II. Areas of Focus

A. Late-Year Tax Law Changes May Delay Tax Filings and Refunds Early Next Year

Many sections of the tax code that impact nearly all taxpayers expired in 2011 or are scheduled to expire in 2012.[23] Temporary provisions add complexity and uncertainty, making it difficult for both the government and taxpayers to plan, especially when it is unclear whether Congress will extend a provision.[24] The extension of expiring provisions (in a so-called "extenders" package) late in the year magnifies these problems, particularly when the change is retroactive.[25]

For example, during the 2011 filing season, millions of taxpayers — those claiming an itemized deduction on Schedule A, the higher education tuition and fees deduction, or the educator expenses deduction — had to wait until February 14, 2011, to file their returns because the IRS was still reprogramming its systems to handle late-year tax-law changes.[26] Other last-minute changes similarly affected the 2006 and 2008 filing seasons,[27] creating the following problems for taxpayers:

23 *See* Joint Committee on Taxation, JCX-1-12, *List of Expiring Federal Tax Provisions 2011-2022* (Jan. 6, 2012); Joint Committee on Taxation, JCX-6-12, *Legislative Background of Expiring Federal Tax Provisions 2011-2022* (Jan. 27, 2012). *See also* Margot Crandall-Hollick, Congressional Research Service, R42485, *An Overview of Tax Provisions Expiring in 2012* (Apr. 17, 2012) (Table 2).

24 National Taxpayer Advocate 2008 Annual Report to Congress 397-409 (Legislative Recommendation: *Eliminate (or Reduce) Procedural Incentives for Lawmakers to Enact Tax Sunsets).*

25 National Taxpayer Advocate 2007 Annual Report to Congress 3-12 (Most Serious Problem: *The Impact of Late-Year Tax-Law Changes on Taxpayers*); IRS, Prepared Remarks of Commissioner Douglas H. Shulman Before Tax Council Policy Institute (Feb. 15, 2012) ("[W]hile the IRS muddles through and does its best by rushing through revised forms and instructions, last-minute retroactive extensions cause significant taxpayer confusion, with a clean-up that often drags on for many months…[In addition] passing legislation with immediate effective dates adds operational risk to the IRS and makes it hard for taxpayers to plan properly to take advantage of tax benefits."). *See also* John L. Harrington, *Taking a New (and Troubling) Look at Expiring Tax Provisions*, 2012 TNT 54-7 (Mar. 20, 2012).

26 Treasury Inspector General for Tax Administration (TIGTA), 2011-40-032, *Interim Results of the 2011 Filing Season*, 1 (Mar. 31, 2011), *available at* http://www.treasury.gov/tigta/auditreports/2011reports/201140032fr.pdf. The IRS estimated the delay would impact about nine million individuals. *Id.* Electronic Return Originators had to hold approximately 6.5 million e-file tax returns to be transmitted on February 14. *Id.* at 4. As of February 11, 2011, the IRS had received and held for processing approximately 100,000 paper tax returns. *Id.* Other taxpayers likely decided to wait until February 14 to file their returns.

27 National Taxpayer Advocate 2007 Annual Report to Congress 4-5.

1. Because on average more than three-fourths of all tax returns claim refunds, delays in processing returns create hardship for taxpayers who rely their refunds to pay essential bills.[28]
2. Because of obsolete instructions and confusion about which rules apply, taxpayers risk filing inaccurate returns with both the federal government and the state governments that "piggyback" on federal computations.[29]
3. Even taxpayers who file accurate returns may face burdensome and counterintuitive instructions, that may require them to report items on lines designed for a different purpose (*e.g.,* reporting a deduction for tuition and fees on a line labeled "domestic production activities deduction").[30]
4. Late-year and retroactive changes reduce the impact of tax incentives, particularly for activities that require preparation and planning.[31]
5. For the same reason, late-year and retroactive changes make it much more difficult, if not impossible, for taxpayers to engage in legitimate tax planning.[32]

28 For example, in response to a November 9, 2010 letter from the House Ways and Means Committee and Senate Finance Committee urging the IRS to prepare for an expected late-year Alternative Minimum Tax (AMT) "patch," which would prevent the AMT exemption from reverting to 2001 levels, IRS Commissioner Shulman noted the IRS was reprogramming its computers, but warned "if legislation has not passed by the end of this year, our computers will have been programmed incorrectly, and we will need to delay filing for these individuals [the 21 million taxpayers] as we re-program our computers to the actual law in effect. Douglas H. Shulman, Commissioner of Internal Revenue, Letter to The Honorable Max Baucus, Chairman, Committee on Finance, United States Senate, *reprinted as, IRS Is Ready for AMT Relief, Shulman Says*, 2010 TNT 231-17 (Dec. 2, 2010). He also noted that "[I]t would be an unprecedented and daunting operational challenge to open the tax filing season under one set of tax laws with respect to AMT and extenders, begin accepting tax returns, and then have the law change." *Id.* For the 2010 and 2011 calendar years, 77 and 75 percent of all returns claimed refunds, respectively, and the average refund was $3,003 and $2,913, respectively. IRS, *2011 and Prior Year, Filing Season Statistics, Cumulative through the weeks ending 12/31/10 and 12/31/11* (Jan. 9, 2012), http://www.irs.gov/newsroom/article/0,,id=252176,00.html. Taxpayers who filed on or before Feb. 26, 2010 and Feb. 25, 2011, claimed refunds at an even higher rate – 85 and 87 percent, respectively, and the average refund was even higher – $3,149 and $3,129, respectively. *IRS, 2011 and Prior Year, Filing Season Statistics, Cumulative through the weeks ending 2/26/10 and 2/25/11* (Jan. 9, 2012), http://www.irs.gov/newsroom/article/0,,id=237562,00.html.

29 As previously reported, fewer taxpayers claim tax benefits that are retroactively extended. National Taxpayer Advocate 2007 Annual Report to Congress 6-7. This may be because the IRS does not have time to update paper instructions or forms used to claim them and electronic filers sometimes fail to update their software before filing. This may also be a problem at the state level, as 37 states use computations from the federal return as a starting point. See Federation of Tax Administrators, *State Personal Income Taxes: Federal Starting Points (as of January 1, 2012)*, http://www.taxadmin.org/fta/rate/stg_pts.pdf. While only 18 states use computations from the "current" version as the starting point, state forms that base their state income tax computations on a prior-year Code generally instruct taxpayers to start with the "current" version and then make adjustments to unwind recent federal tax-law changes. *Id.* Late-year federal tax law changes delay updates to such state instructions.

30 See line 35 of Form 1040 and IRS FS-2007-4, *Special Steps Needed for Paper 1040 Filers to Claim Late Tax Changes* (Jan. 2007), http://www.irs.gov/newsroom/article/0,,id=165640,00.html.

31 Commissioner Shulman recently noted that: "The purpose of the research and experimentation (R&E) credit] is to foster innovation and technological development while spurring economic growth and competitiveness. However, for the past 30 years, it has been extended 14 times, many of those retroactively, for periods ranging from six months to five years. Such persistent uncertainty about the future availability of the R&E credit diminishes its incentive effect as taxpayers often do not know if they can depend on the credit when making decisions on future investments in research and development." IRS, Prepared Remarks of Commissioner Douglas H. Shulman Before Tax Council Policy Institute (Feb. 15, 2012), http://www.irs.gov/newsroom/article/0,,id=254888,00.html.

32 For example, taxpayers are often advised to make estate tax plans. Yet, the estate tax expired at the end of 2009 and was retroactively reinstated at the end of 2010, making estate tax planning very difficult. See IRS, Prepared Remarks of Commissioner Douglas H. Shulman Before Tax Council Policy Institute (Feb. 15, 2012) ("The most recent visible example of this [retroactive revisions that created confusion for taxpayers and difficulty for the IRS] was the expiration of the estate tax at the end of 2009, which was then reinstated at the end of 2010. Upon reinstatement, Congress gave taxpayers the option of using either the 2009 or the new 2011 rules for 2010. This kind of result is not optimal.").

6. When late-year changes increase taxes, taxpayers may be subject to unanticipated penalties for failure to pay sufficient estimated tax. When the changes reduce taxes, taxpayers may have paid or had an employer withhold more than necessary.
7. The burdens associated with late-year changes could reduce tax compliance, as some taxpayers "give up" when faced with the extra complications.
8. The burdens associated with late-year changes undermine public confidence in the fairness and competence of the government.
9. The extensive work the IRS must perform to accommodate late-year changes has an opportunity cost — it requires the IRS to pull employees off other priority work — potentially reducing service to taxpayers who are not directly affected by late-year legislation.[33]

Notwithstanding these problems, late-year tax-law changes could be enacted again this year. Sixty tax provisions expired by the end of 2011 — some of which may be extended retroactively before the end of 2012 — and 41 more are scheduled to expire during 2012.[34] The changes at the end of 2011 include:

- The so-called AMT patch, which kept the Alternative Minimum Tax exemption amount above its pre-2001 levels, has expired.[35] Without retroactive legislation, an estimated 27 million more middle-class taxpayers are subject to the AMT in 2012.[36]
- The deduction for state and local sales taxes (in lieu of the deduction for state and local income taxes) is no longer available.[37] About 11 million returns claimed the deduction for state and local sales taxes in 2010.[38]

33 *See, e.g.*, Douglas H. Shulman, Commissioner of Internal Revenue, Letter to The Honorable Max Baucus, Chairman, Committee on Finance, United States Senate, *reprinted as, IRS Is Ready for AMT Relief, Shulman Says,* 2010 TNT 231-17 (Dec. 2, 2010) ("The overall strain on IRS service operations [to address retroactive changes to the AMT patch or extenders after the beginning of the filing season] would affect not only AMT taxpayers and those who benefit from extenders, but would also spill over into service disruptions and/or delayed refunds for tens of millions of other taxpayers.").

34 *See* Joint Committee on Taxation, JCX-1-12, List of Expiring Federal Tax Provisions 2011-2022 (Jan. 6, 2012); Joint Committee on Taxation, JCX-6-12, Legislative Background of Expiring Federal Tax Provisions 2011-2022 (Jan. 27, 2012).

