

II. Areas of Focus

A. Taxpayers May Not Be Adequately Protected During a Lapse in Appropriations

During the recent threat of a lapse in appropriation, the IRS revised its Contingency Plan²⁶ to identify the limited functions it could perform if the government shut down, as required by the Anti-Deficiency Act.²⁷ Although the plan took into consideration the special circumstances presented during a tax filing season, and identified excepted activities pertaining to the protection of *government* property, it did not provide protections for *taxpayers'* lives and property.

Examples of excepted activities under the current plan include depositing remittances and protecting statute expirations, bankruptcies, liens, and seizure cases. To protect the associated electronic remittances, the IRS would process electronically filed tax returns and issue any refunds generated, absent processing errors. Taxpayer phone assistance would be limited to callers with questions relating to return filing.²⁸

The IRS Plan made no allowance for processing paper tax returns and issuing related refunds, providing taxpayer account assistance, or resolving lien issues.²⁹ Although the Plan provided for Automated Collection System (ACS) representatives across the country to assist callers with levy releases,³⁰ it is unclear whether this workforce could have met taxpayers' needs if those employees were otherwise engaged in activities pertaining to the protection of government property. Consequently, taxpayers suffering from an immediate financial hardship would be offered no remedy. Thus, a taxpayer who was unable to close on a loan because of a federal tax lien or who could not pay for fuel to heat a home without a tax refund would get no assistance when calling the IRS, or would become lost in the accumulated stockpile of unprocessed paper returns and correspondence. TAS estimates that, during the week in which the shutdown might have occurred, over a million callers would have experienced long delays (if their call was answered at all);³¹ a quarter of a million taxpayers would have been turned away at Taxpayer

26 IRS, *FY 2011 Shutdown Contingency Plan* (Rev. Apr. 7, 2011), available at <http://www.whitehouse.gov/omb/contingency-plans> (last visited June 6, 2011).

27 31 U.S.C. §§ 1341 - 1342, prohibits agencies from obligating funds exceeding, or in advance of, appropriations and from employing personnel during a lapse in appropriations except for emergencies involving the safety of human life or the protection of property.

28 IRS, *FY 2011 Shutdown Contingency Plan* (Rev. Apr. 7, 2011), available at <http://www.whitehouse.gov/omb/contingency-plans> (last visited June 6, 2011).

29 *Id.*

30 *Id.* at 38-39.

31 IRS, *FY 2011 Enterprise Snapshot Reports* (Week Ending Apr. 16, 2011). IRS assistors answered nearly 1.5 million calls during the week ending April 16, 2011. It is unknown how many of these callers were seeking assistance with tax filing questions; however, all callers would have experienced the impact of reduced staffing.

Assistance Centers;³² and more than 100,000 pieces of correspondence would have been added to open inventories across the country.³³

The National Taxpayer Advocate believes the Anti-Deficiency Act as written and interpreted does not sufficiently protect *taxpayers'* rights and interests in the event of a government shutdown. The National Taxpayer Advocate recommends that the permissible activities defined in the Anti-Deficiency Act be clarified to provide protection of *taxpayers'* lives and property and will address this issue in the 2011 Annual Report to Congress.

B. TAS Will Continue to Focus on the IRS's Ability to Collect Taxes and Meet Taxpayer Needs as Its Responsibilities Have Expanded and Its Funding Has Been Reduced

The National Taxpayer Advocate has repeatedly expressed concern that the IRS is not sufficiently funded to effectively fulfill its mission of collecting taxes and meeting taxpayer needs. In FY 2011, this subject will again be an area of emphasis.

The job of the IRS is, in essence, to do whatever Congress directs it to do. As long as the IRS has sufficient data to verify taxpayer eligibility for authorized tax benefits, the National Taxpayer Advocate believes the IRS is capable of fulfilling its congressionally assigned tasks if given sufficient resources.³⁴ In recent years, the IRS has been given more and more tasks, but it is not receiving the resources it needs to fulfill these tasks without cutting corners. And when the IRS cuts corners, taxpayers can be harmed and revenue collection may suffer.

The IRS's challenges have been heightened as the tax code has grown longer and more complex by the year. In addition, the increasing number of late-year tax-law changes, most notably the extension of expiring tax breaks, has required the IRS annually to make extensive last-minute programming changes and forced the IRS to defer accepting certain tax returns until well after the filing season has begun. During the 2011 season, for example, the IRS could not process Form 1040 returns on which deductions were itemized until February 15.³⁵ Because more than 75 percent of taxpayers are entitled to refunds that average over \$2,800,³⁶ these delays often have a significant adverse financial impact on taxpayers.

Finally, Congress has increasingly been tasking the IRS with administering economic and social benefits programs. In 2008, Congress directed the IRS to make Economic Stimulus Payments. Also beginning in 2008, Congress made available the first of three iterations of

32 IRS, *FY 2011 Enterprise Customer Contact Reports* (Week Ending Apr. 16, 2011).

33 IRS, *Accounts Management Reports: AMIR Summary* (Week Ending Apr. 16, 2011).

34 For a discussion of the characteristics of programs that the IRS is able to administer effectively, see National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, 75-104 (*Running Social Programs Through the Tax System*).

35 See IRS News Release, IR-2011-16, *IRS Begins Processing Tax Forms Affected by Late Tax Changes; Taxpayers Can e-File Immediately* (Feb. 15, 2011).

36 See IRS Filing Season Statistics (as of May 13, 2011), at <http://www.irs.gov/newsroom/article/0,,id=239536,00.html>.

the First-Time Homebuyer Credit. Beginning in 2009, Congress provided the Making Work Pay Credit. Then last year, Congress enacted the Hiring Incentives to Restore Employment (HIRE) Act, which provides incentives for small businesses to hire additional workers, and the Patient Protection and Affordable Care Act, which contains numerous provisions that will require interaction between the IRS and businesses or individuals.

Administering a more complex tax code, implementing last-minute tax-law changes just before the filing season, and running benefits programs all require resources. Yet for FY 2011, the IRS's budget was reduced slightly as compared with FY 2010,³⁷ and its funding for FY 2012 remains unclear. The Administration has proposed an increase of more than nine percent over FY 2011 levels,³⁸ the House Appropriations Committee has approved a bill that would reduce funding by five percent below FY 2011 levels,³⁹ and the Senate has not yet acted.

Prior to FY 2011, the IRS had received budget increases for several years. Yet even so, the agency was falling behind in its ability to meet taxpayer needs. Two key indicators of taxpayer service are the IRS's ability to answer taxpayer telephone calls and the IRS's ability to respond to taxpayer correspondence. From FY 2004 to FY 2010, the percentage of calls the IRS answered from taxpayers seeking to speak with a telephone assister dropped from 87 percent to 74 percent.⁴⁰

Over the same period, the IRS's ability to timely process taxpayer correspondence also declined. Comparing the final week of FY 2004 with the final week of FY 2010, the backlog of taxpayer correspondence in the tax adjustments inventory jumped by 76 percent (from 357,151 to 628,016), the percentage of "uncontrolled" correspondence received but not yet entered into IRS computer systems increased by 134 percent (from 8.3 percent to 19.4 percent of correspondence), and the percentage of taxpayer correspondence classified as "overage" increased by 135 percent (from 11.5 percent to 27.0 percent of correspondence).⁴¹

If subjected to spending freezes or cuts, the IRS will fall further behind in collecting taxes and serving America's taxpayers. The National Taxpayer Advocate has previously expressed the view that the IRS, as the tax collector, should generally be exempt from any budget freeze or reduction. According to the most recent estimate available, \$345 billion in tax is due but not timely and voluntarily paid each year.⁴² As the *de facto* "Accounts

37 Department of Defense and Full-Year Continuing Appropriations Act, 2011, Pub. L. No. 112-10, § 1119, 1125 Stat. 38, 107 (2011).

38 See *Department of the Treasury, FY 2012 Budget in Brief* (showing FY 2010 enacted levels), at http://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/FY2012_IRS_508.pdf.

39 See Fiscal Year 2012 Financial Services and General Government Appropriations Act (as approved by the House Appropriations Committee on June 23, 2011).

40 See IRS FY 2010 Enforcement Results, available at http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf.

41 Compare IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 25, 2010) with IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 25, 2004).

42 The IRS's most recent estimate of the tax gap is for Tax Year 2001. See IRS News Release, IR-2006-28, *IRS Updates Tax Gap Estimates* (Feb. 14, 2006). While the results are somewhat dated, they represent the most reliable estimate available.

Receivable Department” of the federal government, the IRS collects well over 90 percent of all federal revenue.⁴³ On a budget of about \$12.1 billion,⁴⁴ the IRS collected about \$2.35 trillion in FY 2010.⁴⁵ In other words, every \$1 appropriated for the IRS produced about \$194 in federal revenue.⁴⁶

For that reason, dollars appropriated for the IRS are not a cause of the deficit problem. Rather, they are better viewed as part of the solution to the deficit problem. Despite differing views about the appropriate level of taxation, there is widespread agreement that taxes that are due and owing under the law should be collected. Spending cuts mean the IRS will not have the resources to ensure that all taxpayers pay their fair share, thereby effectively forcing compliant taxpayers to pay more to subsidize noncompliance by others and giving noncompliant business taxpayers a competitive advantage. Moreover, the IRS will not have the ability to meet the service needs of the taxpayers who are paying our nation’s bills.

During the coming year, TAS will continue to study the adequacy of resources available to the IRS to enable it to fulfill the responsibilities Congress has assigned it and will continue to advocate for a reasonable balance between its responsibilities and its resources.

C. TAS Will Focus on Its Own Ability to Meet Sharply Increasing Taxpayer Needs

The workload facing our own organization, the Taxpayer Advocate Service (TAS), has increased substantially in recent years. Although TAS has other important responsibilities, Congress created TAS largely to serve as the IRS’s “safety net” for taxpayers who are experiencing significant hardships. In practice, TAS is often a taxpayer’s last resort for resolving a tax problem.⁴⁷ We assist taxpayers who are experiencing a current or imminent financial hardship as a result of an IRS action or inaction (*e.g.*, where an IRS levy against a taxpayer’s paycheck will lead to eviction or a shutoff of utilities) or who are experiencing a systemic hardship because the IRS has not served them on a timely or accurate basis (*e.g.*, where the IRS has failed to issue a refund or adequately consider a taxpayer’s response to an audit or collection notice). By statute, Congress has required that TAS make at least one advocate available for each state,⁴⁸ and we currently have 74 offices serving taxpayers.

43 See IRS Fact Sheet, FS-2011-09, *IRS FY 2012 Budget Proposal Summary* (Feb. 2011), available at <http://www.irs.gov/newsroom/article/0,,id=235959,00.html>.

