#26 DIRECT THE IRS TO STUDY THE FEASIBILITY OF USING AN AUTOMATED FORMULA TO IDENTIFY TAXPAYERS AT RISK OF ECONOMIC HARDSHIP

Present Law

The Internal Revenue Code (IRC) contains several provisions that protect taxpayers experiencing economic hardship from IRS collection actions. IRC § 6330 authorizes a taxpayer in a collection due process hearing to propose collection alternatives, which may be based on an inability to pay the tax due to economic hardship. IRC § 6343 requires the IRS to release a levy if the IRS determines that the levy "is creating an economic hardship due to the financial condition of the taxpayer."

Under Treasury Regulation § 301.6343-1 and the Internal Revenue Manual, economic hardship exists when an individual is "unable to pay his or her reasonable basic living expenses." IRC § 7122(d) requires the IRS to develop and publish schedules of national and local allowances (known as allowable living expenses or ALEs) to ensure that taxpayers entering into offers in compromise are left with "an adequate means to provide for basic living expenses."

Reasons for Change

In general, the IRS is required to halt collection actions if a taxpayer demonstrates that he or she is in economic hardship. However, the IRS routinely enters into installment agreements (IAs) with taxpayers without undertaking the financial analysis required to make a hardship determination. For example, taxpayers need not submit any financial information to qualify for streamlined IAs and may enter into them online without interacting with an IRS employee. Many anxious or intimidated taxpayers seek to resolve their liabilities as quickly as possible and do not know the IRS is required to halt collection action if they are in economic hardship. As a result, taxpayers often agree to make tax payments they cannot afford.

TAS estimates that about 40 percent of taxpayers who entered into streamlined IAs through the IRS's Automated Collection System (ACS) in fiscal year (FY) 2018 had incomes at or below their ALEs. To emphasize the point: About four out of every ten taxpayers who agreed to streamlined IAs in ACS would have received the benefit of collection alternatives, such as offers in compromise or currently not collectible-hardship (CNC-Hardship) status, if they had known to call the IRS to explain their financial circumstances.

That is not a fair result. Whether a taxpayer is left with sufficient funds to pay for the basic living expenses for himself or herself and family should not depend on the taxpayer's knowledge of the IRS's procedural rules.

Furthermore, taxpayers with incomes below their ALEs are more likely than other taxpayers to default on installment agreements because they are unable to afford the payments. The default rate on streamlined IAs among taxpayers with incomes at or below their ALEs within ACS in FY 2018 was about 39 percent. A taxpayer who defaults on an installment agreement is subject to additional collection actions, which harms the taxpayer and creates rework for the IRS.

To address this problem, the TAS Research function has developed an automated algorithm that we believe can, with a high degree of accuracy, identify taxpayers whose incomes are below their ALEs. If the IRS validates this formula or develops an alternative formula that is reasonably accurate, it could place a "low-income" indicator on the accounts of all taxpayers whom the formula identifies as having incomes below their ALEs.

While the ALE standards represent only average expenses for taxpayers and should not be used to automatically close a case as CNC-Hardship, an ALE-based indicator would be a useful starting point for financial analysis in the collection context. It could be used to alert collection employees speaking with a taxpayer over the phone of the need to request additional financial information so the IRS could analyze the specific facts and circumstances of the taxpayer's case. The indicator could also be used to trigger a notification to taxpayers entering into IAs online that informs them of their right to contact the IRS collection function for assistance if they believe they cannot pay their tax debt without incurring economic hardship. The IRS could also use this algorithm to screen out these taxpayers from automated collection treatments such as the Federal Payment Levy Program, from selection for referral to private collection agencies, or for passport certification, unless and until the IRS has made direct personal contact with the taxpayer to verify his or her financial information.

In short, an automated economic hardship screen would benefit taxpayers and the IRS alike. It would help protect low-income taxpayers from agreeing to make payments that would leave them without adequate means to provide for their basic living expenses, and it would help the IRS avoid the rework that occurs when taxpayers default on IAs they cannot afford.

Recommendation

- Direct the IRS to study the feasibility of developing an automated formula to identify taxpayers who are at high risk of economic hardship and, if a reliable formula can be developed, to apply the formula for purposes of scoring cases for collection assignment, responding appropriately to taxpayers who contact the IRS regarding a balance due, alerting taxpayers at risk of economic hardship who seek to enter into streamlined IAs online of the resources available to them, and determining whether to exclude taxpayers' debts from automated collection treatments such as the Federal Payment Levy Program, selection for referral to private collection agencies, and passport certification, unless and until the IRS has been able to verify the taxpayers' financial information.