35 IRC § 55(d)(1). The AMT exemption amount was first increased on a temporary basis by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 701, 115 Stat. 38, 148 (2001) and most recently increased by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, § 201, 124 Stat. 3296, 3299 (2010). Between 2011 and 2012, the exemption declined from $74,450 to $45,000 for a married couple filing jointly, from $48,450 to $33,750 for a single person or the head of a household, and from $37,225 to $22,500 for married people filing separately. *Id.* The National Taxpayer Advocate has repeatedly identified the AMT as a serious problem for taxpayers and has recommended its repeal in prior reports and congressional testimony. *See* National Taxpayer Advocate 2008 Annual Report to Congress 356-362 (Legislative Recommendation: *Repeal the Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2006 Annual Report to Congress 3-5 (Most Serious Problem: *Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2004 Annual Report to Congress 383-385 (Legislative Recommendation: *Alternative Minimum Tax)*; National Taxpayer Advocate 2003 Annual Report to Congress 5-19 (Most Serious Problem: *Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2001 Annual Report to Congress 166-177 (Legislative Recommendation: *Alternative Minimum Tax for Individuals*); *see also Alternative Minimum Tax*, Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means (Mar. 7, 2007) (statement of Nina E. Olson, National Taxpayer Advocate); *Blowing the Cover on the Stealth Tax: Exposing the Individual AMT*, Hearing Before the Subcomm. on Taxation and IRS Oversight of the Senate Comm. on Finance (May 23, 2005) (statement of Nina E. Olson, National Taxpayer Advocate).

36 Tax Policy Center, Table T11-0131, *Aggregate AMT Projections, 2011-2022* (June 3, 2011), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3012.

37 IRC § 164(b)(5)(I).

38 IRS, Statistics of Income Bulletin, I*ndividual Income Tax Returns, Preliminary Data, 2010* (Winter 2012) (Figure A), http://www.irs.gov/pub/irs-soi/12inwinbulincomeprlim10.pdf.

- People over age 70½ can no longer make tax-free withdrawals from their IRAs for a charitable contribution.[39] About six million returns filed by people over age 65 reported taxable IRA distributions in 2009.[40]
- The deduction for mortgage insurance premiums is no longer available.[41] About four million returns claimed the deduction for mortgage insurance premiums in 2009.[42]
- Teachers can no longer deduct up to $250 for classroom supplies they buy with their own money.[43] About four million returns claimed the deduction for classroom supplies in 2010.[44]
- Individuals can no longer deduct qualified tuition and related expenses.[45] About two million returns claimed the qualified tuition and related expenses deduction in 2010.[46]
- The 15-year straight-line cost recovery method applicable to certain improvements has expired.[47]
- The dollar limitation on certain assets that small businesses can deduct rather than depreciate declined, as did the phase-out range for this deduction.[48]
- The research and experimentation tax credit expired again.[49] About 70,000 returns claimed the research and experimentation credit in 2010.[50]

The changes scheduled to take effect at the end of 2012 include:

- The Bush-era tax cuts, which set marginal income tax rates of 10 percent, 15 percent, 25 percent, 28 percent, 33 percent, and 35 percent, are set to expire.[51] About 82 million returns computed tax liability at one of these rates in 2009.[52]

39 IRC § 408(d)(8)(F).

40 IRS, Statistics of Income, Pub. 1304, *Individual Income Tax Returns – 2009*, Table 1.5 All Returns: *Sources of Income, Adjustments, and Tax Items, by Age 73* (July 2011), http://www.irs.gov/pub/irs-soi/09inalcr.pdf.

41 IRC § 163(h)(3)(E)(iv).

42 IRS, Statistics of Income, *Individual Statistical Tables by Filing Status*, Table 1.2 (2012), http://www.irs.gov/pub/irs-soi/09in12ms.xls.

43 IRC § 62(a)(2)(D).

44 IRS, Statistics of Income Bulletin, *Individual Income Tax Returns, Preliminary Data, 2010* (Winter 2012) (Figure A).

45 IRC § 222(e).

46 IRS, Statistics of Income Bulletin, *Individual Income Tax Returns, Preliminary Data, 2010* (Winter 2012) (Figure A).

47 IRC § 168(e)(3)(E)(iv).

48 IRC § 179(b). These amounts are scheduled to decline again in 2013. *Id.*

49 IRC § 41(h)(1)(B).

50 TAS Research (Mar. 9, 2012).

51 IRC § 1(i); The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. No. 107-16, § 901, 115 Stat. 38, 150 (2001); The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA), Pub. L. No. 111-312, § 101, 124 Stat. 3296, 3298 (2010).

52 Statistics of Income Bulletin, *Individual Income Tax Rates and Shares, 2009* (Winter 2012) (Figure A), http://www.irs.gov/pub/irs-soi/12inwinbulratesshare.pdf.

- Reduced dividend and capital gains tax rates of zero percent and 15 percent are set to expire.[53] In 2010, about 28 million returns reported dividends and about 20 million reported a net capital gain (seven million) or loss (13 million).[54]
- Various marriage penalty relief provisions are set to expire.[55] The IRS received about 54 million returns from married taxpayers filing jointly and another three million from married taxpayers filing separately in 2009.[56]
- The increased earned income tax credit (EITC) for families with three or more children and the higher EITC income limits for joint filers are set to expire.[57] About 27 million returns claimed the EITC in 2009 and about three million of them reported three or more qualifying children.[58]
- The American Opportunity Credit for tuition and other higher education expenses is set to expire.[59] About 12 million returns claimed the American Opportunity Credit in 2010.[60]
- The so-called "Pease" limitation on itemized deductions (known as Pease after the member of Congress who helped create it) and the personal exemption phase-outs ("PEP") are set to return, re-injecting complexity into the tax code.[61] About six million returns were subject to the Pease limitation in 2009 before its repeal.[62] About four million returns reporting income in excess of $200,000 claimed a personal exemption in 2009.[63]

53 IRC § 1(h); The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), Pub. L. No. 108-27, § 303, 117 Stat. 752, 764 (2003); The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), Pub. L. No. 109-222, § 102, 120 Stat. 345, 346 (2006); TRUIRJCA, Pub. L. No. 111-312, § 102, 124 Stat. 3296, 3298 (2010).

54 IRS, Statistics of Income Bulletin, *Individual Income Tax Returns, Preliminary Data, 2010* (Winter 2012) (Figure A).

55 *See, e.g.*, IRC § 1(f)(8); The Working Families Tax Relief Act of 2004 (WFTRA), Pub. L. No. 108-311, § 105, 118 Stat. 1166, 1169 (2004); JGTRRA, Pub. L. No. 108-27, § 107, 117 Stat. 752, 755 (2003); EGTRRA, Pub. L. No. 107-16, § 901, 115 Stat. 38, 150 (2001); TRUIRJCA, Pub. L. No. 111-312, §§ 101, 102, 124 Stat. 3296, 3298 (2010).

56 IRS, Statistics of Income, Pub. 1304, *Individual Income Tax Returns – 2009*, Table 1.6 *All Returns: Number of Returns, by Age, Marital Status, and Size of Adjusted Gross Income, Tax Year 2009* 77 (July 2011), http://www.irs.gov/pub/irs-soi/09inalcr.pdf.

57 IRC § 32; EGTRRA, Pub. L. No. 107-16, §§ 201, 901, 115 Stat. 38, 45, 150 (2001); TRUIRJCA, Pub. L. No. 111-312, §§ 101, 103, 124 Stat. 3296, 3298-99 (2010).

58 IRS, Statistics of Income, Pub. 1304, *Individual Income Tax Returns – 2009*, Table 2.5 *Returns with Earned Income Credit, by Size of Adjusted Gross Income* 100 (July 2011), http://www.irs.gov/pub/irs-soi/09inalcr.pdf.

59 IRC § 25A(i).

60 IRS, Statistics of Income Bulletin, *Individual Income Tax Returns, Preliminary Data, 2010* (Winter 2012) (Figure A).

61 IRC §§ 68(g) (Pease) and 151(d)(3)(F) (PEP); EGTRRA, Pub. L. No. 107-16, §§ 101, 901, 115 Stat. 38, 41,150 (2001); TRUIRJCA, Pub. L. No. 111-312, §§ 101, 102, 124 Stat. 3296, 3298 (2010). In 2011, the applicable threshold would have been $169,550 for Pease (regardless of filing status), and $169,550 (for single filers) or $254,350 (for married joint filers). See Margot L. Crandall-Hollick, Congressional Research Service, R42485, *An Overview of Tax Provisions Expiring in 2012* 7 (Apr. 17, 2012). For a discussion of problems with phase-outs such as these, see National Taxpayer Advocate 2008 Annual Report to Congress 410-413 (Legislative Recommendation: *Eliminate (or Simplify) Phase-outs*).

62 IRS, Statistics of Income, Pub. 1304, *Individual Income Tax Returns – 2009*, Table 2.1 *Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2009* 81 (July 2011), http://www.irs.gov/pub/irs-soi/09inalcr.pdf.

63 IRS, Statistics of Income, Pub. 1304, *Individual Income Tax Returns – 2009*, Table 2.3 *All Returns: Exemptions by Type and Number of Exemptions, by Size of Adjusted Gross Income, Tax Year 2009* 81 (July 2011), http://www.irs.gov/pub/irs-soi/09inalcr.pdf.

- The increased child tax credit of $1,000 per child is set to expire.[64] About 23 million returns claimed a child tax credit in 2010.[65]
- The increased credit for expenses associated with the adoption of a child is set to expire.[66] About 97 thousand returns claimed the adoption credit in 2010.[67]

For the IRS, delivering a successful filing season requires extensive planning and coordination among numerous functions. For every change in law, the IRS must:

1. Develop forms, instructions, and publications for taxpayers;
2. Develop training materials for IRS telephone assistors, field assistance personnel, and others to help them answer taxpayer questions;
3. Work with tax preparation software developers to ensure that they have the guidance they need to produce accurate products and that they and others who transmit returns electronically do so in a format the IRS can accept;
4. Provide instructions to personnel at Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites to ensure that they can prepare accurate returns; and
5. Write programming code that allows the IRS to accept and perform various automated reviews of the returns.