44 Department of the Treasury, *FY 2012 Budget in Brief* (showing FY 2010 enacted levels).

45 Government Accountability Office, GAO-11-142, *Financial Audit: IRS’s Fiscal Years 2010 and 2009 Financial Statements* at 59 (Nov. 2010).

46 In evaluating the likely revenue benefits of additional funding, the average return on investment (ROI) of 194:1 is less important than the marginal ROI that can be achieved for each additional dollar spent. While the marginal ROI is considerably less than 194:1 and will differ by program, studies generally show that, within reasonable limits, each additional dollar appropriated to the IRS generates substantially more than an additional dollar in federal revenue, assuming the funding is wisely spent.

47 Where a taxpayer disagrees with an IRS liability determination or collection action, the taxpayer generally may seek redress before the Office of Appeals or the United States Tax Court. However, a taxpayer requires considerable knowledge or professional assistance to utilize the Appeals or Tax Court processes, and most taxpayers do not take their cases that far.

48 IRC § 7803(c)(2)(D)(i)(I).

Through May, TAS receipts have remained relatively steady at 190,204 cases in FY 2011 as compared with 191,901 for the same period in FY 2010. However, these levels reflect a steady increase in cases over the last several years, as receipts rose from 168,856 in FY 2004 to 298,933 in FY 2010. There are two main reasons why TAS cases increase. First, the majority of TAS's cases stem from IRS compliance actions, and the IRS has substantially increased the number of these actions in recent years.⁴⁹ Second, TAS receives more cases during economic downturns, when more taxpayers cannot pay their tax bills and get into trouble with the IRS.

To date, TAS has managed to handle the increased caseload. After several years of declining staffing, TAS has been able to hire three new categories of employees over the past few years to assist our Case Advocates in doing their jobs. We now have 116 "Intake Advocates," who answer telephone calls, respond to simple taxpayer questions, and assist with case-building by identifying key facts and issues and requesting necessary documentation. We also have 127 "Lead Case Advocates," who mentor and assist Case Advocates with unusually challenging cases, maintain partial caseloads of their own, and help develop TAS best practices. Finally, we have 18 "Campus Technical Advisors," who provide technical guidance and support on complex cases worked by the IRS in each of its ten campuses. These additional specialty positions have freed up our Case Advocates to spend more direct time resolving taxpayer cases and have given them helpful resources when they get stuck on technical issues. TAS management has also taken steps to improve efficiencies.⁵⁰

As a result of these measures, TAS has continued to perform well. In FY 2010, TAS obtained full relief for taxpayers in 69 percent of our cases and partial relief for taxpayers in an additional five percent.⁵¹ (In other cases, taxpayers generally are not entitled to relief.) These levels are consistent with historical norms. In addition, ongoing surveys conducted by an independent polling firm among taxpayers assisted by TAS show that customer satisfaction stood at 84 percent in FY 2004 and at 85 percent in FY 2010.

Despite these positive results and despite actions taken by TAS management to offset the significant increase in case receipts, including the creation of Intake Advocate, Lead Case

49 From FY 2004 to FY 2010, levies rose from 2,029,613 to 3,606,818, liens rose from 534,392 to 1,096,376, and seizures rose from 440 to 605. See IRS FY 2010 Enforcement Results, available at http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf.

50 One important current project is the development and deployment of a new, fully integrated system for TAS, which will automate many manual operations and integrate case advocacy, systemic advocacy, and all other TAS activities. This system, known as the Taxpayer Advocate Service Integrated System, or TASIS, will replace more than ten stand-alone systems and databases and improve efficiency by enabling employees to work across IRS systems, maintain and search case files electronically, and handle the intake, screening, and distribution of work electronically. TASIS will also enable management to ensure a more even distribution of workload because it will provide information not merely on the number of cases per Case Advocate but also on case complexity, required skills, and anticipated time required for case completion. Assuming the funding committed to the project is not cut or deferred, we anticipate that much of TASIS will be operational in 2013.

51 TAS determines relief rates based upon whether TAS is able to provide full or partial relief or assistance on the issue initially identified by the taxpayer. Because TAS frequently provides relief on issues that differ from the ones the taxpayer initially identified, the relief rate, as calculated, is understated.

Advocate, and Campus Technical Advisor positions, the deployment of automated tools and improved, more efficient processes, the growth in casework is beginning to strain TAS's capacity. (A more in-depth discussion of our productivity efforts relating to human capital, systems, and process improvements is provided in Sections VII and VIII of this report.) Because cases generally come to TAS only when a taxpayer is suffering from a financial hardship or the IRS's regular processes have not worked as they should, TAS has had a policy of assisting all taxpayers who meet our case-acceptance criteria since Congress created our organization in 1998. If the imbalance between our resources and the demand for our services widens much further, however, we will have no choice but to decline to accept certain categories of cases, leaving taxpayers to fend for themselves.

During the coming year, we will continue to seek efficiencies and continue to call attention to the imbalance between our increasing case inventories and our relatively static budgets, as well as the impact this imbalance is having on taxpayers.

D. TAS Will Engage Taxpayers in a Dialogue About Tax Complexity and Tax Reform

In FY 2012, the Office of the Taxpayer Advocate will continue its research concerning the trade-offs between the benefits delivered through the tax system and the tax code complexity that erodes compliance. Numerous social tax expenditures may offer popular benefits with a relatively light administrative burden, yet other provisions may be so complex as to deter compliance or even participation.⁵² While lawmakers debate the policy merits of various provisions, taxpayers need to understand their practical impact.

Unless the tax system becomes more transparent and user-friendly, taxpayers' perceptions of fairness and ultimately their compliance with the system may continue to erode. Complexity may benefit those who can afford expensive advice that offers access to certain tax breaks, effectively discriminating against taxpayers who cannot afford advice. Taxpayers who believe others are unfairly paying less may feel justified in "fudging" to right the perceived wrong. Even at the cost of relinquishing prized tax credits, deductions, deferrals, or exclusions, taxpayers may wish to reduce complexity. The payoff would be improved taxpayer morale.⁵³

To further this dialogue about tax reform, the Taxpayer Advocate Service is operating an electronic suggestion box to monitor comments from taxpayers on what they would be willing to give up if others also would relinquish tax breaks, resulting in a simpler tax system.⁵⁴ What particular provisions of the existing tax system are especially burdensome

52 See National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 101-119 (Research Study: *Evaluate the Administration of Tax Expenditures*); 2009 Annual Report to Congress vol. 2, 75-104 (Research Study: *Running Social Programs Through the Tax System*).

53 See generally National Taxpayer Advocate 2010 Annual Report to Congress 3-14 (Most Serious Problem: *The Time for Tax Reform Is Now*).

54 See National Taxpayer Advocate 2010 Annual Report to Congress xi (Preface).

or seem particularly unfair? Thus far, TAS has received approximately 1,500 comments.⁵⁵ Interestingly, some of the suggestions use terms of art at variance with their technical meaning; for example, describing a “flat” tax as imposing higher rates at graduated income levels. These comments highlight a need for education on technical tax terms as well as an underlying instinct for fairness with respect to ability to pay. A selection of these comments is posted at www.TaxpayerAdvocate.irs.gov.

E. TAS’s Continued Advocacy Efforts to Improve the Earned Income Tax Credit Program

Noncompliance has long been a concern associated with the Earned Income Tax Credit (EITC). Generally, noncompliance is best described as a continuum of behavior from inadvertent error to negligence to recklessness (in disregard of the law) to fraud at civil or criminal levels.⁵⁶ Similarly, social scientists have classified noncompliance of different types, such as procedural, unknowing, asocial, brokered, symbolic, social, or habitual.⁵⁷ Compliance may be influenced by factors such as demographic affiliations, personal morals, social norms, deterrence probabilities, trust in government, complexity and convenience, as well as preparers and other third parties.⁵⁸ In view of the diverse aspects of noncompliance as applied to the EITC, “it seems likely that there is not one compliance problem, but a series of sometimes distinct compliance problems that call for a more focused but still multifaceted approach to reflect specific types of noncompliance problems.”⁵⁹

Heeding this observation, in FY 2012 TAS will review proposals and apply previous research findings to help reduce EITC noncompliance.⁶⁰ Previous TAS research findings suggest that the EITC claims of many taxpayers are denied for lack of documentation even if they could meet applicable residence and relationship requirements.⁶¹ In addition, TAS is actively focusing on its own advocacy in EITC TAS cases, as discussed later in this report.⁶²

55 TAS had received 1,515 suggestions as of June 18, 2011. See Tax Reform Suggestion Box at www.TaxpayerAdvocate.irs.gov.

56 See National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 81 (Research Study: *Running Social Programs Through the Tax System*).

57 See Robert Kidder & Craig McEwen, *Taxpaying Behavior in Social Context: A Tentative Typology of Tax Compliance and Noncompliance*, 2 Taxpayer Compliance (1989); Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 Kans. L. Rev. 1145 (2003), available at http://works.bepress.com/leslie_book/8 (last visited June 6, 2011).

58 See National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 87 (Research Study: *Researching the Causes of Noncompliance: An Overview of Upcoming Studies*).

59 Leslie Book, *Preventing the Hybrid from Backfiring: Delivery of Benefits to the Working Poor Through the Tax System*, 2006 Wisc. L. Rev. 1103, 1114.

60 See National Taxpayer Advocate 2004 Annual Report to Congress vol. 2 (EITC Audit Reconsideration Study).

61 See *Hearing on Improper Payments in the Administration of Refundable Tax Credits, Before the Subcomm. on Oversight, H. Comm. on Ways and Means*, 112th Cong. (statement of Nina E. Olson, National Taxpayer Advocate) (May 25, 2011).

62 See *Improving Advocacy in TAS Earned Income Tax Credit Cases*, *infra*; Appendix VIII: *Earned Income Tax Credit Case Review Team Report*, *infra*.

