. Conduct a consumer education campaign before the filing season about RALs and RACs, including some tips on how to identify indirect costs associated with these products.
3. Revise Revenue Procedure 2007-40; IRS Publication 1345, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns*; and IRS Publication 3112, *Applying and Participating in IRS e-file*, to require all e-file participants offering RAL and RAC products to provide a standard "truth-in-lending" statement to help the taxpayer better understand the terms of the loan product, including any "hidden" or "indirect costs of the loan product."