Because of the magnitude of these challenges, and the uncertainty about such a large number of important provisions, the 2013 filing season is already at risk. In her 2007 report, the National Taxpayer Advocate recommended that the Treasury Department and the tax-writing committees create a formal process through which IRS estimates of the filing-season impact of significant tax legislation are transmitted to the tax-writing committees at several points during the year, with a focus on legislation to extend expiring tax provisions.[68] The 2013 filing season is likely to pose problems for many (if not most) taxpayers and the IRS if Congress does not address the many provisions that have already expired or soon will. In FY 2013, TAS will work with lawmakers, the IRS, and taxpayers to help avert or minimize problems associated with any late-year tax-law changes.

64 IRC § 24(a); EGTRRA, Pub. L. No. 107-16, §§ 201, 901, 115 Stat. 38, 45, 150 (2001); TRUIRJCA, Pub. L. No. 111-312, §§ 101, 103, 124 Stat. 3296, 3298-99 (2010). The credit will drop to $500 in 2013.

65 IRS, Statistics of Income Bulletin, *Individual Income Tax Returns, Preliminary Data, 2010* (Winter 2012) (Figure A).

66 IRC § 36C and its predecessor, IRC § 23; EGTRRA, Pub. L. No. 107-16, §§ 201, 901, 115 Stat. 38, 45, 150 (2001); Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 10909, 124 Stat. 119, 1021 (2010); TRUIRJCA, Pub. L. No. 111-312, § 101(b), 124 Stat. 3296, 3298 (2010).

67 IRS, Statistics of Income Bulletin, *Individual Income Tax Returns, Preliminary Data, 2010* (Winter 2012) (Figure A).

68 National Taxpayer Advocate 2007 Annual Report to Congress 12.

B. Improve Tax Administration through Taxpayer Advocate Directives

The National Taxpayer Advocate is required by IRC § 7803(c)(2)(A)(iii) to propose changes to the IRS's administrative practices to mitigate systemic problems faced by taxpayers. In furtherance of this statutory requirement, the Commissioner of Internal Revenue delegated to the National Taxpayer Advocate the authority to issue Taxpayer Advocate Directives (TADs) to change IRS procedures" to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment or provide an essential service to taxpayers."[69] Only the Commissioner, Deputy Commissioner, or National Taxpayer Advocate may modify or rescind a TAD.[70]

A TAD enables the National Taxpayer Advocate to formally elevate systemic problems to IRS executives. Since 2001, the National Taxpayer Advocate has issued eight TADs.[71] She issued four (50 percent) in the last 12 months, as she has increasingly relied upon TADs as an important way to fulfill the statutory mandate. The TAD procedures themselves, however, could be more effective in prompting the IRS to address or respond to problems.

For example, IRS executives have failed to respond to proposed TADs timely.[72] On June 13, 2011, the National Taxpayer Advocate issued a proposed TAD to the Commissioner of the W&I division, directing him to issue guidance and implement a procedure for adjusting the

69 Delegation Order 13-3 (formerly DO-250, Rev. 1), *reprinted as* IRM 1.2.50.4 (Jan. 17, 2001); *see also* IRM 13.2.1.6 (July 16, 2009).

70 *Id.*

71 This figure does not include "proposed TADs."

72 A proposed TAD is a preliminary step to issuance of a TAD, but a proposed TAD may not be elevated in the same manner as a TAD. IRM 13.2.1.6.1.2 (July 16, 2009).

accounts of taxpayers victimized by fraudulent return preparers.[73] The W&I Commissioner failed to respond timely to the proposed TAD.[74]

As another example, in response to a TAD directing the IRS to take various actions, the IRS challenged the National Taxpayer Advocate's authority to issue a TAD to the Chief Counsel or to interpret the law.[75] Interpreted broadly, this conclusion could severely limit the National Taxpayer Advocate's TAD authority. The IRS may be saying that it will not even bother to respond in writing to any TAD (even if only to modify or rescind it) if the TAD could be viewed as interpreting the law. Because nearly everything the IRS does is governed by law, it is very difficult for a TAD to address problems that taxpayers are facing without making a recommendation as to how the law should be interpreted. For example, if a TAD seeks to prevent the IRS from infringing taxpayer rights, which are embodied in law, the IRS may decline to respond to the TAD on the basis that it interprets law. The IRS's position significantly reduces the utility of these directives and undermines the purpose for which they were created.

73 Proposed TAD 2011-1 (June 13, 2011) (seeking various actions within 10, 45, and 90 days). See also National Taxpayer Advocate 2011 Annual Report to Congress 48 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*) and National Taxpayer Advocate 2011 Annual Report to Congress 558 (Legislative Recommendation: *Assessment of Civil Penalties Against Preparers of Fraudulent Returns*).

74 On August 16, 2011, the National Taxpayer Advocate elevated four Taxpayer Assistance Orders involving the same issue to the Deputy Commissioner for Services and Enforcement. On September 2, 2011, the Deputy Commissioner for Services and Enforcement wrote to the National Taxpayer Advocate that the IRS is "in the process of developing procedures to adjust taxpayers' accounts where the taxpayer never received a refund or portion of a refund due to preparer fraud and appropriate documentation has been submitted." As those procedures were not timely implemented, on January 12, 2012, the National Taxpayer Advocate issued a TAD to the Commissioners of the SB/SE and W&I operating divisions directing various actions within 14, 45, and 90 days. Taxpayer Advocate Directive 2012-1 (Establish procedures for adjusting the taxpayer's account in instances where a tax return preparer altered the return without the taxpayer's knowledge or consent, and the preparer obtained a fraudulent refund) (Jan. 12, 2012), *See Tax Fraud by Identity Theft Part 2: Status, Progress, and Potential Solutions, Hearing before the Subcomm. On Fiscal Responsibility and Economic Growth, S. Comm. on Finance* (Mar. 20, 2012) (statement of Nina E. Olson, National Taxpayer Advocate, http://www.irs.gov/pub/irs-utl/nta_testimony_idtheft_032012.pdf. These Commissioners responded on Feb. 2, 2012, by agreeing to address the problem, but proposing to complete the actions more slowly – within 14 days, 90 days, and six months. *See* Memorandum for Steven. T. Miller, Deputy Commissioner for Services and Enforcement, Appeal of TAD 2012-1 (Feb. 3, 2012), at http://www.taxpayeradvocate.irs.gov//userfiles/file/TAD_2012-1_appeal.pdf. SB/SE issued interim guidance to its employees regarding collection activity in cases where the taxpayer has been victimized by a tax return preparer. See Interim Guidance Memo (IGM) SBSE-05-0612-035, *Return Preparer Fraud or Misconduct* (June 5, 2012), http://apps2.irs.gov/pub/foia/ig/sbse/igm_sbse_05-0612-035.pdf. W&I, however, has yet to issue guidance to its employees. In response, the National Taxpayer Advocate issued Interim Guidance to TAS employees, providing additional direction and suggestions about effectively advocating in these cases. See IGM TAS-13-0212-008, *Interim Guidance on Advocating for Taxpayers When a Return Preparer Appears to Have Committed Fraud* (Feb. 7, 2012), http://www.irs.gov/pub/foia/ig/tas/tas-13-0212-008.pdf. Recently, in response to continued delays by W&I in developing procedures, the National Taxpayer Advocate issued a supplemental Interim Guidance Memorandum, instructing her employees to elevate all cases involving return preparer fraud adjustments to their Local Taxpayer Advocates, who will issue Taxpayer Assistance Orders (TAOs) rather than first submit the request to adjust the case through less-urgent channels. See IGM TAS-13-0512-017, *Interim Guidance for Preparing Taxpayer Assistance Orders (TAOs) Involving Return Preparer Fraud* (May 22, 2012), http://www.irs.gov/pub/foia/ig/tas/tas-13-0512-017.pdf.

75 TAD 2012-3 (Jan. 12, 2012) (*Review IRS Priorities in the Examination Process to Protect Taxpayer Rights, Improve Taxpayer Service, and Further Compliance*), http://www.irs.gov/pub/irs-utl/taxpayeradvocatedirective_2012-3.pdf; Memorandum for National Taxpayer Advocate from Deputy Commissioner for Services and Enforcement and Deputy Commissioner for Operations Support, *Taxpayer Advocate Directive 2012-3* (Jan. 27, 2012), http://www.irs.gov/pub/irs-utl/irsresponse_taxpayeradvocatedirective_2012-3.pdf ("We have consulted with the Office of Chief Counsel and concluded that the National Taxpayer Advocate has no authority to issue a TAD to the Chief Counsel. Moreover, the procedures governing the issuance of TADs provide that a TAD may not be issued to interpret the law, and that procedural limitation remains in effect today. The Chief Counsel concurs with our interpretation regarding the limitations on the issuance of TADs."). The TAD was issued to elevate problems taxpayers were facing in connection with the correspondence examination process, as described in a TAS study, including problems caused by obsolete regulations. National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 63-90 (*An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*). One portion of the TAD directed the IRS to update the obsolete regulations.

In addition, if obsolete regulations are causing problems for taxpayers and the National Taxpayer Advocate wants to elevate those problems through a TAD, the IRS should be required to respond in writing. There is no apparent reason for the IRS to be required to respond to TADs addressing non-legal problems, but not TADs addressing problems caused by obsolete regulations.