1. Certain EITC Proposals Do Not Address Underlying Causes of Noncompliance and Could Result in Incorrect Disallowance

A significant level of noncompliance has resulted in the classification of the EITC as the fourth largest source of “improper payments” by the government in FY 2010.⁶³ Several proposals attempt to address concerns about noncompliance and improper payments. At the end of 2010, the Department of the Treasury announced a pilot program to assess the usefulness of state benefits data “to help validate EITC eligibility.”⁶⁴ Meanwhile, the Treasury Inspector General for Tax Administration (TIGTA) has reiterated a recommendation that the IRS consider “Federal Case Registry [FCR] information to determine its accuracy and applicability for exercising existing math error authority to deny the EITC during upfront processing of the tax return.”⁶⁵ The National Taxpayer Advocate continues to object specifically to the use of FCR data for *summary* denial of EITC claims “since the underlying factual situation is inherently qualitative in nature.”⁶⁶ Moreover, applying data collected for other purposes to an EITC claim is akin to verifying addresses with a telephone directory to deny a home mortgage interest deduction. Even if virtually all of the entries in a directory were accurate, they were compiled for a different purpose, do not disprove eligibility under the tax law, were compiled at a prior date and may not be current, and should not deprive a taxpayer of a due process right to present his or her own facts. Enforcement on a mass-production model may not be as effective as service to low income taxpayers on an individual basis.⁶⁷

While the Improper Payments Information Act of 2002 requires reporting on certain payments,⁶⁸ it does not prescribe any particular remedy.⁶⁹ A report on actions to correct *causes* of improper EITC payments could address the service necessary to administer complex eligibility requirements. Meanwhile, there are other tax credits, such as those creating incentives for alternative fuels or for incremental expenditures on research and experimentation, that can result in large refunds; thus, investigating whether these

63 See GAO, GAO-11-575T, *Improper Payments: Recent Efforts to Address Improper Payments and Remaining Challenges* 4 (Apr. 15, 2011) (reporting \$16.9 billion in improper EITC payments); Improper Payments Information Act of 2002, Pub. L. No. 107-300, 116 Stat. 2350 (2002) (governing payments over \$10 million “derived from Federal funds”); OMB Circ. A-123, Appdx. C, M-11-16, Pt. I at 5 (Apr. 14, 2011) (imposing threshold of 2.5 percent of program outlays); Garrett Hatch & Virginia A. McMurtry, *Improper Payments Information Act of 2002: Background, Implementation, and Assessment*, Cong. Res. Serv. (CRS) No. RL34164 (Oct. 4, 2010); *Hearing on Improper Payments in the Administration of Refundable Tax Credits, Before the Subcomm. on Oversight, H. Comm. on Ways and Means, 112th Cong.* (statement of Nina E. Olson, National Taxpayer Advocate) (May 25, 2011).

64 Dept. of the Treasury, *Performance and Accountability Rept. FY 2010* (Nov. 15, 2010) 280.

65 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2009-40-024, *The Earned Income Tax Credit Program Has Made Advances; However, Alternatives to Traditional Compliance Methods Are Needed to Stop Billions of Dollars in Erroneous Payments* 13-14 (Dec. 31, 2008), referenced in Ref. No. 2011-40-023, *Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year* 9 (Feb. 7, 2011) (hereinafter *Reduction Targets*).

66 National Taxpayer Advocate 2002 Annual Report to Congress 196 (Legislative Recommendation: *Math Error Authority*).

67 See National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 94-116 (Research Study: *IRS Earned Income Credit Audits*).

68 Pub. L. No. 107-300, 116 Stat. 2350 (2002), cited in *Reduction Targets* 1.

69 See generally Lawrence Zelenak, *Tax or Welfare? The Administration of the Earned Income Tax Credit*, 52 UCLA L. REV. 1867, 1896-98 (2005).

credits have been properly granted would be worthwhile whether or not they fit the definition of “improper payments.”⁷⁰

Additionally, TIGTA objects to “the IRS’ use of a dollar tolerance” in limiting the number of EITC recertification examinations, notwithstanding the cost-benefit analysis inherent in tolerances.⁷¹ This objection suggests an approach to EITC that appears disproportionate to potential noncompliance at low income levels. In sum, TAS continues to monitor EITC administration to ensure that enforcement initiatives do not replace or undermine service efforts that could increase taxpayer compliance.⁷²

2. TAS Is Conducting Research to Better Understand the Causes of EITC Noncompliance

TAS is collaborating with the IRS on two pilot programs to reduce EITC noncompliance through improved service to taxpayers. As discussed below, one program tests the use of affidavits to establish qualifying child status, while the other tests improvements to the examination process. Additionally, TAS’s efforts to improve EITC case advocacy by TAS employees are discussed elsewhere in this report.⁷³ These efforts complement applied research on increasing EITC compliance.

a. Effectiveness Of Affidavits During EITC Audits

To verify the accuracy of the millions of EITC claims every year, the IRS audits some of the returns filed.⁷⁴ EITC audits represent approximately 30 percent of all individual taxpayer audits in FY 2010.⁷⁵

70 See, e.g., Steven Mufson, *Paper Industry Pushed Further into the Black by ‘Black Liquor’ Tax Credits*, Washington Post (Apr. 26, 2011) (identifying large business taxpayers benefiting from multi-million dollar cellulosic biofuel credits as well as a refundable provision); Office of Management & Budget, Budget of the U.S. Govt. FY 2011, *Analytical Perspectives* at 177 (explaining that “byproducts derived from the processing of paper or pulp (known as black liquor when derived from the kraft process) . . . would qualify as cellulosic biofuel and, to the extent so qualifying, could result in substantial revenue losses and a windfall to the paper industry”); *Union Carbide v. Comm’r*, T.C. Memo. 2009-50 (describing multi-million dollar research credits); *Eustace v. Comm’r*, T.C. Memo. 2001-66 (describing the use of amended returns to claim refunds of research credit), aff’d 312 F.3d 905 (7th Cir. 2002).

71 TIGTA, Ref. No. 2008-40-131, *While Progress Has Been Made, Limits on the Number of Examinations Reduce the Effectiveness of the Earned Income Tax Credit Recertification Program* (July 3, 2008), referenced in *Reduction Targets* 9.

72 Elsewhere this report discusses an ongoing IRS pilot program to test certain improvements to the audit process and taxpayer service suggested by previous TAS research.

73 See *Improving Advocacy in TAS Earned Income Tax Credit Cases*, *infra*.

74 Over 26 million filers claimed EITC in tax year (TY) 2009. Internal Returns Transaction File for tax year 2009 from the Compliance Data Warehouse (Mar. 17, 2010).

75 IRS Pub. 55, *Data Book*, 2006 - 2010, Table 9; IRS EITC Program Office response to TAS information request (May 18, 2011) (473,999 returns were selected for audit on the basis of EITC out of 1,581,394 individual returns audited in FY 2010).

FIGURE II.1, COMPARISON OF ALL INDIVIDUAL TAX RETURNS TO INDIVIDUAL TAX RETURNS CLAIMING EITC, 2006 - 2010

FY	All Individual Returns			Returns with EITC			EITC Compared to All Individual Returns		
	Exams	Recommended Additional tax (\$) (in billions)	\$ per Exam	Exams	Recommended Additional tax (\$) (in billions)	\$ per Exam	Percent of Exams	Percent of Recommended Additional tax (\$)	Percent of \$ per Exam
2006	1,283,950	13.05	10,160	517,617	1.49	2,872	40.3	11.4	28.3
2007	1,384,563	15.71	11,343	503,267	1.49	2,969	36.3	9.5	26.2
2008	1,391,581	12.46	8,956	503,755	1.99	3,958	36.2	16.0	44.2
2009	1,425,888	14.94	10,478	508,180	2.15	4,232	35.6	14.4	40.4
2010	1,581,394	15.07	9,527	473,999	1.97	4,162	30.0	13.1	43.7
Average	1,413,475	14.24	10,077	501,364	1.82	3,639	35.5	12.8	36.1

The most common reason EITC claims are disallowed during an audit is because taxpayers do not substantiate that their children lived with them for over half of the tax year as required.⁷⁶ Currently, IRS audit procedures allow taxpayers to provide either official records or letters on official letterhead to meet the residency test for a child. The process of verifying a child's residency is burdensome for taxpayers, third parties, and the IRS. One proposed change to IRS audit procedures would give the taxpayer the option of using a third type of documentation – a third-party affidavit. This new procedure would allow third parties with knowledge of the child's residency to fill out a standardized affidavit rather than write a letter. TAS has recommended that the IRS pursue the adoption of a third-party affidavit on numerous occasions.⁷⁷

The IRS first tested the use of affidavits in a tax year 2003 IRS initiative to use affidavits to document residency of qualifying children of low income taxpayers who participated in a test of a proposed EITC pre-certification process. At that time, the IRS concluded that affidavits would be acceptable as well as convenient documentation:

Affidavits were believed to be easier for taxpayers to obtain than official documents or letters. *The results show that affidavits had a higher acceptance rate than the other two types of documents. In each of the tests, about one-half of the records and*

⁷⁶ IRS, *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Return* 13 (Feb. 28, 2002).

⁷⁷ See National Taxpayer Advocate 2002 Annual Report to Congress 50-52 (Most Serious Problem: *EITC Eligibility Determinations Can Be Made Less Burdensome*); National Taxpayer Advocate 2003 Annual Report to Congress 30 (Most Serious Problem: *Earned Income Tax Credit Compliance Strategy*); National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 41 (Research Study: *EITC Audit Reconsideration Study*); National Taxpayer Advocate 2005 Annual Report to Congress 106-108, 114, 119 (Most Serious Problem: *Earned Income Tax Credit Exam Issues*); National Taxpayer Advocate 2006 Annual Report to Congress 297-298, 308-309 (Most Serious Problem: *Correspondence Examination*); National Taxpayer Advocate 2007 Annual Report to Congress 230, 236, 240 (Most Serious Problem: *EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 96, 115 (Research Study: *IRS Earned Income Credit Audits – A Challenge to Taxpayers*); National Taxpayer Advocate 2009 Annual Report to Congress 125, 129 (Most Serious Problem: *Beyond EITC: The Needs of Low Income Taxpayers Are Not Being Adequately Met*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, at 97-98 (Research Study: *Running Social Programs Through the Tax System*).

*statements or letters were accepted compared to approximately three-quarters of the affidavits.*⁷⁸ [Emphasis added.]

In 2009, the IRS, with the assistance of TAS Research, began a three-year study to investigate whether the use of third-party affidavits can help EITC claimants demonstrate the residency of qualifying children during audits. The study is in its second year of data collection, which began in February 2011 with EITC audits of tax year 2010 returns.

The objectives of this study are to answer the following questions:

- To what extent does the use of affidavits reduce underclaims or increase overclaims?
- What percentage of taxpayers used affidavits to try to demonstrate residency of their qualifying children?
- How does the option of using a third-party affidavit affect the efficiency of the audit process?

b. EITC Examination Effectiveness

Typical EITC taxpayers working near or at minimum wage levels tend to have limited education and literacy skills, and minimal understanding of financial matters. They are also likely not skilled at dealing with the IRS on issues involving complicated matters of tax law. The law clearly places the burden of proof on the taxpayer, but if the taxpayer cannot sufficiently understand the rules or negotiate the audit process, reaching the goal of a correct audit outcome is brought into question. The National Taxpayer Advocate has long been concerned that various barriers are preventing the IRS from treating taxpayers fairly. To address this concern, TAS is collaborating with the Wage and Investment (W&I) and Small Business/Self-Employed (SB/SE) divisions to test whether alternative approaches to conducting EITC correspondence examinations affect the audit change rate, because some audits have denied taxpayers EITC for which they qualify. This pilot program was initiated in response to research and recommendations TAS has made in past years.⁷⁹ Results will help guide recommendations for improvements to the examination process.

78 See IRS, *Earned Income Tax Credit Initiatives: Report on Qualifying Child Residency Certification, Filing Status, and Automated Underreporter Tests* 14 (2008).

79 See National Taxpayer Advocate 2003 Annual Report to Congress 28 (Most Serious Problem: *Earned Income Tax Credit Compliance Strategy*); National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 43 (Research Study: *EITC Audit Reconsideration Study*); National Taxpayer Advocate 2005 Annual Report to Congress 17 (Most Serious Problem: *Trends in Taxpayer Service*); National Taxpayer Advocate 2005 Annual Report to Congress 113-114 (Most Serious Problem: *Earned Income Tax Credit Exam Issues*); National Taxpayer Advocate 2006 Annual Report to Congress 293-295 (Most Serious Problem: *Correspondence Examination*); National Taxpayer Advocate 2007 Annual Report to Congress 234, 238 (Most Serious Problem: *EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 96, 107, 116 (Research Study: *IRS Earned Income Credit Audits – A Challenge to Taxpayers*); National Taxpayer Advocate 2009 Annual Report to Congress 118-119, 129 (Most Serious Problem: *Beyond EITC: The Needs of Low Income Taxpayers Are Not Being Adequately Met*).

The first phase of the pilot program is taking place during the 2011 filing season. A representative sample of taxpayers undergoing EITC correspondence audits has been selected. Participating IRS examiners have attended training sessions with the National Taxpayer Advocate, among others. The training included a panel discussion with Low Income Taxpayer Clinic (LITC) directors who shared their experiences working with EITC taxpayers and recommendations for overcoming communication challenges.

During the first phase, IRS correspondence examiners are placing outbound calls to taxpayers in this test group at two points during the examination process: about ten days after the initial contact letter, and just prior to issuing the Statutory Notice of Deficiency for taxpayers who have not responded. During the calls, the IRS examiners explain the examination process to the taxpayers and answer taxpayer questions. TAS Research will collect data on audit outcomes to determine if this revision to IRS examination procedures has helped taxpayers overcome communication barriers they may be experiencing during the examination process.

During the second phase, taxpayers who did not retain all of their EITC and who did not agree to their audit outcomes will be referred to TAS. TAS Case Advocates will then attempt to contact these taxpayers to help them through the process of proving eligibility for EITC. TAS Research will analyze the final audit outcomes after this phase to determine whether TAS assistance impacted the audit results. The goal is to complete this study by the end of March 2012.

F. The IRS Needs To Do More to Alleviate the Harm Its Lien Filing Practices Can Create For Many Taxpayers

The National Taxpayer Advocate addressed the adverse impact of the IRS lien filing policies on taxpayers and future tax compliance in her 2009 and 2010 Annual Reports to Congress. She proposed several administrative and legislative steps to improve these policies and procedures and to grant relief to taxpayers harmed by the automatic filing of liens, and issued two Taxpayer Advocate Directives (TADs) on this subject.⁸⁰ On February 24, 2011, the IRS announced a new effort to help financially struggling taxpayers get a “fresh start,” which included several changes to the processes used to file and withdraw Notices of Federal Tax Lien (NFTL).⁸¹ Specifically, the IRS raised the dollar threshold that governs the issuance

80 National Taxpayer Advocate 2010 Annual Report to Congress 302-310; National Taxpayer Advocate 2009 Annual Report to Congress 17-40; National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18. See also National Taxpayer Advocate 2009 Annual Report to Congress 357-364; Taxpayer Advocate Directive (TAD) 2010-1, *Immediately discontinue automatic lien filing on Currently Not Collectible (CNC) hardship accounts with an unpaid balance of \$5,000 or more, require employees to make meaningful notice of federal tax lien (NFTL) filing determinations, and require managerial approval for filings of an NFTL in all cases where the taxpayer has no assets* (Jan. 20, 2010); TAD 2010-2, *Withdrawal of a notice of federal tax lien (NFTL) where the statutory withdrawal criteria are satisfied, even if the underlying lien has been released* (Jan. 20, 2010). For copies of the TADs see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix VIII, available at <http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf>. The TADs are still open and may be elevated to the Commissioner of Internal Revenue pending IRS action on National Taxpayer Advocate recommendations.

81 IRS, Media Relations Office, *IRS Announces New Effort to Help Struggling Taxpayers Get a Fresh Start; Major Changes to Lien Process*, IR-2011-20 (Feb. 24, 2011).

of most NFTLs from \$5,000 to \$10,000, an action the IRS claims will result in fewer tax liens.⁸² The IRS also announced plans to make it easier for taxpayers to obtain NFTL withdrawals after fully paying their tax debts, or after they have arranged with the IRS to pay their outstanding tax debts through “direct debit” installment agreements.

TAS has worked closely with the IRS in developing guidance for the implementation of these initiatives. TAS actively collaborated with the SB/SE Collection Policy function in drafting internal guidance to allow withdrawals of NFTLs after lien releases, conforming to the IRS Office of Chief Counsel opinion issued on October 8, 2009.⁸³ The National Taxpayer Advocate is very pleased with the recently-issued guidance that adopts her recommendations and provides significant relief to affected taxpayers.⁸⁴ TAS is looking forward to working with the IRS in revising its lien filing policies so fewer withdrawals will be necessary.

From October 1, 2010 to March 31, 2011, the IRS filed approximately 612,000 NFTLs, an increase of 25 percent over the same period in fiscal year (FY) 2010.⁸⁵ While it may be premature to evaluate the full impact of the IRS’s recent changes to the lien filing process, the National Taxpayer Advocate remains concerned that these changes do not rescind the IRS policy of automatically filing liens based on a dollar threshold of the unpaid tax liability, which continues to harm millions of taxpayers, instead of requiring a lien-filing determination to be based on a thorough analysis of the taxpayer’s circumstances.⁸⁶ Such analysis should balance the need to protect the government’s interests in the taxpayer’s assets with a corresponding concern for the financial harm the lien will create for that taxpayer. In FY 2012, TAS will work with the IRS to fully evaluate the results of its limited changes to the lien filing process, and identify additional opportunities to improve this critical area of tax administration. In the meantime, TAS is conducting its own study of the impact of NFTL filings on future tax compliance and will refine its recommendations based on study findings.⁸⁷

82 The IRS Collection Process Study (CPS), commenced in response to TADs 2010-1 and 2010-2 (Jan. 20, 2010), recommended increasing the threshold from \$5,000 to \$50,000, which in the IRS’s own estimates would reduce the IRS’s 1.1 million liens filed in calendar year (CY) 2010 by only 40,000 to 41,000, or about four percent. IRS, *Collection Process Study* (CPS) 121 (Sept. 30, 2010). Therefore, an increase of the threshold to \$10,000 may have little impact on the number of liens filed.

83 National Office Program Manager Technical Advice, PMTA-2009-158 (Oct. 9, 2009).

84 SB/SE, *Interim Guidance Memorandum*, Control No. SB/SE-05-0611-037 (Jun. 10, 2011). See also National Taxpayer Advocate 2010 Annual Report to Congress 302-310; National Taxpayer Advocate 2009 Annual Report to Congress 17-40; National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18; TAD 2010-2 (Jan. 20, 2010).

85 IRS, Collection Activity Report NO-5000-23, *Collection Workload Indicators* (Mar. 10, 2011).

86 The IRS filed liens against nearly 1.1 million taxpayers in calendar year (CY) 2010. IRS, *Fiscal Year 2010 Enforcement Results*, available at http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf. The total number of taxpayers harmed by IRS lien-filing policies is much greater than 1.1 million because over five million liens filed in recent years continue to negatively affect taxpayers’ credit for at least seven years from the date they pay off their debts, or up to indefinitely when unpaid tax debts become legally unenforceable due to expiration of the statutory period for collection. See National Taxpayer Advocate 2010 Annual Report to Congress 302-310; National Taxpayer Advocate 2009 Annual Report to Congress 17-40.

87 The objectives of the study are: 1) to determine whether any amounts of payments are likely attributable to the NFTL; 2) to determine the effect of the NFTL on future payment compliance; 3) to determine the effect of the NFTL on future filing compliance; and 4) to determine whether the NFTL is associated with a decline in future income. For a more detailed discussion of the design of this study, see National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 89-100 (TAS Research and Related Studies: *Estimating the Impact of Liens on Taxpayer Compliance Behavior: An Ongoing Research Initiative*).

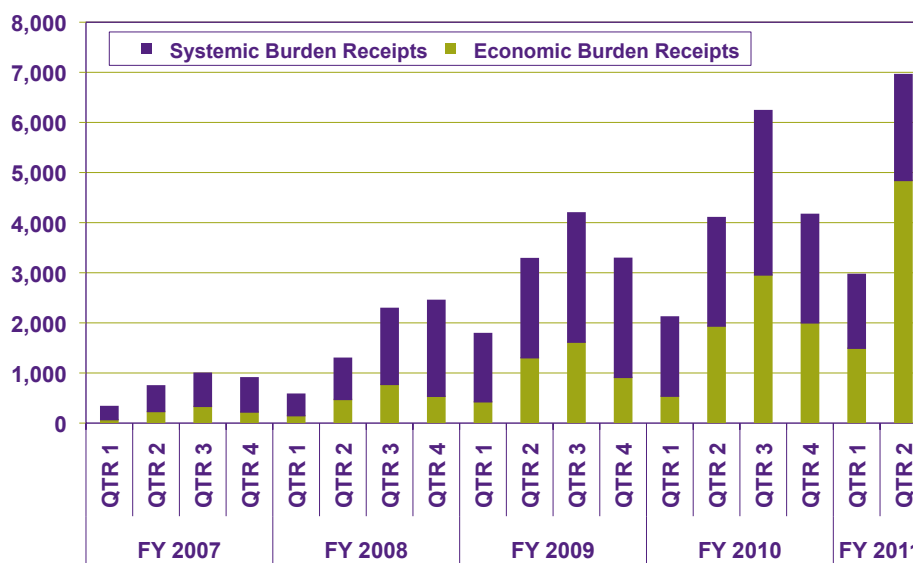
TAS will also continue to advocate for taxpayers that experience harm from current NFTL policies and issue Taxpayer Assistance Orders (TAOs) when necessary.⁸⁸

G. The IRS Needs to Improve Its Identity Theft Victim Assistance Strategy

Effective June 2010, the Wage and Investment Division's Identity Protection Specialized Unit (IPSU) began working the majority of non-economic burden identity theft (IDT) cases.⁸⁹ In fiscal year (FY) 2010, the IPSU worked nearly 3,400 cases that TAS would otherwise have worked; in FY 2011 to date, this number has already increased to 8,954 cases.⁹⁰

However, despite these process improvements, TAS's IDT receipts continued to increase substantially in FY 2011, as reflected in Figure II.2 below.