As a final example, on August 16, 2011, the National Taxpayer Advocate issued a TAD seeking to resolve problems resulting from the IRS's interpretation of key terms of its offshore voluntary compliance program, as further discussed below.[76] The IRS appealed the TAD to the Deputy Commissioner for Services and Enforcement, who rescinded portions of the TAD.[77] On September 26, 2011, the National Taxpayer Advocate elevated her concerns to the Commissioner of Internal Revenue for a formal response, pursuant to authority under IRC § 7803(c).[78] IRC § 7803(c)(3) specifically requires the Commissioner to "establish procedures requiring a formal response to all recommendations submitted to the Commissioner by the National Taxpayer Advocate within 3 months..." The Commissioner did not provide a formal written response. We understand the Commissioner has interpreted IRC § 7803(c)(3) as requiring the IRS to establish a process that allows it to respond in writing to the "Most Serious Problems" identified by the National Taxpayer Advocate. As the examples discussed here illustrate, the TAD process could be updated and improved.

In FY 2013, the National Taxpayer Advocate plans to continue to use TAD authority. She will also continue to seek legislation to codify the TAD process so that TADs can be more effective, including authority to elevate a TAD to the IRS Commissioner.[79]

C. The IRS's Identity Theft Victim Assistance Strategy Requires Additional Improvements and Continued Oversight

In general, tax-related identity theft occurs when an individual intentionally uses the Social Security number (SSN) of another person to file a false tax return with the intention of obtaining an unauthorized refund.[80] Identity theft wreaks havoc on our tax system in many

76 *See* TAD 2011-1 (*Implement 2009 Offshore Voluntary Disclosure Program FAQ #35 and Comply with the Freedom of Information Act*) (Aug. 16, 2011), http://www.irs.gov/advocate/article/0,,id=251887,00.html. For further discussion of these problems, see National Taxpayer Advocate 2011 Annual Report to Congress (Most Serious Problem: *IRS Offshore Voluntary Disclosure Program "Bait And Switch" May Undermine Trust for the IRS and Future Compliance Programs*).

77 *See* Memorandum for National Taxpayer Advocate from Deputy Commissioner for Services and Enforcement, *Taxpayer Advocate Directive 2011-1* (Oct. 14, 2011), http://www.irs.gov/pub/irs-utl/dcir_memo_tad_2011-1.pdf.

78 Memorandum for Commissioner of Internal Revenue from National Taxpayer Advocate, *Recommendations Regarding Taxpayer Advocate Directive 2011-1* (Sept. 26, 2011), http://www.irs.gov/pub/irs-utl/recommendations_tad2011-1.pdf.

79 Because the IRS sometimes is slow in responding to TADs, which are issued pursuant to a delegation order, TADs could be a more effective tool if Congress codified them, as proposed by the National Taxpayer Advocate. See National Taxpayer Advocate 2011 Annual Report to Congress 573-581 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*). They might also be more effective if they could be elevated by the National Taxpayer Advocate to the Commissioner of Internal Revenue for a formal written response.

80 This type of tax-related identity theft is referred to as "refund-related" identity theft. In "employment-related" identity theft, an individual files a tax return using his or her own taxpayer identification number, but uses another individual's SSN to obtain employment, and consequently, the wages are reported to the IRS under the SSN. The IRS has procedures in place to minimize the tax administration impact to the victim in these employment-related identity theft situations. Accordingly, we will focus on refund-related identity theft in this report.

ways. Victims of identity theft not only must deal with the aftermath of an emotionally draining crime, but may also have to deal with the IRS for years to untangle the resulting tax account problems. Identity theft also impacts the public fisc, as Treasury funds are diverted to pay out improper refunds claimed by opportunistic perpetrators. In addition, identity theft takes a significant toll on the IRS, tying up limited resources that it could otherwise shift to taxpayer service or compliance initiatives.

Since 2004, the National Taxpayer Advocate has written extensively about the impact of identity theft on taxpayers and tax administration, and TAS has worked closely with the IRS to improve its efforts to assist taxpayers who become identity theft victims.[81] The IRS has adopted many of TAS's recommendations and made significant progress in this area in recent years. Notwithstanding these efforts, identity theft continues to pose significant challenges for the IRS.

1. The IRS and TAS Continue to See Unprecedented Levels of Identity Theft Casework

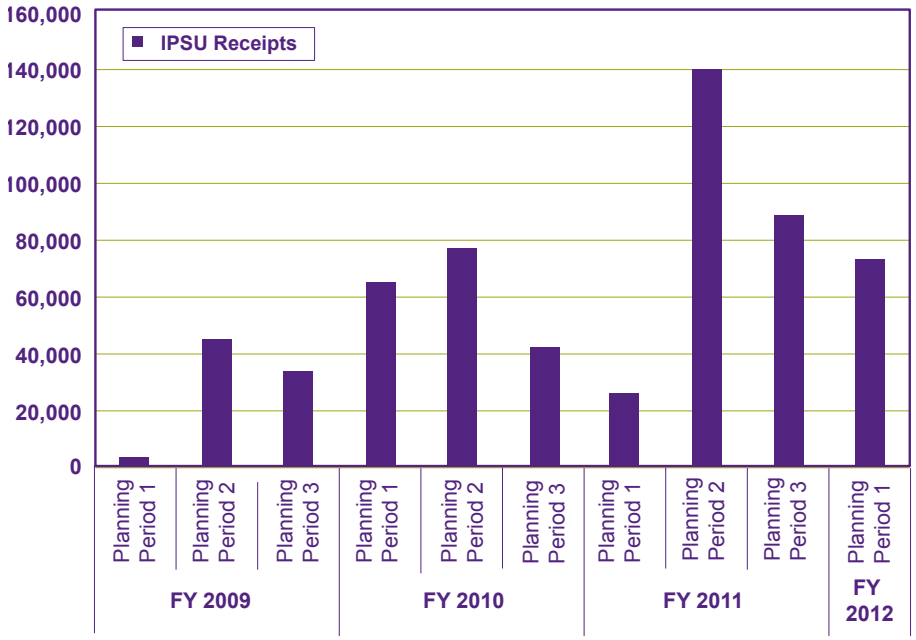
Today, identity theft can be an organized, large-scale operation. Indeed, the most recent IRS data show more than 450,000 identity theft cases servicewide.[82] The Identity Protection Specialized Unit (IPSU), the centralized IRS organization established in 2008 to assist identity theft victims, is experiencing unprecedented levels of case receipts.[83] As this chart shows, IPSU receipts have increased substantially over the two previous years.

81 See National Taxpayer Advocate 2011 Annual Report to Congress 48-73 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*); National Taxpayer Advocate 2009 Annual Report to Congress 307-317 (Status Update: *IRS's Identity Theft Procedures Require Fine-Tuning*); National Taxpayer Advocate 2008 Annual Report to Congress 79-94 (Most Serious Problem: *IRS Process Improvements to Assist Victims of Identity Theft*); National Taxpayer Advocate 2007 Annual Report to Congress 96-115 (Most Serious Problem: *Identity Theft Procedures)*; National Taxpayer Advocate 2005 Annual Report to Congress 180-191 (Most Serious Problem: *Identity Theft*); National Taxpayer Advocate 2004 Annual Report to Congress 132-142 (Most Serious Problem: *Inconsistence Campus Procedures*); *Hearing on Identity Theft and Tax Fraud Before the Subcomm. on Oversight and Social Security*, H. Comm. on Ways and Means, 112th Cong. (May 8, 2012) (statement of Nina E. Olson, National Taxpayer Advocate); *Hearing on Tax Compliance and Tax-Fraud Prevention*, H. Comm. on Oversight and Government Reform, Subcomm. on Government Organization, Efficiency, and Financial Management, 112th Cong. (Apr. 19, 2012) (statement of Nina E. Olson, National Taxpayer Advocate); *Tax Fraud by Identity Theft Part 2: Status, Progress, and Potential Solutions* Hearing Before the S. Comm. on Finance, Subcomm. on Fiscal Responsibility and Economic Growth, 112th Cong. (Mar. 20, 2012) (statement of Nina E. Olson, National Taxpayer Advocate); *The Spread of Tax Fraud by Identity Theft: A Threat to Taxpayers, a Drain on the Public Treasury*, Hearing Before the S. Comm. on Finance, Subcomm. on Fiscal Responsibility and Economic Growth, 112th Cong. (May 25, 2011) (statement of Nina E. Olson, National Taxpayer Advocate); *Filing Season Update: Current IRS Issues,* Hearing Before the S. Comm. on Finance, 111th Cong. (Apr. 15, 2010) (statement of Nina E. Olson, National Taxpayer Advocate); I*dentity Theft: Who's Got Your Number,* Hearing Before the S. Comm. on Finance, 110th Cong. (Apr. 10, 2008) (statement of Nina E. Olson, National Taxpayer Advocate).

82 Data provided by the IRS Office of Privacy, Governmental Liaison, and Disclosure (email dated Apr. 17, 2012).

83 With the IRS moving to a specialized approach to identity theft victim assistance, it is unclear what role the IPSU will play in the future. The National Taxpayer Advocate believes it is important for the IPSU to continue to serve as the "traffic cop" and serve as the single point of contact with the identity theft victim, as discussed later in this report.

FIGURE II.1, IPSU PAPER INVENTORY RECEIPTS, FY 2009 TO FY 2012 BY PLANNING PERIOD[84]

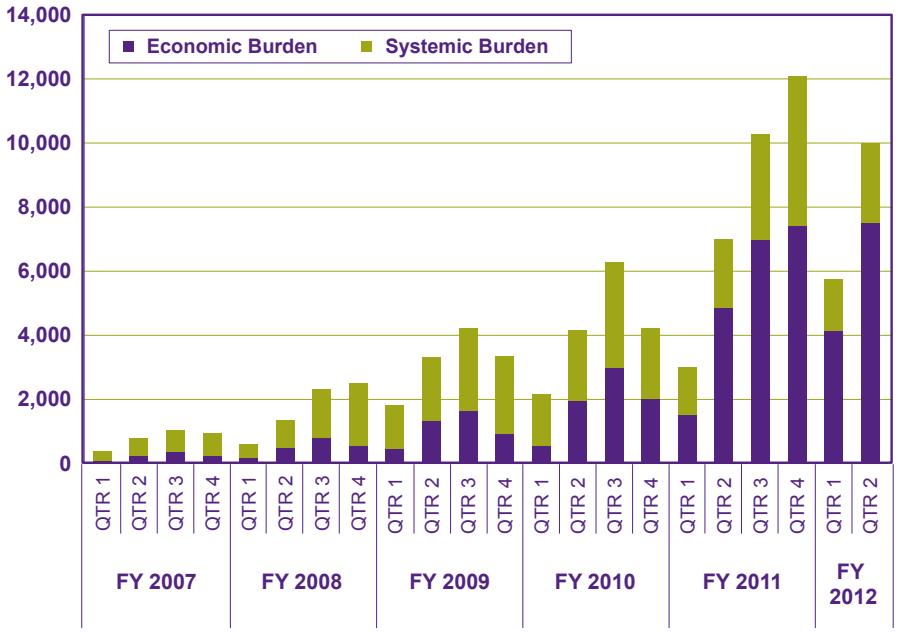


The Taxpayer Advocate Service has experienced a similar surge in cases, as TAS identity theft receipts rose 93 percent in fiscal year (FY) 2011 over FY 2010. The upward trend continued in the first two quarters of FY 2012, when TAS received nearly 16,000 identity theft cases, a 57 percent increase over the same period in FY 2011.[85] The growth in casework reflects the both the increase in identity theft incidents and the IRS's inability to address the victims' tax issues promptly.

84 Data obtained from IRS Identity Protection Specialized Unit (Mar. 13, 2012). The IPSU tracks cases by "planning period." Planning Period 1 covers Oct. 1 to Dec. 31, Planning Period 2 covers Jan. 1 to June 30, and Planning Period 3 covers July 1 to Sept. 30.

85 There were over 10,000 identity theft cases in TAS during the same period in FY 2011. Data obtained from TAMIS (Apr. 1, 2012; Apr. 1, 2011).

FIGURE II.2, IDENTITY THEFT CASES RECEIVED QUARTERLY IN TAS, FY 2007 THROUGH FY 2011 AND SECOND QUARTER OF FY 2012[86]



2. The Social Security Administration Should Restrict Access to the Death Master File

The National Taxpayer Advocate is concerned that the federal government continues to facilitate tax-related identity theft by making public the Death Master File or DMF — a list of recently deceased individuals that includes their full name, SSN, date of birth, date of death, and the county, state, and ZIP code of the last address on record.[87] There is some uncertainty about whether the Social Security Administration (SSA) has the legal authority to restrict public access to DMF records in light of the Freedom of Information Act.[88] For that reason, we strongly support legislation to restrict public access to the DMF.[89] However, we believe the SSA has at least a reasonable basis for seeking to limit public access to the DMF. By waiting for legislation that may or may not pass, we unnecessarily expose taxpayers to potential harm. For this reason, in FY 2013 we will continue to encourage the SSA to act on its own to restrict public access to the DMF.

86 Data obtained from TAMIS. TAS retrieved the data on the first day of the month following the end of each quarter for FY 2007 through second quarter of FY 2012.

87 *See* Office of the Inspector General, SSA, *Personally Identifiable Information Made Available to the General Public via the Death Master File*, A-06-08-18042 (June 2008).

88 The Freedom of Information Act, 5 USC § 552, provides for public access to records and information maintained by Federal agencies.

89 *See* National Taxpayer Advocate 2011 Annual Report to Congress 519-523 (Legislative Recommendation: *Restrict Access to the Death Master File*).

3. Creating New Exceptions to Taxpayer Privacy Protections Poses Risks and Should Be Approached Carefully, if at All

Internal Revenue Code (IRC) § 6103 generally provides that returns and return information shall be confidential and then delineates a number of exceptions to this general rule. Section 6103(i)(2) authorizes the disclosure of return information (other than "taxpayer return information"[90]) in response to requests from federal law enforcement agencies for use in criminal investigations. There is no corresponding exception in IRC § 6103 that allows for the release of identity theft information to state or local agencies.[91] However, IRC § 6103(c) provides that a taxpayer may consent to disclosure of returns and return information to any person designated by the taxpayer. Under this exception, the IRS has developed a pilot that would facilitate a consent-based sharing of identity theft information with state and local law enforcement agencies.[92]

It is our understanding that some have called for the expansion of exceptions to IRC § 6103, ostensibly to help state and local law enforcement combat identity theft. The current framework of IRC § 6103 includes sufficient exceptions to allow the IRS to share information with state and local law enforcement about identity thieves. In FY 2013, the National Taxpayer Advocate will continue to advocate that loosening of these statutory privacy protections is not appropriate at this time.

Based upon advice from its Office of Chief Counsel, the IRS has developed a pilot in which tax data related to the "bad return" may be shared with state and local law enforcement agencies based on the victim's written consent.[93] We believe this approach strikes an appropriate balance — protecting taxpayer return information while simultaneously giving state and local authorities more information to investigate and combat identity theft. However, we are concerned that once the information is in the hands of state and local law enforcement, there is no prohibition in the tax code against redisclosure. Therefore, we renew our request that Congress consider modifying IRC § 6103(c) to explicitly limit the use of tax return information to the purpose agreed upon by the taxpayer and to prohibit the redisclosure of such information.[94] Further, the IRS should make any participation in this pilot conditional on an agreement that state and local authorities will not use this information for any purpose unrelated to the identity theft investigation.

90 "Taxpayer return information" is defined as return information "which is filed with, or furnished to, the Secretary by or on behalf of the taxpayer to whom such return information relates." IRC § 6103(b)(3).

91 Note, however, that certain disclosures to state law enforcement are permissible. See IRC § 6103(i)(3)(B)(i) (disclosure of return information, including taxpayer return information, can be made to the extent necessary to advise appropriate officers or employees of any state law enforcement agency of the imminent danger of death or physical injury to any individual; disclosure cannot be made to local law enforcement agencies). While identity theft may cause emotional and economic injury, the typical identity theft situation does not pose an imminent danger of death or physical injury.

92 *See* http://www.irs.gov/privacy/article/0,,id=256965,00.html (last visited June 8, 2012).

93 *See id*.

94 *See* National Taxpayer Advocate 2011 Annual Report to Congress 505.

4. There is a Continuing Need for the IRS's Identity Protection Specialized Unit (IPSU) to Play a Centralized Role in Managing Identity Theft Cases

In April 2008, before the IRS created the Identity Protection Specialized Unit (IPSU), Commissioner Shulman described his vision of IPSU as providing "a central point of contact for the resolution of tax issues caused by identity theft." He further elaborated that "[t]his unit will provide end-to-end case resolution. Victims will be able to communicate with one customer service representative to have their questions answered and issues resolved quickly and efficiently."[95]

The IRS has now changed its strategy for assisting identity theft victims and is moving away from using a single "traffic cop" to resolve cases and toward a "specialized" approach, which may make the process more complicated for victims. In this specialized environment, each function that deals with identity theft will create a dedicated group of employees to work solely on these issues.

While the National Taxpayer Advocate acknowledges potential benefits to this specialized approach (if implemented properly), she does see the value in retaining IPSU as a "traffic cop" to help the taxpayer navigate around the IRS as various functions handle different aspects the case. In FY 2013, the National Taxpayer Advocate will continue to advocate for IPSU to remain involved as the single point of contact for identity theft victims.

In FY 2013, TAS will:

- Work cooperatively with the IRS to determine what role the IPSU should play in the specialized approach to helping victims;
- Review and suggest improvements to the identity theft processing procedures developed by the specialized units in each function;
- Encourage TAS's Local Taxpayer Advocates (LTAs) to advocate for identity theft victims by issuing Taxpayer Assistance Orders (TAOs) when appropriate; and
- Continue to train TAS employees on how to resolve identity theft cases.

D. The IRS Should Take Steps to Limit Opportunities for Refund Fraud, While Not Unreasonably Delaying Legitimate Refund Claims

In FY 2013, TAS will remain focused on the IRS response to refund fraud. The growth of spending programs that are run through the tax code and require large IRS payments to taxpayers has made this kind of refund fraud more alluring. The IRS has had difficulty verifying the legitimacy of claims for recently enacted tax benefits such as Economic Stimulus Payment, First-Time Homebuyer Credit, Work Opportunity Credit, and Making Work Pay Credit. In FY 2011, the Accounts Management Taxpayer Assurance Program (AMTAP)

95 *Identity Theft: Who's Got Your Number,* Hearing Before the S. Comm. on Finance, 110th Cong. (Apr. 10, 2008) (response of IRS Commissioner Douglas H. Shulman to questions from Chairman Max Baucus), *available at* http://finance.senate.gov/hearings/hearing/download/?id=f989b16e-5da3-452d-9675-b75d796fe2b4.

delayed nearly two million refund claims, identifying them as questionable or potentially fraudulent.[96] The Electronic Fraud Detection System (EFDS) selected over one million returns for screening, a 72 percent increase from the previous year.[97] The large volume of fraudulent tax refund claims requires the IRS to devote significant resources to filtering out these claims and adjusting the accounts of the affected taxpayers.

To better protect the public fisc from a surge of new refund schemes, the IRS has expanded its use of sophisticated fraud detection models based on data mining to filter out questionable refund claims. The IRS estimates that EFDS has an 89 percent accuracy rate — which means the system may still catch upwards of 100,000 legitimate taxpayers.[98] While the IRS can try to screen out as many suspicious refund claims as possible, it is unrealistic to expect the IRS to detect and stop all such claims given its resource and time constraints. Because the fraud detection algorithms are constantly evolving in response to new patterns, there will always be a lag in the filters.

The IRS is responsible for processing over 145 million individual income tax returns annually, including more than 109 million requests for refunds.[99] In 2011, the average refund amount was approximately $2,913, representing a significant lump-sum payment for individual taxpayers with incomes below the median adjusted gross income of $31,494.[100]

At the same time the IRS is being urged to do more to combat refund fraud, taxpayers are clamoring for the IRS to process returns and issue refunds faster. While there is still room for the IRS to make marginal improvements in both areas, the two goals are fundamentally at odds.