FIGURE II.2, TAS IDENTITY THEFT RECEIPTS, FY 2007 – SECOND QUARTER FY 2011, ECONOMIC AND SYSTEMIC BURDEN



TAS and W&I will review a sample of identity theft cases to determine what factors are driving taxpayers to seek the assistance of the IPSU (systemic burden identity theft issues)

88 See IRC § 7811(a). In FY 2010, the National Taxpayer Advocate, TAS Area Directors, and Local Taxpayer Advocates issued 26 Taxpayer Assistance Orders (TAOs) which involved lien issues. From October 1, 2010, to May 31 2011, TAS issued 15 additional TAOs.

89 See Memorandum of Understanding Between the National Taxpayer Advocate and the Commissioner, Wage & Investment to Transition TAS Criteria 5-7 Identity Theft Cases to Wage & Investment Identity Protection Specialized Unit (IPSU) (Mar. 31, 2010). The following are examples of when TAS would continue to advocate for identity theft victims: (1) the taxpayer declines referral to the IPSU; (2) the IPSU has already tried to provide relief in the past, and has failed; (3) systemic burden cases that require advocacy which might lead to the issuance of a TAO on behalf of the taxpayer; (4) taxpayer cases added to the Taxpayer Advocate Management Information System (TAMIS) will remain in TAS and be resolved through the Operations Assistance Request (OAR) process; (5) taxpayers not satisfied with the assistance provided through the IPSU; (6) taxpayers being assisted by the IPSU, who subsequently face economic burden while the IPSU is processing their request, will come to TAS for assistance, when the IPSU cannot provide relief within 24 hours; (7) congressional cases; and (8) any cases previously open in TAS. See National Taxpayer Advocate, Interim Guidance on Referring Identity Theft Criteria 5-7 Cases to the Identity Protection Specialized Unit (IPSU) (May 17, 2010).

90 IRS, *IPSU Identity Theft Report* (Oct. 2, 2010); IRS, *IPSU Identity Theft Report* (May 21, 2011).

and TAS (economic burden issues and cases meeting the exceptions detailed in the TAS/W&I memorandum). The team will conduct a detailed analysis of a random sample of TAS and W&I cases closed between January 1, 2011, and March 31, 2011, to identify the underlying source of casework and any procedural gaps contributing to increased receipts.

Identity theft cases present unique complexities for IRS employees and the TAS Case Advocates assigned to help the taxpayers. For example, steps for resolving identity theft cases include:

- Verifying taxpayer identity and researching of account history;⁹¹
- Identifying illegitimate tax information on a taxpayer's account;⁹²
- Addressing the immediate needs of a taxpayer experiencing economic hardship;⁹³
- Proposing account adjustments and ensuring an identity theft marker is placed on the account;⁹⁴ and
- Conducting a global account search to identify possible related problems, and correcting those problems.⁹⁵

These are just some of the steps in the methodical process of validating that the taxpayer's account has been compromised by identity theft and eliminating all traces of the corrupted information from that account. This process is one reason that identity theft cases typically take 36 percent longer to resolve than the average TAS case.⁹⁶

In addition, it is often quite difficult for the IRS to ascertain which person is the true owner of the Social Security number (SSN) in question. When the IRS requests certain documents to verify the victim's identity before taking steps to resolve the tax account, the true owner of the SSN may feel victimized again by this process. We will train our

91 At the initial stage of the case, the Case Advocate verifies the identity of the taxpayer (*i.e.*, that he or she is the owner of the Social Security number on the tax return). IRM 10.5.3.2.1 (Dec. 10, 2010).

92 The Case Advocate must then analyze the taxpayer's account and assess which information is legitimate and which information belongs to the fraudulent filer. IRM 21.6.2.4.3.1 (Apr. 2, 2010).

93 The next step is to advocate for the immediate release of any legitimate refunds due to the innocent taxpayers (*i.e.*, any amounts that were held in abeyance by the IRS).

94 The Case Advocate then must request that the IRS make the appropriate account adjustments so that the illegitimate information is removed. See IRM 21.6.2.4.3.2 (Mar. 8, 2010); IRM 21.6.2.4.3.3 (Mar. 8, 2010). The IRS marks the accounts of identity theft victims to protect them from tax-related identity theft actions. This marker puts IRS employees on notice that the individual owning this SSN has been or may be the victim of identity theft and allows the IRS to track the number of affected taxpayer accounts, protect federal revenue threatened by identity theft, and reduce taxpayer burden. IRM 10.5.3.2.2 (Dec. 10, 2010).

95 The Case Advocate then must analyze the taxpayer's accounts for other issues which may be related to the identity theft but that are unknown to the taxpayer and correct those issues. IRM 13.1.21.1.3.13 (Feb. 1, 2011).

96 Through May, the average identity theft case takes approximately 114 days to resolve in FY 2011, while the average TAS case takes approximately 84 days for the same period. Data obtained from TAMIS.

Case Advocates to understand the unique anxiety that identity theft causes in its victims. Additional interim communication may be required to reassure such taxpayers, and will be a key component of issue resolution.

One reason for the increase in IDT cases is the “unpostable” process, in which the IRS flags certain questionable refund claims and does not allow these returns to post. Since the IRS started using an electronic indicator in 2009 to flag SSNs as being potentially compromised by identity theft, it has tracked over 980,000 incidents impacting over 600,000 taxpayers.⁹⁷ The IRS, in anticipation of the increase in flagged accounts, enlisted IPSU and Accounts Management Taxpayer Assurance Program (AMTAP) employees to resolve IDT unpostable returns, and directs most IDT unpostable cases to AMTAP for resolution.

However, TAS is concerned that AMTAP does not have adequate staffing to handle this additional workload. This is evident from the 107 Taxpayer Assistance Orders issued by TAS to AMTAP in FY 2011 as a result of AMTAP’s unresponsiveness to TAS Operations Assistance Requests.⁹⁸ TAS met with AMTAP to discuss the backlog of TAS OARS. For the remainder of FY 2011 and throughout FY 2012, TAS will work with AMTAP to improve taxpayer service and reduce inventory for both organizations.

One of the uglier faces of identity theft involves misuse of a deceased taxpayer’s SSN to obtain federal refunds. Identity thieves utilize publicly-available information provided by the Social Security Administration (SSA) to obtain a decedent’s full name, SSN, date of birth, address, *etc.*⁹⁹ When the identity of a decedent is stolen and used to file a fraudulent tax return, the mourning relatives must submit multiple documents including an identity theft affidavit, Social Security card, and birth certificate to prove the deceased was a victim of identity theft. If the IRS has previously processed a return on which the deceased individual’s SSN was used, surviving relatives and executors of estates must re-submit returns involving deceased taxpayers on paper (electronically filed returns will be rejected).¹⁰⁰ It then takes months to get these accounts corrected and to process a refund.

97 See IRS Office of Privacy, Information Protection, and Data Security (PIPDS) Incident Tracking Statistics Reports for calendar years ending 2009 and 2010 and for the period of January 1, 2011, through March 31, 2011. The IRS Deputy Commissioner for Operations Support reported that the IRS tracked more than 470,000 incidents of identity theft affecting more than 390,000 taxpayers. See *The Spread of Tax Fraud by Identity Theft: A Threat to Taxpayers, a Drain on the Public Treasury, Hearing Before the Subcommittee on Fiscal Responsibility and Economic Growth, S. Comm. on Finance* (May 25, 2011) (statement of Beth Tucker, IRS Deputy Commissioner for Operations Support). The significant majority of the difference is attributable to one or more mass schemes blocked by IRS filters.

98 Data obtained from TAMIS. TAOs issued through May 31, 2011. See *Importance of the Taxpayer Assistance Order, infra*. An Operations Assistance Request (Form 12412) is the form that TAS employees use when requesting that the IRS complete an action on a TAS case when TAS lacks the authority to take that action.

99 In 1980, the Social Security Administration created a Death Master File as a result of a consent judgment reached in a Freedom of Information Act lawsuit brought by a private citizen. Deceased taxpayers’ SSNs and related information are now regularly obtained and used by government agencies, credit reporting agencies, financial firms, and genealogists. Unfortunately, it is also used by identity thieves to commit tax fraud.

100 IRS Publication 1346, *Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns*, available at <http://core.publish.no.irs.gov/pubs/pdf/64403j10.pdf> (last visited June 6, 2011).

Thus far in 2011, the IRS has received 660,000 decedent returns.¹⁰¹ Effective April 17, 2011, the IRS instituted business rules to filter out some of these “decedent scheme” returns; within one month, it stopped 42,441 decedent-related returns claiming questionable refunds estimated at \$194 million.¹⁰² The IRS estimates that an additional 221,000 returns claiming \$700 million in refunds would have been stopped had the business rules been in place at the beginning of the filing season.¹⁰³ To combat this issue, the IRS has instituted measures to identify and invalidate fraudulent returns, and delete refunds claimed on returns filed with SSNs belonging to decedents. The IRS is notifying taxpayers when a return and refund are held pending investigation of items reported on the return.¹⁰⁴

Recently, the National Taxpayer Advocate testified before Congress regarding the IRS’s response to identity theft. In this testimony, she identified the following recommendations, including:

1. Allowing taxpayers the option to turn off the ability to file electronically;
2. Systematically retiring dormant (or inactive) social security numbers;
3. Utilizing information reporting earlier in the filing season;
4. Notifying taxpayers of potential identity theft; and
5. Working with the social security administration to keep social security numbers out of the public domain.

The National Taxpayer Advocate will follow up on these specific recommendations in a Status Update on the IRS’s identity theft victim assistance procedures in her 2011 Annual Report to Congress. She will also continue to advocate for the use of an identity theft PIN, which the IRS has begun testing and appears to be a promising approach to alleviate taxpayer burden. TAS is participating in the recently-convened Identity Theft Assessment Action Group, a cross-functional team conducting a servicewide assessment of the identity theft program. In FY 2012, TAS will continue to:

- Work cooperatively with the IRS to determine if the identity theft cases coming to TAS should instead be worked by the IRS’s specialized identity theft unit (the IPSU) under an agreement between TAS and the IRS;
- Encourage Local Taxpayer Advocates (LTAs) to advocate for identity theft victims by issuing Taxpayer Assistance Orders in appropriate situations;¹⁰⁵

101 TAS notes from IRS Decedent Schemes conference call (Apr. 25, 2011).

102 TAS notes from IRS Decedent Schemes conference call (May 12, 2011, and Apr. 21, 2011).

103 TAS notes from IRS Decedent Schemes conference call (May 12, 2011).

104 Lack of real-time processing of information returns from third parties (Forms W-2, Forms 1099, etc.) exacerbates the problem.