With the introduction of e-filing, combined with the increasing number of refundable credits run through the tax code, our tax system has shifted, for better or worse, to one of instant gratification. Approximately 77 percent of taxpayers file electronically, which means the IRS can process most refund requests within ten days.[101] If the overriding goal is to process returns and deliver legitimate refunds as quickly as possible, it is inevitable that some dishonest people will get away with fraud and some honest taxpayers will be harmed.

On the other hand, if the IRS decides to place greater value on deterring refund fraud, it will need additional time and resources to review returns. As a result, the roughly 110

96 The Electronic Fraud Detection System (EFDS) is one tool the IRS uses to select questionable returns for verification prior to releasing refunds. EFDS selected 1,054,704 questionable returns for screening in calendar year (CY) 2011. The IRS stopped an additional 893,267 potentially fraudulent returns as part of the Operation Mass Mail (OMM) program. *See* Wage and Investment (W&I) Division response to TAS information request (July 27, 2011, and updated Nov. 4, 2011).

97 The volume of returns selected to be screened rose from 611,845 in CY 2010 to 1,054,704 in CY 2011 (through Oct. 15, 2011), a 72 percent increase. *See* W&I response to TAS information request (July 27, 2011, and updated Nov. 4, 2011).

98 National Taxpayer Advocate 2011 Annual Report to Congress 28.

99 In calendar year 2011, the IRS processed 145,320,000 individual tax returns, with 109,337,000 requests for refunds. IRS, *Filing Season Statistics – Dec. 31, 2011, at* http://www.irs.gov/newsroom/article/0,,id=252176,00.html (last visited Mar. 12, 2012).

100 IRS, *Filing Season Statistics – Dec. 31, 2011, at* http://www.irs.gov/newsroom/article/0,,id=252176,00.html (last visited Mar. 12, 2012); Compliance Data Warehouse, Individual Returns Transaction File for CY 2011.

101 IRS, *IRS e-file Launches Today; Most Taxpayers Can File Immediately,* IR-2012-7 (Jan. 17, 2012).

million taxpayers who receive refunds will have to wait longer to get them, perhaps considerably longer.[102] It is unfair to the IRS for us to ignore this reality; we must recognize that there is no way around these trade-offs.

The National Taxpayer Advocate supports the IRS's increased use of data mining and automated screens to identify suspicious refund claims. We commend the IRS's efforts to use every tool at its disposal to combat refund fraud. However, we have cautioned the IRS to not lose sight of the fact that no matter how well-developed a particular filter is, it will inevitably affect legitimate taxpayers. The National Taxpayer Advocate has insisted that as the IRS develops these filters, it must also create procedures that would allow honest taxpayers with legitimate refund claims to receive their money without unnecessary delay.

The IRS established the Taxpayer Protection Unit (TPU) to communicate with the taxpayers whose refunds it is holding, so they have the opportunity to document and explain their claims. Taxpayers whose returns were flagged by the identity theft filters were instructed to call the TPU. Unfortunately, the TPU has been woefully understaffed and has had difficulty answering taxpayer calls.[103] In her testimony before the Senate Finance Committee in March, the National Taxpayer Advocate noted that the TPU's level of service had fallen as low as 11.7 percent, meaning that only one out of nine callers got through and those who did had to wait an average of 3,990 seconds (roughly one hour and six minutes)![104]

The IRS Office of Return Integrity and Correspondence Services (RICS) has taken steps to ensure that the TPU is staffed at the appropriate level. In FY 2013, TAS will continue to monitor the effectiveness of the identity theft filters and the TPU. We will also work with RICS to review any proposed new filters and minimize their impact on legitimate taxpayers.

For example, if EFDS cannot initially verify wage and withholding information, AMTAP applies a "soft freeze" (*i.e.*, the refund will be released systemically) on the account while its employees begin a manual verification process[105] that can take up to 11 weeks.[106] In many cases, AMTAP cannot verify the information within this timeframe. Rather than releasing the refunds, AMTAP is now placing permanent freezes on these accounts while the wage verification is completed. The National Taxpayer Advocate is concerned that once a case is placed in a "hard freeze" (i.e., the refund must be manually released), it will lose its urgency in being worked. Thus, TAS has been advocating that the IRS develop the ability to briefly

102 In calendar year 2011, the IRS processed 145,320,000 individual tax returns, with 109,337,000 requests for refunds. *IRS, Filing Season Statistics – Dec. 31, 2011, at* http://www.irs.gov/newsroom/article/0,,id=252176,00.html (last visited Mar. 12, 2012).

103 See *Filing Season Effects of Reduced Funding for Taxpayer Service, supra.*

104 *Tax Fraud by Identity Theft Part 2: Status, Progress, and Potential Solutions*, Hearing Before the S. Comm. on Finance, Subcomm. on Fiscal Responsibility and Economic Growth, 112th Cong. (Mar. 20, 2012) (statement of Nina E. Olson, National Taxpayer Advocate).

105 This includes contacting the taxpayer's employer or if directed by the employer, the payroll processing firm to verify wages and withholding. AMTAP employees will also perform research to ensure they have the employer's current address.

106 IRM 21.9.1.2.3(1) (Mar. 7, 2011).

extend the soft freeze period. It is TAS's position that only those returns that have been verified as not legitimate should be placed in a hard freeze.

In FY 2012, TAS will begin to analyze a representative sample of its "held refund" cases to identify and quantify the main causes for cases coming to TAS. We will prepare a report summarizing important findings from this analysis and identifying the "highest risk" TAS cases (i.e., the types of refund hold cases most likely to come to TAS). The report will include recommendations for how the IRS can handle these types of cases more effectively. TAS anticipates completing this report by the end of June 2013.

As noted above, the National Taxpayer Advocate is very concerned that AMTAP has not developed procedures that would allow employees to complete the verification within the 11-week period.[107] In FY 2013, we will focus on helping AMTAP develop better procedures to verify wages for questionable tax returns.

E. Improve Automated Examination Procedures

Faced with growing responsibilities and shrinking examination resources, the IRS increasingly turns to automated procedures to assess tax liabilities (*e.g.*, the automated substitute for return (ASFR) program, automated underreporter (AUR) program, math error adjustments, automated questionable credit or refund (AQC) program, and correspondence examinations).[108] In FY 2011, the IRS made 12,660,956 contacts — mostly automated — that taxpayers might regard as examinations, but only 1,564,690 of which were "real" examinations of individuals.[109]

The National Taxpayer Advocate refers to automated assessments (*i.e.*, AUR, ASFR, math error, and AQC) as "unreal" examinations because they do not provide the same taxpayer rights as "real" examinations. For example, while the IRS is generally prohibited from auditing a return twice, it can examine a return that was already subject to an "unreal" audit.[110]

Even real audits have become more automated, as correspondence examinations have increased. Between FY 2000 and FY 2011 face-to-face audits of individuals rose by 56 percent (from 251,108 to 391,621), but correspondence exams increased by 220 percent (from 366,657 to 1,173,069).[111] By FY 2011, the IRS was conducting 75 percent (1,173,069) of all individual examinations by correspondence in a highly automated campus setting.[112]

107 IRM 21.9.1.2.3(1), *Stopping the Refund* (Oct. 1, 2010).

108 *See e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 15-27 (*Introduction to Revenue Protection Issues*).

109 IRS Pub. 55B, Data Book, Tables 9a, 14, and 15 (2011) (including 4,703,000 AUR contact cases, 4,998,266 math error notices, and 1,395,000 ASFR). Some math errors may make taxpayer-favorable adjustments. The math error data was for calendar year 2011.

110 *See* IRC § 7605(b); Rev. Proc. 2005-32, § 4.03, 2005-1 C.B. 1206 (discussing procedures the IRS does not consider examinations).

111 IRS Pub. 55B, Data Book, Table 9a (2000); IRS Pub. 55B, Data Book, Table 9a (2011).

112 IRS Pub. 55B, Data Book, Table 9a (2011).

This reliance on automation is likely to expand as the IRS receives, and attempts to process and use, more third-party data. For example, credit card issuers recently began reporting the charges they process for businesses,[113] and brokerage firms recently began reporting the cost basis (as well as gross proceeds) of stock, bond, and mutual fund sales.[114]

Automated assessment procedures rely on unexplained data mismatches to change a taxpayer's liability. However, a return may not match third-party data even if the return is accurate, and some mismatches remain unexplained due to communication difficulties.

As recently described in the 2011 Annual Report to Congress, the National Taxpayer Advocate's blog, a Taxpayer Advocate Directive, and in testimony before Congress, these automated assessment procedures present the following challenges:[115]

- The IRS could resolve many apparent mismatches without contacting taxpayers.[116]
- Computer-generated letters do not always reach taxpayers.[117]
- When the letters are delivered, the taxpayers often find them confusing.[118]
- When a taxpayer calls, the IRS does not always answer the phone timely.[119]

113 IRC § 6050W.

114 IRC § 6045(g).

115 See, *e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 63-91 (*An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*); National Taxpayer Advocate 2011 Annual Report to Congress 15-27 (*Introduction to Revenue Protection Issues*); TAD 2012-3 (Jan. 12, 2012) (*Review IRS Priorities in the Examination Process to Protect Taxpayer Rights, Improve Taxpayer Service, and Further Compliance,* at http://www.irs.gov/pub/irs-utl/taxpayer advocatedirective_2013-13.pdf); *Tax Compliance and Tax-Fraud Prevention*, Hearing Before the Subcomm. on Government Organization, Efficiency, and Fin. Management, House Comm. on Oversight and Government Reform (Apr. 19, 2012) (statement of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate, Blog, *What Is an Audit Anyway?* (Jan. 25, 2012), http://www.taxpayeradvocate.irs.gov/Blog/Whats-an-Audit-Anyway; National Taxpayer Advocate, Blog, *Are IRS Correspondence Audits Really Less Burdensome for Taxpayers?* (Feb. 6, 2012), http://www.taxpayeradvocate.irs.gov/Blog/are-irs-correspondence-audits-really-less-burdensome-for-taxpayers; National Taxpayer Advocate, Blog, *IRS Correspondence Examinations: Are They Really As Effective As the IRS Thinks?* (Mar. 13, 2012), http://www.taxpayeradvocate.irs.gov/Blog/irs-correspondence-examinations-are-they-really-as-effective-as-the-irs-thinks; National Taxpayer Advocate, Blog, *Virtual Face-To-Face Audits: A Prescription for Curing the IRS's Ailing Correspondence Examination Process* (Apr. 4, 2012), http://www.taxpayeradvocate.irs.gov/Blog/virtual-face-to-face-audits.