105 TAS is increasing awareness of the need for greater advocacy for victims of identity theft. Through May, TAS issued 90 TAOs with identity theft as the underlying cause of the taxpayer’s problem in FY 2011.

- Identify additional authentication procedures for taxpayers who have been victims of identity theft, to ensure that identity thieves cannot pose as the taxpayer and obtain access to taxpayer data;
- Provide additional training to TAS employees on how to resolve identity theft cases; and
- Advocate that the SSA find a way to redact portions of decedents' SSNs before public release in order to eliminate the ability of identity thieves to commit tax fraud using the Death Master File.

H. TAS Continues to Advocate for Changes in the Two-Year Equitable Relief Deadline and for Victims of Domestic Violence and Abuse

Congress enacted “innocent spouse” rules as a recognition that it is sometimes appropriate to relieve spouses of the tax liability that stems from a joint return¹⁰⁶ or arises due to the operation of community property laws.¹⁰⁷ The current rules, found in IRC §§ 6015 and 66(c) (last sentence), were enacted as part of the IRS Restructuring and Reform Act of 1998 (RRA 98).¹⁰⁸ IRC § 6015(f) and the last sentence of IRC § 66(c), referred to as equitable relief provisions, allow relief when, taking into account all the facts and circumstances, it would be inequitable to hold the taxpayer liable for the tax.

While sections 6015(b) and (c) of the Internal Revenue Code require taxpayers to request relief within two years after the IRS commences collection activity, section 6015(f) and section 66(c) do not contain any time limit for requesting *equitable* innocent spouse relief. Instead, these provisions provide that the Secretary shall prescribe procedures for granting equitable relief. A Treasury regulation, added after RRA 98, however, imposes a two-year time limit for requesting equitable relief under section 6015(f).¹⁰⁹ In 2009, the Tax Court, in *Lantz v. Commissioner*¹¹⁰ and *Mannella v. Commissioner*¹¹¹ held that the two-year rule for section 6015(f) in the regulation was invalid and granted equitable relief. In a number of

106 Married taxpayers who file a joint return are jointly and severally liable for the tax with respect to the return, regardless of who was responsible for the income (or omission). IRC § 6013(d)(3).

107 Taxpayers in community property states who do not file joint returns are generally required to report half of the community property on their returns. *Poe v. Seaborn*, 282 U.S. 101 (1930).

108 Pub. L. No. 105-206, § 3201, 112 Stat. 685, 734 (1998).

109 Treas. Reg. § 1.6015-5(b)(1), 67 Fed. Reg. 47278 (July 18, 2002), imposes a two-year time limit that commences with the first IRS collection activity with respect to liability arising from a joint return. Additional IRS guidance imposes the same deadline for claims for equitable relief from the operation of community property rules under IRC § 66. Rev. Proc. 2000-15, §§ 4.01(3) and 5, 2000-1 C.B. 447 at 448, 449, *superseded by* Rev. Proc. 2003-61, §§ 4.01(3) and 5, 2003-2 C.B. 296 at 297, 299.

110 *Lantz v. Comm'r*, 132 T.C. 131 (2009), *rev'd and remanded by* 607 F.3d 479 (7th Cir. 2010).

111 *Mannella v. Comm'r*, 132 T.C. 196 (2009), *rev'd and remanded by* 631 F.3d 115 (3d Cir. 2011).

subsequent cases in which the taxpayer requested relief after the two-year period expired,¹¹² including, in 2010, *Jones v. Commissioner*,¹¹³ the Tax Court granted relief. In 2010, the Tax Court's decisions in *Lantz* and in *Mannella* were reversed by two Courts of Appeals that found the regulation valid,¹¹⁴ and in 2011, a third Court of Appeals also found the regulation was valid and reversed the Tax Court's decision in *Jones*.¹¹⁵ Other cases are pending in various appellate courts.¹¹⁶

The National Taxpayer Advocate, in her 2006 Annual Report to Congress, submitted a legislative recommendation that Congress remove the two-year rule for requesting equitable innocent spouse relief.¹¹⁷ In her 2010 Annual Report to Congress, the National Taxpayer Advocate described the legislative history of IRC § 6015, and again recommended that Congress remove the two-year rule.¹¹⁸ Some taxpayers with cases pending in appellate courts filed supplemental briefing materials in which they advised the courts of the National Taxpayer Advocate's analysis.¹¹⁹ Local Taxpayer Advocates also raised this issue during their annual congressional visits in which they discuss the Annual Report to Congress with members of Congress and their staffs.

Members of Congress, including a senator who served on the conference committee that fashioned the equitable relief provisions as part of RRA 98, have urged the IRS to remove

112 *Young v. Comm'r*, T.C. Docket No. 12718-09 (May 12, 2011); *Pullins v. Comm'r*, 136 T.C. No. 20 (2011); *Stephenson v. Comm'r*, T.C. Memo. 2011-16; *Hall v. Comm'r*, 135 T.C. No. 19 (2010), *appeal docketed*, No. 10-2628 (6th Cir. Dec. 14, 2010); *Buckner v. Comm'r*, T.C. Docket No. 12153-09, *appeal docketed*, No. 10-2056 (6th Cir. Aug. 18, 2010); *Carlile v. Comm'r*, T.C. Docket No. 11567-09; *Payne v. Comm'r*, T.C. Docket No. 10768-09, *appeal docketed*, No. 10-72855 (9th Cir. Sept. 17, 2010); *Coulter v. Comm'r*, T.C. Docket No. 1003-09, *appeal docketed*, No. 10-680 (2d Cir. Feb. 24, 2010); *Jones v. Comm'r*, T.C. Docket No. 17359-08, *appeal docketed*, No. 10-1985 (4th Cir. Aug. 30, 2010); *Mannella v. Comm'r*, 132 T.C. 196 (2009), *rev'd and remanded by* 631 F.3d 115 (3d Cir. 2011); *Lantz v. Comm'r*, 132 T.C. 131 (2009), *rev'd and remanded by* 607 F.3d 479 (7th Cir. 2010).

113 *Jones v. Comm'r*, T.C. Docket No. 17359-08, *rev'd and remanded by* 2011 WL 2307644 (4th Cir., June 13, 2011).

114 *Mannella v. Comm'r*, 631 F.3d 115 (3d Cir. 2011), *rev'g and remanding* 132 T.C. 196 (2009); *Lantz v. Comm'r*, 607 F.3d 479 (7th Cir. 2010), *rev'g and remanding* 132 T.C. 131 (2009).

115 *Jones v. Comm'r*, 2011 WL 2307644 (4th Cir., June 13, 2011) *rev'g and remanding* T.C. Docket No. 17359-08.

116 Adhering to the rule in *Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), *aff'd* 445 F.2d 985 (10th Cir. 1971), that the Tax Court will defer to a Court of Appeals decision which is squarely in point where appeal from the Tax Court decision lies to that Court of Appeal, the Tax Court continues to hold the regulation invalid in cases appealable to other courts. See, e.g., *Hall v. Comm'r*, 135 T.C. No. 19 (2010), *appeal docketed*, No. 10-2628 (6th Cir. Dec. 14, 2010); *Buckner v. Comm'r*, T.C. Docket No. 12153-09, *appeal docketed*, No. 10-2056 (6th Cir. Aug. 18, 2010); *Payne v. Comm'r*, T.C. Docket No. 10768-09, *appeal docketed*, No. 10-72855 (9th Cir. Sept. 17, 2010); *Coulter v. Comm'r*, T.C. Docket No. 1003-09, *appeal docketed*, No. 10-680 (2d Cir. Feb. 24, 2010).

117 National Taxpayer Advocate 2006 Annual Report to Congress 540-541 (Legislative Recommendation: *Eliminate the Two-Year Limitation Period for Taxpayers Seeking Equitable Relief under IRC §§ 6015 or 66*).

118 National Taxpayer Advocate 2010 Annual Report to Congress 377-382.

119 See e.g., taxpayers' statements of supplemental authorities filed on Jan. 6, 2011, at *Coulter v. Comm'r*, docket No. 10-680 (2d Cir.); on Jan. 7, 2011, at *Jones v. Comm'r*, docket No. 10-1985 (4th Cir.); and on Mar. 3, 2011, at *Buckner v. Comm'r*, docket No. 10-2056 (6th Cir.). Rule 28(j), Federal Rules of Appellate Procedure, permits a party to advise the court of "pertinent and significant" authorities that come to the party's attention after the party's brief has been filed, or after oral argument but before decision.

the two-year rule.¹²⁰ The Commissioner has agreed to review the rule,¹²¹ but in the meantime the IRS continues to follow the Treasury regulation even in cases in which it concedes the taxpayer otherwise qualifies for equitable relief.¹²² TAS will continue to advocate for removal of the two-year rule as a condition for obtaining equitable relief.

In a related development, recent cases demonstrate that the IRS may have difficulty evaluating claims of domestic violence or abuse raised by taxpayers seeking innocent spouse relief.¹²³ In partnership with a Washington, DC coalition for the prevention of domestic violence, TAS will produce training materials and a video to assist IRS public-contact employees in recognizing domestic violence and abuse and the special needs and issues these taxpayers may present in cases throughout the IRS.

The training will include a case study and will address a wide range of issues, such as how to avoid interpreting a taxpayer's survival techniques, which may involve denial, inconsistent statements, or evasiveness, as a lack of truthfulness. Because traditional forms of documentary evidence are often unavailable, the training will explore the acceptability of alternative forms of substantiation, such as testimony and third-party affidavits. The confidentiality of taxpayer information, especially current whereabouts, may be of paramount importance to the taxpayer, and the training will suggest tactics for discussing disclosure rules, and for maintaining contact with elusive or transient taxpayers.

I. TAS Maintains a Close Eye on the IRS's Health Care Implementation Efforts

The National Taxpayer Advocate outlined the main health care tax provisions in the 2010 Annual Report to Congress and identified potential challenges and concerns with how the law may be administered. Because of the far-reaching scope of the health care provisions and their potential impact on taxpayers and the IRS, TAS maintains a close eye on the IRS's implementation efforts. TAS continues to participate in regularly scheduled briefings with senior IRS officials as well as holding bi-weekly internal meetings regarding implementation efforts. Additionally, TAS is reviewing all IRS guidance and proposed guidance to identify potential issues prior to implementation.

120 See H.R. Conf. Rept. No. 105-599, 105th Cong., 2d Sess. 249-51(1998), reflecting Sen. Baucus' committee membership. In an April 18, 2011, letter to the Commissioner of the IRS, Sen. Baucus as Senate Finance Committee Chair, Sen. Tom Harkin, and Sen. Sherrod Brown explained that the "two-year rule has been running counter to the spirit of the equitable relief provision as a 'safety-valve' for innocent spouses that takes into account all the facts and circumstances of each case." In a separate letter to the Commissioner on the same date, 49 House members expressed their view that the two-year rule "violated the spirit of the original law." The letters are *available at* 2011 TNT 75-27 and 2011 TNT 75-28 (Apr. 18, 2011).