116 A TAS study found that the IRS had sufficient information to avoid charging math errors for incorrect dependent TINs 56 percent of the time. National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 113, 120, 139. TAS recommended the IRS review the types of adjustments that have a high abatement rate to see if it could resolve more of the apparent mismatches without charging a math error. *See id*; National Taxpayer Advocate 2011 Annual Report to Congress 74-92 (Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*).

117 Ten percent of IRS mail is undeliverable. TIGTA, Ref. No. 2010-40-055, *Current Practices Are Preventing a Reduction in the Volume of Undelivered Mail* 1 (May 14, 2010). TAS recommended the IRS create a unit to research current addresses before sending important notices. *See* 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*).

118 A 2007 survey of EITC taxpayers subject to a correspondence exam indicated 26.5 percent did not know the notice they received was an audit notice and only about half knew what they needed to do to respond to the notice. National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 103-104.

119 Although its telephone customer service representatives (CSR) achieved an 88 percent level of service (LOS) in FY 2004, the LOS declined to 70 percent in FY 2011, and due to funding constraints, the IRS has reduced its LOS goal for FY 2012 to 61 percent. IRS, Joint Operations Center, *Snapshot Reports: Customer Account Services – CAS* (week ending Sept. 30, 2011); Wage and Investment, Business Performance Review 4 (Feb. 2012). In other words, in FY 2011, 30 percent of the calls did not get through, and if the IRS reaches its goal for FY 2012, nearly 40 percent will not get through. The average wait time on the correspondence exam lines was 9.5 minutes in FY 2011, not counting an additional 12 minutes or more if you tried to reach the examiner through the main IRS toll-free number. National Taxpayer Advocate, Blog, *IRS Correspondence Examinations: Are They Really As Effective As the IRS Thinks?* (Mar. 13, 2012).

- If the taxpayer reaches an IRS employee, the employee may not be able to resolve the inquiry.[120]
- If a taxpayer calls again, he or she is unlikely to reach the same examiner.[121]
- If the taxpayer writes to the IRS, the agency does not always respond timely.[122]
- When taxpayers can communicate with the IRS, it often abates the assessment.[123]
- When taxpayers do not communicate with the IRS, it often does not collect any assessed liability.[124]

The current correspondence examination procedures present many of the same communication issues. While all taxpayers may have problems communicating with the IRS, these challenges are more daunting for low income taxpayers who may be less likely to have a current address on file with the IRS and may have even greater difficulty navigating the IRS or understanding its computer-generated letters. Consider the following exam-related data.

- Forty-two percent of all correspondence exams in FY 2010 were closed without any personal contact.[125]
- Forty-six percent of all correspondence exams in FY 2011 (536,174 out of 1,173,069) covered the Earned Income Tax Credit.[126]
- Correspondence examinations involving the EITC produced a 30 percent response rate for FY 2010,[127] but face-to-face exams covering EITC resulted in an 85 percent response rate for FY 2007.[128]

120 According to one recent study, 62 percent of correspondence examination callers are repeat callers, and 13 percent called more than eight times. POP Team Recommendations, *Solutions to Improve Taxpayer Satisfaction in Correspondence Examination Briefing Document* (June 21, 2010).

121 Correspondence examination moved in 2008 to a universal call routing (UCR) system that directs incoming calls to the first available tax examiner. We note that legislation provides that "to the extent practicable and if advantageous to the taxpayer, one Internal Revenue Service employee shall be assigned to handle a taxpayer's matter until it is resolved." The IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3705(b), 112 Stat. 685, 777 (1998). RRA 98 also required the IRS to include in all manually-generated correspondence the name, telephone number, and unique identifying number of the employee the taxpayer may contact regarding the correspondence. Pub. L. No. 105-206, § 3705(a), 112 Stat. 685, 777 (1998). The IRS avoids this requirement, however, by defining manually generated correspondence narrowly. *See* National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 81-82.

122 Comparing the final week of FY 2004 with the final week of FY 2011, the backlog of taxpayer correspondence in the tax adjustments inventory jumped by 158 percent (from 357,151 to 920,768), and the percentage of correspondence classified as "over-age" increased by 309 percent (from 11.5 percent to 47.0 percent). *Compare* IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Oct. 1, 2011) with IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 25, 2004).

123 The IRS granted 83.3 percent of all AUR abatement requests in FY 2011. IRS, Enforcement Revenue Information System Summary Database (Dec. 2011).

124 From FY 2006 through FY 2011, the IRS collected less than ten percent of the Taxpayer Delinquent Account (TDA) dollars established through the ASFR process. National Taxpayer Advocate 2011 Annual Report to Congress 93-108.

125 Automated Information Management System (AIMS) from the CDW (Dec. 2011).

126 IRS Pub. 55B, Data Book, Table 9a (2011).

127 National Taxpayer Advocate 2011 Annual Report to Congress (Most Serious Problem: *The IRS Needs to Reevaluate Earned Income Tax Credit Measures and Take Steps to Improve Both Service and Compliance*) (IRS comments).

128 *Id*.

- Taxpayers who use representatives during an audit are nearly twice as likely to be found eligible for the EITC compared to those who are not represented.[129]
- Among EITC audit reconsideration cases where the examination was originally closed as "late response" or "no response," about 43 percent had favorable outcomes from the audit reconsideration process — about the same as the favorable outcome rate for all taxpayers in the sample.[130]
- Thirty-eight percent of taxpayers who received no phone calls from the IRS were awarded EITC under audit reconsideration, but 67 percent of those who received three or more calls were awarded EITC.[131]
- Over 70 percent of EITC taxpayers who had been audited said they would prefer an examination method other than correspondence.[132]
- According to the IRS's 2011 customer satisfaction surveys, 40 percent of taxpayers were dissatisfied with correspondence exams, but only 18 percent were dissatisfied with face-to-face exams.[133]

These data suggest that automated procedures are more likely to produce inaccurate over-assessments, particularly for taxpayers who have literacy challenges or lack representation. They may also diminish end-to-end accountability by IRS employees, generate rework, burden, and other hidden costs, and leave many taxpayers unsatisfied.

The National Taxpayer Advocate offered a number of recommendations to address these problems in the 2011 Annual Report,[134] including that the IRS establish a team to consider examination strategy from the taxpayer's perspective. She also recommended that the IRS consider expanding its use of "virtual service delivery" — technology that allows taxpayers to meet with IRS employees by video conference.

Following publication of that report, she discussed the difficulties with the correspondence examination process in a series of blog postings, and issued a Taxpayer Advocate Directive

129 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 96, 108-113.

130 National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, ii and 9-10 (*EITC Reconsideration Study*). When they had a favorable outcome, they retained about 96 percent of the EITC they originally claimed. *Id*.

131 National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, ii and 9-10 (*EITC Reconsideration Study*).

132 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2 106-108.

133 ICF Macro, IRS, SB/SE, Field Examination Program Customer Satisfaction Survey, Annual National Report Closed Cases Apr. 2010–Mar. 2011; Pacific Consulting Group, IRS, Customer Satisfaction Survey, Correspondence Exam (CCE) SB/SE National Report, Covering January through March 2011, with Annual Results 5 (July 2011).

134 National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 63-90 (*An Analysis of the IRS Examination Strategy: Suggestions To Maximize Compliance, Improve Credibility, And Respect Taxpayer Rights*); National Taxpayer Advocate 2011 Annual Report to Congress 15-27 (*Introduction to Revenue Protection Issues*).

to formally elevate these concerns.[135] The IRS modified the TAD,[136] and declined to convene a team or expand VSD, but invited the National Taxpayer Advocate to discuss the problem at the IRS Enforcement Committee meeting. The National Taxpayer Advocate addressed the committee in April and continues to advocate for improvements to correspondence examination procedures.[137] The IRS has yet to convene a team to conduct a comprehensive of its examination program and address her concerns.

As described in more detail below, TAS is also collaborating with the IRS to study whether additional communications with EITC taxpayers generate significantly different audit results. In FY 2013, TAS will continue this study while working with the IRS to address the problems identified in the 2011 report.

F. TAS Will Continue Advocating for American Taxpayers Abroad Who Are Expressing Fear and Frustration about FBAR, FATCA and Other International Penalties [138]

U.S. taxpayers abroad who do not comply with complex information reporting requirements may be subject to financially devastating penalties that often are not commensurate with the tax liability at issue.[139] Most penalty provisions applicable to international taxpayers, including FATCA and FBAR, contain a reasonable cause exception and give the IRS broad authority to issue regulations and guidance.[140] The National Taxpayer Advocate remains concerned about the apparent lack of clear procedures and transparent published guidance in the Internal Revenue Bulletin (IRB) that describes and reaffirms the taxpayer-favorable procedures provided by IRM regarding the application of these penalties to "benign" U.S. taxpayers abroad.[141] Organizations representing U.S. taxpayers abroad, as well as

135 TAD 2012-3 (Jan. 12, 2012) (*Review IRS Priorities in the Examination Process to Protect Taxpayer Rights, Improve Taxpayer Service, and Further Compliance*), http://www.irs.gov/pub/irs-utl/taxpayeradvocatedirective_2012-3.pdf.