121 Letter from Comm'r Shulman to the Hon. Jim McDermott, U.S. House of Representatives (Apr. 29, 2011), *available at* 2011 TNT 86-34.

122 See Notice CC-2010-5 (Mar. 12, 2010) designating for litigation the issue of the two year rule with respect to IRC § 6015(f) claims. IRM 25.15.7.8.7 (Feb. 25, 2011). The IRS conceded that taxpayers would be entitled to relief but for the two-year rule in the regulation in the *Hall, Buckner, Carlile, Payne, Coulter, Jones, Mannella, and Lantz* cases cited above.

123 *Thomassen v. Comm'r*, T.C. Memo. 2011-88; *Stephenson v. Comm'r*, T.C. Memo. 2011-16.

TAS has also engaged in extensive training of its own employees and external partner organizations. TAS has just completed a three-part health care training class delivered to all employees, providing an overview of the health care tax provisions, with a focus on the small business tax credit. TAS has also provided training to all Low Income Taxpayer Clinics and community groups¹²⁴ to ensure they know how the new health care provisions will affect the taxpayers they assist.

In FY 2012, TAS will continue its efforts to identify potential issues early in the implementation process and raise those issues to the IRS or propose legislative changes when necessary. TAS will also continue identifying training needs for TAS employees as well as outreach opportunities to educate taxpayers.

1. Small Business Health Care Tax Credit Calculator

The Small Business Health Care Tax Credit is the first of the major health care tax provisions to go into effect.¹²⁵ The credit requires a number of calculations to determine eligibility and credit amount. A TAS employee, noting the complicated nature of the credit, created a calculator to aid other employees in the process. TAS has completed development of the calculator, and after accuracy tests, will make it available to all employees for case work. TAS is working with the IRS to make the calculator available to all IRS employees as well as to the public.

While TAS has taken the lead on the calculator, TAS is hopeful that it will serve as a model for future development by the IRS of additional tools to assist its employees and taxpayers.

2. Research Efforts

The long implementation lead-time for many of the largest health care provisions affords the IRS time to tailor implementation to the target population. This includes using a research-based approach to designing forms, publications, and outreach materials. TAS is conducting a comprehensive review of IRS, TAS, and external research on the taxpayer population affected by the new health care provisions, particularly low income taxpayers, small businesses, and self-employed individuals. Developing a better understanding of the specific needs and preferences of these taxpayer populations will allow the IRS to shape its implementation efforts to respond to those needs. The research will also include the IRS's outreach and education efforts to taxpayers about the new health care tax provisions. In FY 2012, TAS will continue its research, use the results to identify areas where additional research is needed, and ensure that the IRS applies the resulting information to improve its administration of these provisions.

124 For example: TAS provided training at the 2011 National Community Tax Coalition Annual Conference reaching approximately 50 representatives serving low income communities across the country.

125 For more detailed information regarding Small Business Health Care Tax Credit, including eligibility rules and IRS guidance, see <http://www.irs.gov/newsroom/article/0,,id=223666,00.html> (last visited June 2, 2011).

3. Communication Efforts

One of the difficulties of the IRS's implementation efforts is that the IRS is being asked to implement decisions of other agencies.¹²⁶ TAS is concerned about this dynamic because the IRS will be the face of health care for many taxpayers but will not be the decision-maker in most circumstances. In FY 2012, TAS will work with the IRS to develop a communication strategy for taxpayers. The strategy will focus on helping taxpayers navigate the process, telling them what to expect from the IRS, and what the IRS can and cannot do related to health care. This early outreach is necessary to set expectations and direct taxpayers to the correct agency or function to resolve issues.

In FY 2011, TAS will also partner with the IRS to get information about health care implementation out to stakeholders to increase awareness of coming tax law changes. TAS will work with the IRS to ensure stakeholder participation in the IRS notice and comment process.

J. Exempt Organization Reinstatement Applications May Cause Significant Delays in Processing Exempt Organization Applications

The Pension Protection Act of 2006 added § 6033(i) and (j) to the Internal Revenue Code, requiring exempt organizations previously below the filing threshold to file a so-called electronic postcard annually or undergo automatic revocation of tax-exempt status for failure to file for three years in a row.¹²⁷ In July 2010, the tax-exempt status of approximately 300,000 organizations was at risk.¹²⁸ Meanwhile, the Commissioner extended a May 17, 2010, filing deadline to October 15, 2010, by which time about 50,000 of those organizations filed, coming off the at-risk list.¹²⁹ On June 8, 2011, the IRS revoked the exempt status of approximately 275,000 organizations.¹³⁰ Even if fewer than half of these nonprofits apply for reinstatement of exempt status, a six-figure caseload would represent an historic spike

126 Implementation of the health care law requires the IRS to work closely with the Department of Health and Human Service and the Department of Labor.

127 See Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 (2006). Generally, new IRC § 6033(j)(1) revokes the exempt status of an organization that fails to fulfill its filing requirement – under either pre-existing subsection (a)(1) or new subsection (i) of IRC § 6033 – for three years in a row. Prior to passage of the Pension Protection Act of 2006, exempt organizations with annual gross receipts normally of \$25,000 or less did not have a filing requirement. See Rev. Proc. 83-23, 1983-1 C.B. 687, *modified and superseded by* Rev. Proc. 2011-15, 2011-3 I.R.B. 322.

128 See IRS Exempt Organizations, *Ann'l Rep't* FY 2010, 8 (“The IRS posted a list of the names and last-known addresses of more than 300,000 at-risk organizations with filing due dates from May 17 through October 15, 2010, and no record of having filed a required annual return or notice for 2007, 2008 or 2009.”) at http://www.irs.gov/pub/irs-tege/fy2011_eo_workplan.pdf (last visited on June 6, 2011); Amy Blackwood & Katie L. Roeger, *Here Today, Gone Tomorrow: A Look at Organizations that May Have Their Tax-Exempt Status Revoked* 1, Nat'l Ctr. for Charitable Statistics, Urban Inst. (July 8, 2010) (“Over 292,000 nonprofit organizations may lose their tax-exempt status in the coming months for failing to file a tax return with the Internal Revenue Service (IRS).”). In 2010, the IRS had posted an online list of so-called at-risk organizations (*i.e.*, organizations that had failed to file returns for two consecutive years). The number of organizations on the list on July 14, 2010, was 321,091.

129 See IRS News Release: *IRS Identifies Organizations that Have Lost Tax-Exempt Status; Announces Special Steps to Help Revoked Organizations*, IR-2011-63 (June 8, 2011); IRS Pub. 4839-B, *One-Time Filing Relief for Tax-Exempt Organizations* (Aug. 2010).

130 See IRS News Release: *IRS Identifies Organizations that Have Lost Tax-Exempt Status; Announces Special Steps to Help Revoked Organizations*, IR-2011-63 (June 8, 2011).

in the volume of applications and would impact processing of all new exempt organization applications, not just reinstatements.¹³¹

Consequently, TAS is concerned about possible delays in processing. An organization that does not receive a determination on its application for exempt status within approximately nine months of filing has a right to file suit for a declaratory judgment regarding its exemption status.¹³² However, a court procedure could be practically inaccessible to small charities. It is unclear if the *pro bono* bar and the judiciary itself would have adequate capacity if demand is voluminous. Accordingly, the pressure is on the IRS to provide taxpayer service through timely application processing.

Moreover, TAS is aware of certain issues raised by previous waivers of filing for certain classes of organizations, especially quasi-public entities.¹³³ As it has done previously, the IRS could achieve a measure of efficiency by resolving common issues all at once, rather than solely on a case-by-case basis.¹³⁴ In other words, reinstatement could be accomplished for certain classes of organizations all at once. For instance, the IRS recently announced transitional relief for certain small organizations allowing reinstatement retroactive to the automatic revocation date.¹³⁵ This is a good example of relief for a class of organizations.

K. IRS's Inconsistency and Failure to Follow Its Published Guidance Damaged Its Credibility With Practitioners Involved in the Offshore Voluntary Disclosure Program

U.S. persons are generally required to report foreign accounts on Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts* (FBAR) and to report income from such accounts on U.S. tax returns. The IRS “strongly encouraged” taxpayers who failed to file these and other similar returns to participate in the 2009 Offshore Voluntary Disclosure Program (OVDP), rather than quietly filing amended returns and paying any taxes due.¹³⁶ It warned that those making “quiet” corrections could be “criminally prosecuted.” OVDP participants would generally be subject to a 20 percent “offshore” penalty in lieu of various other

131 See IRS Exempt Organizations, *Ann'l Rep't* FY 2010, 3 (charting volume of annual determinations of applications for tax exemption) as 89,448, 85,927, 83,835, 89,703, 90,812, 84,225, 77,309, and 65,590 in 2003-2010).

132 See IRC § 7428 (providing that an organization can request a declaratory judgment regarding qualification for tax-exempt status from the United States Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia 270 days after applying for tax-exempt status).

133 See Rev. Proc. 95-48, 1995-2 C.B. 418 (waiving requirement to file for certain governmental units and affiliates).

134 See IRS Pub. 4839, *Annual Form 990 Filing Requirements for Tax-Exempt Organizations Forms 990, 990-EZ, 990-PF and 990-N (e-Postcard)* (indicating that a revoked organization must reapply for exempt status).

135 Notice 2011-43 (posted June 8, 2011) at <http://www.irs.gov/pub/irs-drop/n-11-43.pdf>.

136 See IRS, *Voluntary Disclosure: Questions and Answers*, <http://www.irs.gov/newsroom/article/0,,id=210027,00.html> (last visited June 6, 2011) (Feb. 9, 2011) (first posted May 6, 2009) (hereinafter OVDP “FAQ”). According to FAQ #10 (“Taxpayers are strongly encouraged to come forward under the Voluntary Disclosure Practice. Those taxpayers making “quiet” disclosures should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years. The IRS will be closely reviewing these returns to determine whether enforcement action is appropriate.”).

penalties.¹³⁷ The IRS announced, however, that “[U]nder no circumstances will a taxpayer be required to pay a penalty greater than what he would otherwise be liable for under existing statutes.”¹³⁸ Taxpayers who would not be subject to significant penalties because their violations were not willful, or because they qualified for the “reasonable cause” exception, believed this statement applied to them.

On March 1, 2011, more than a year after the 2009 OVDP ended, the IRS “clarified” its seemingly unambiguous statement.¹³⁹ It would no longer consider whether taxpayers in the 2009 OVDP would pay less under existing statutes on the basis of non-willfulness or reasonable cause. Such taxpayers could either agree to pay more than they believed they owed or withdraw from the 2009 OVDP and face the possibility the IRS would assert massive civil penalties and seek criminal prosecution. Both options were problematic. Withdrawal would waste all of the resources already expended on the 2009 OVDP application and would not bring the taxpayer closure or certainty, as advertised. Moreover, in any future examination the IRS might have to request and review the items that were before the examiner processing the 2009 OVDP submission.¹⁴⁰

Pressuring taxpayers who would pay less under existing statutes to remain in the program and pay more than they believe they owed was even worse. It violated longstanding IRS policy along with most conceptions of fairness and due process.¹⁴¹ The IRS’s inconsistency and failure to follow its published guidance damaged its credibility with practitioners and could be subject to legal challenge.¹⁴² In 2011, TAS will continue to communicate with taxpayers and practitioners to determine the impact of the IRS’s apparent reversal, advocate for the IRS to abide by the plain language of the original terms of the OVDP (as reasonably interpreted by the public and many of the IRS’s examiners), and document our findings in the National Taxpayer Advocate’s 2011 Annual Report to Congress.¹⁴³

137 OVDP FAQ #12.

138 OVDP FAQ #35 (stating “[V]oluntary disclosure examiners do not have discretion to settle cases for amounts less than what is properly due and owing. **These examiners will compare the 20 percent offshore penalty to the total penalties that would otherwise apply to a particular taxpayer. Under no circumstances will a taxpayer be required to pay a penalty greater than what he would otherwise be liable for under existing statutes.**”) (Emphasis added.).

139 Memorandum from Director, SB/SE Examination, and Director, International Individual Compliance, for all OVDI Examiners, *Use of Discretion on 2009 OVDP Cases* (Mar. 1, 2011). This reversal was not properly disclosed to the public as required by the Freedom of Information Act. See 5 U.S.C. § 552. IRS revenue agents had to deliver the bad news to practitioners one at a time. This must have been particularly uncomfortable for agents who had agreed to settle on the previously more favorable terms with the practitioners’ other clients just the week before.

140 In our view this contradicted the portion of FAQ #35, which stated “[T]hese examiners [the OVDP examiners] will compare the 20 percent offshore penalty to the total penalties that would otherwise apply to a particular taxpayer.”

141 Policy Statement 4-7; IRM 1.2.13.1.5 (Feb. 23, 1960).

142 See, e.g., Pedram Ben-Cohen, *IRS’s Offshore Bait and Switch: The Case for FAQ 35*, 46 DTR J-1 (Mar. 9, 2011).

143 We note that President Barack Obama recently signed the *Plain Writing Act of 2010* (H.R. 946), Pub. L. 111-274, Oct. 13, 2010, 124 Stat. 2861 (5 U.S.C. 301 note), to “improve the effectiveness and accountability of Federal agencies to the public by promoting clear Government communication that the public can understand and use.” *Id.* It defines “plain writing” as writing that is “clear, concise, well-organized, and follows other best practices appropriate to the subject or field and intended audience.” *Id.*

L. TAS Will Work with the IRS on Taxpayer Communication and Correspondence Issues

The IRS issues more than 200 million notices each year, but these notices have a long-standing problem. The notices and letters sometimes confuse taxpayers and tax practitioners, do not always provide accurate and timely information, and do not achieve the intended business results.¹⁴⁴ In August 2008, the IRS Commissioner chartered the Taxpayer Communications Taskgroup (TACT), a cross-functional team (including TAS) created to study and improve the clarity, accuracy, and effectiveness of written communications to taxpayers.¹⁴⁵ TACT's objectives included:

- Simplifying and clarifying language;
- Streamlining and improving business processes;
- Developing alternative electronic solutions;
- Eliminating unnecessary or duplicative notices, letters, reminders, and inserts;
- Reducing erroneous correspondence; and
- Instituting effective measures, including taxpayer responsiveness.

To that end, TACT enlisted an outside consulting firm, Siegel and Gale, to help the IRS explore how its correspondence with taxpayers supports or hinders the IRS's goal of helping the "large majority of compliant taxpayers" while ensuring that the "minority who are unwilling" become compliant.¹⁴⁶

Siegel and Gale found, among other things, that the IRS's proliferation of notices contributes to an unwieldy process. IRS notices are confusing, do not help people respond effectively, contribute to noncompliance, and lack a consistent, compelling IRS voice.¹⁴⁷ The firm also found the IRS's "one-size-fits-all" approach is ineffective because notices have static content, *e.g.*, referring to an overpayment and an underpayment in the same notice; and employ a monotonous, adversarial voice highlighting punishment above all else.¹⁴⁸ Moreover, IRS notices did not consistently offer all payment options, including offers in compromise, and did not explain the differences between voluntary and involuntary payment methods, such as levies.¹⁴⁹ With this in mind, Siegel and Gale helped the TACT in

144 IRS, *Taxpayer Communications Taskgroup (TACT) Charter 5* (Nov. 20, 2008).

145 IRS, Publication 4701, *Progress on the Implementation of the Taxpayer Assistance Blueprint 21* (Oct. 2009).

146 Siegel + Gale, *Summary Report: Key Findings, The IRS' Correspondence System 1* (Dec. 16, 2008).

147 *Id.* at 2, 3, 4, 7, 8, 9.

148 *Id.* at 7.

149 *Id.* at 8.

redesigning 40 notices that account for approximately 70 percent of IRS correspondence.¹⁵⁰ Further, Siegel and Gale conducted tests comparing comprehension of existing and redesigned notices, such as the CP 2000, *Automated Underreporter*, L1058, *Final Notice – Notice of Intent to Levy and Notice of Your Right to a Hearing*, and CP 521, *Installment Agreement Reminder* to “test market” them to members of the public.¹⁵¹

TACT wrapped up most of its activities at the end of 2009. The group made progress by developing a prototype for a Correspondence Management Information System to track measurement data related to correspondence, eliminating inserts for representatives’ copies of notices, implementing a new “red button” error reporting mechanism for employee reporting of taxpayer receipt of erroneous notices, and submitting a legislative proposal to permit future electronic delivery of notices. The TACT also developed a pilot to test the timing and potential elimination of the interim letter, which the IRS sends to taxpayers 30 days after receiving their correspondence to let taxpayers know that the IRS will respond to their letters or inquiries in the future. The IRS’s interim letter causes increased telephone call volume from taxpayers and additional taxpayer correspondence when the IRS fails to timely respond to issues raised in taxpayers’ letters.¹⁵²

Following the TACT’s success, the Commissioner created the Office of Taxpayer Correspondence (OTC) to continue its work.¹⁵³ On January 10, 2010, the IRS released nine of the redesigned notices, including notice CP 08, *Additional Child Tax Credit*, CP 53, *Unable to Direct Deposit Refund*, CP 120, *Confirmation of Tax-Exempt Status*, and CP 139, *Form 940/941 Not Required*.¹⁵⁴ To date, the OTC has redesigned 85 notices.¹⁵⁵

The OTC also grapples with undelivered mail issues.¹⁵⁶ The National Taxpayer Advocate addressed undelivered mail and taxpayer correspondence as two of the IRS’s Most Serious

150 IRS, *TACT: Taxpayer Communications Taskgroup Presentation* 11 (Aug. 10, 2009) (presented to the National Association of Enrolled Agents). See <http://www.irs.gov/taxpros/article/0,,id=218038,00.html> (last visited May 17, 2011).

151 *Id.* at 7. See IRS, *Simplicity Laboratory Evaluation of Original and Revised IRS Forms CP521, L-1058, and CP2000* (Feb. 2009).

152 IRS, *TACT: Taxpayer Communications Taskgroup Final Meeting Presentation* 7 (Sept. 29, 2009). See also National Taxpayer Advocate 2006 Annual Report to Congress 222-248 (Most Serious Problem: Correspondence Delays).

153 Gadi Dechter, *Analysis: IRS aims for letter-perfect language* at http://www.govexec.com/story_page_pf.cfm?articleid=47794&printerfriendlyvers=1 (last visited June 6, 2011). See also <http://www.irs.gov/newsroom/article/0,,id=218133,00.html> (last visited May 17, 2011).

154 See <http://www.irs.gov/taxpros/article/0,,id=218038,00.html> (last visited May 18, 2011). The webpage includes links to each notice with further explanations and links to other areas of the website to assist taxpayers. The CP 08 informs taxpayers that they may qualify for the additional child tax credit. The CP 53 explains, “Your refund check will be sent by mail,” because the IRS cannot honor direct deposits of prior year refunds. The IRS issues CP 120 when a taxpayer has filed a return claiming tax-exempt status; the revised form explains how to obtain tax-exempt status if an IRS letter granting it is not available. The CP 139 allows taxpayers to stop filing Form 941, *Employer’s Quarterly Federal Tax Return*, and Form 940, *Employer’s Annual Federal Unemployment Tax Return*, if they have filed a Form 941 for four quarters with no tax due, and it provides guidance on when a taxpayer should file the forms in the future.

155 Gadi Dechter, *Analysis: IRS aims for letter-perfect language*, http://www.govexec.com/story_page_pf.cfm?articleid=47794&printerfriendlyvers=1 (last visited June 6, 2011)

156 Emails from Office of Taxpayer Correspondence Chief of Staff Program Manager (May 12, 2011, and May 17, 2011). Gadi Dechter, *Analysis: IRS aims for letter-perfect language*, http://www.govexec.com/story_page_pf.cfm?articleid=47794&printerfriendlyvers=1 (last visited June 6, 2011).

Problems in her 2010 Annual Report to Congress.¹⁵⁷ TAS is working on OTC's Undelivered Mail Team to implement recommendations made in the report; specifically, trying to integrate address hygiene¹⁵⁸ into all affected IRS systems, expand correct international addressing, and implement intelligent mail bar coding into all IRS correspondence.¹⁵⁹

In FY 2012, TAS will work with the OTC on correspondence design in other program areas that affect taxpayers. In addition, we will advocate for a test of accounts that the IRS shelved or placed in the queue whereby the IRS will send taxpayers monthly balance due notices to determine if taxpayers will increase or accelerate their payments, or contact the IRS to resolve their accounts or avoid pyramiding of their tax liabilities.

157 National Taxpayer Advocate 2010 Annual Report to Congress 221-234 (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*); 235-249 (Most Serious Problem: *The IRS Does Not Process Vital Taxpayer Responses Timely*).

158 "Address hygiene" pertains to a process where every notice address is compared to a third party's address database and corrected if necessary before the notice is sent. For example, the IRS has software that will check the addresses on some notices against a United States Postal Service database before it finalizes the batch of notices sent to printing.

159 IRS, Office of Taxpayer Correspondence (OTC), *Undelivered Mail Core Team Highlights* (Apr. 13, 2011).