136 Memorandum for National Taxpayer Advocate from Deputy Commissioner for Services and Enforcement and Deputy Commissioner for Operations Support, *Taxpayer Advocate Directive 2012-3* (Jan. 27, 2012), http://www.irs.gov/pub/irs-utl/irsresponse_taxpayeradvocatedirective_2012-3.pdf. The IRS also challenged the National Taxpayer Advocate's authority to elevate these issues using a TAD without the intervening step of a proposed TAD. *Id.* (*"it is our view that the requirements under IRM 13.2.1.6.1.3 for issuance of the TAD without the intervening step of a proposed TAD have not been satisfied in this case."*). As discussed above, codifying the National Taxpayer Advocate's authority to issue a TAD would allow her to be more effective in addressing the systemic problems that taxpayers are facing.

137 National Taxpayer Advocate, *Briefing for the Enforcement Committee* (Apr. 23, 2012).

138 For a list of international information return penalties see National Taxpayer Advocate 2011 Annual Report to Congress 133-34 (*Introduction to International Issues*). Among the most publicized are the penalties for failure to disclose foreign financial accounts (FBAR) and foreign financial assets (FATCA).

139 Penalties for failure to file information returns may range, for example, depending on willfulness, prompt remediation and other factors, from $10,000 per violation to the greater of $600,000 or 300 percent of the foreign account balance for certain willful failures that continue for extended periods. *See, e.g.*, penalties imposed under 31 U.S.C. § 5321(a)(5) and IRC §§ 6038, 6038A, 6038B, 6038C, 6039F, 6046, 6046A, 6048. See also IRC §§ 6038D, 6662(b)(7) and 31 U.S.C. § 5321(b)(1). For a list of international information return penalties, see National Taxpayer Advocate 2011 Annual Report to Congress 133-34 (*Introduction to International Issues*). Among the most publicized are the penalties for failure to disclose foreign financial accounts (FBAR) and foreign financial assets (FATCA).

140 *See, e.g.*, IRC §§ 6038D(g); 6038A(d)(3); 6038B(c)(2); 6039F(c)(2); 31 U.S.C. § 5321(a)(5)(B)(ii); (reasonable cause exception); IRC §§ 6038A(a); 6038B(a)(2); 6038D(h); 6039F(e) (authority to issue regulations).

141 Reasonable cause applies to most, but not all, of the penalties. *See generally* IRM 20.1.9.1, International Penalties - Overview; see also IRM 20.1.1, *Introduction and Penalty Relief*; IRM 4.26.16, *Report of Foreign Bank and Financial Accounts (FBAR)*.

individuals, continue to complain about being intimidated by excessive penalties that the IRS can apply to relatively "benign actors."[142]

In the 2011 Annual Report to Congress, the National Taxpayer Advocate urged the IRS to reaffirm its longstanding policy of using penalties "to encourage voluntary compliance,"[143] and to reassure "benign" U.S. taxpayers abroad, who are trying to comply or return into compliance, that it would not always seek to apply the maximum penalties.[144] She also recommended giving "benign" taxpayers clear guidance about what to do if they have inadvertently failed to file FBARs or other international information returns and how they can return into compliance.

In early December of 2011, as the Annual Report to Congress was *en route* to the printer, the IRS posted a fact sheet on its website making clear that it would apply a "reasonable cause exception" when imposing penalties for non-willful failure to file an FBAR.[145] In late December, the IRS also issued temporary regulations implementing FATCA reporting requirements for individuals and released the final version of Form 8938, *Statement of Specified Foreign Financial Assets.*[146]

The National Taxpayer Advocate commends the IRS for releasing the fact sheet and establishing higher FATCA reporting thresholds for U.S. taxpayers abroad.[147] These developments are steps in the right direction.

However, she remains concerned that the fact sheet does not have the same level of authority as changes made to the IRM itself or items of guidance published in the Internal Revenue Bulletin — and the IRS itself would be the first to point out that taxpayers generally cannot rely on fact sheets and press releases. In addition, organizations representing U.S. taxpayers abroad and the press have voiced concerns about unintended consequences

142 *See, e.g.*, Michael Cohn, *Expats Protest IRS Treatment of Citizens Overseas*, Accounting Today (Mar. 12, 2012), *at* http://www.accountingtoday.com/news/Expats-Protest-IRS-Treatment-Citizens-Overseas-61998-1.html (last visited Apr. 18, 2012); Robert W. Wood, *Despite FATCA, FBAR Penalties Still Under Fire*, Forbes (Mar. 12, 2012), at http://www.forbes.com/sites/robertwood/2012/03/12/despite-fatca-fbar-penalties-still-under-fire/ (last visited Apr. 18, 2012). TAS also continues to receive complaints about FATCA and FBAR penalties through Systemic Advocacy Management System (SAMS). SAMS submissions involving international issues increased more than threefold from calendar year (CY) 2008 to CY 2011, with a spike of 48 submissions in CY 2011. There were 27 SAMS submissions in CY 2012 (through May 29, 2012).

143 *See, e.g.*, H.R. Conf. Rep. No. 101-386 at 661 (1989) ("the IRS should develop a policy statement emphasizing that civil tax penalties exist for the purpose of encouraging voluntary compliance."); the IRS's 1998 Penalty Policy Statement acknowledged "the Service uses penalties to encourage voluntary compliance by ...helping taxpayers understand that compliant conduct is appropriate and that non-compliant conduct is not." *See* Policy Statement P-1-18 (Aug. 20, 1998), *superseded by* Policy Statement 20-1 (June 29, 2004). For an in-depth analysis of the civil tax penalty regime, see National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, at 1 (*A Framework for Reforming the Penalty Regime*).

144 National Taxpayer Advocate 2011 Annual Report to Congress 191-205.

145 *See* IRS, *Information for U.S. Citizens or Dual Citizens Residing Outside the U.S.*, FS-2011-13 (Dec. 7, 2011). The "reasonable cause exception" is mandated by statute (*see* 31 U.S.C. § 5321(a)(5)(B)(ii)(II)). *See also* Kristen A. Parillo, *IRS to Minimize Penalties on Dual U.S.-Canadian Citizens Unaware of U.S. Tax Filing Obligations*, 2011 TNT 233-9 (Dec. 5, 2011); Marie Sapirie, Reasonable Cause May Save Expats from Failure-to-File Penalties, 2011 TNT 237-3 (Dec. 9, 2011).

146 *See* Temp. Reg. §§ 1.6038D-0T through 1.6038D-8T; IRS Form 8938, *Statement of Specified Foreign Financial Assets* and Form Instructions (Nov. 2011).

147 A taxpayer with a foreign tax home and who meets certain additional foreign presence tests must report specified foreign assets, the total value of which exceeds $400,000 on the last day of the tax year, or more than $600,000 at any time during the year, for married filing jointly ($200,000 and $300,000 respectively for filing statuses). Reporting thresholds for taxpayers living in the U.S are substantially lower. *See* Temp. Reg. § 1.6038D-2T; Instructions to Form 8938, *Statement of Specified Foreign Financial Assets* (Nov. 2011).

of new FATCA rules for foreign financial institutions,[148] which make it harder for U.S. taxpayers living abroad to open and maintain legitimate bank accounts overseas.[149]

In FY 2013, TAS will address these concerns and continue advocating to alleviate burden for U.S. taxpayers abroad by eliminating duplicate FBAR and FATCA filings and providing formal guidance on filing compliance for non-resident U.S. taxpayers.[150] We look forward to working with the IRS on future formal guidance for these taxpayers and will report to Congress on the results.[151]

Specifically, the National Taxpayer Advocate has recommended the IRS future guidance follow these general principles:

- *Achieving certainty for both the affected taxpayers and the IRS in the context of FBAR and information reporting compliance.* Certainty for the taxpayer means that the taxpayer knows what penalties (if any) apply to past noncompliance if he or she comes back into compliance, and that any such penalties will not be disproportionate given his or her particular facts and circumstances. Certainty for the IRS means the taxpayer is back in the tax system with his or her past noncompliance treated appropriately, and in such a way that it encourages (rather than discourages) future compliance.
- *Publishing a full and complete description of international compliance regimes in the Internal Revenue Bulletin.* Since 2009, the IRS has published more than 20 documents or statements regarding offshore voluntary disclosure and FBAR compliance, many of which have back-tracked from previous positions, cross-referenced cross-references in other documents, and left taxpayers and IRS employees confused about the IRS's

148 FATCA also applies to foreign financial institutions (FFIs) which are required to report to the IRS certain information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. IRC §§ 1471-1474. On Feb. 8, 2012, the IRS issued proposed regulations under IRC §§ 1471-1474 requesting comments by April 30, 2012. IRS News Release, IR-2012-15 (Feb. 8, 2012).

149 *See, e.g.*, American Citizens Abroad (ACA) Comments on the Proposed Treasury Regulations Concerning FATCA Dated February 8, 2012 (Apr. 4, 2012), at http://www.aca.ch/acastatementapril2012s.pdf (last visited Apr. 19, 2012); April Carvelli, Taxes Pushing U.S. Citizens to Renounce, Imperfect Parent (Apr. 17, 2012) (quoting Francisca N. Mordi, Vice President and Senior Tax Counsel at the American Bankers Association, who stated she received a number of calls from Americans in Europe complaining about banks closing their accounts. "They're going to drop Americans like hot potatoes," Mordi says. "The foreign banks are upset enough about the regulations that they're saying they just won't keep American customers, and it's giving (Americans living abroad) a lot of sleepless nights."), *at* http://www.imperfectparent.com/topics/2012/04/17/taxes-pushing-u-s-citizens-to-renounce/ (last visited Apr. 19, 2012); James Fellows, *The FATCA Chronicles: Tales From China, Canada, and Estonia*, The Atlantic (Jan. 3, 2012), *at* http://www.theatlantic.com/international/archive/2012/01/the-fatca-chronicles-tales-from-china-canada-and-estonia/250771/ (last visited Apr. 19, 2012); Judi Lembke, *Americans in Sweden Suffer U.S. Tax Crackdown*, The Local (Sweden's News in English) (Mar. 6, 2012), at http://www.thelocal.se/39522/20120306/ (last visited Apr. 18, 2012).

150 FATCA requirements appear to overlap significantly with the disclosure requirements of the FBAR. *See* IRS, *Comparison of Form 8938 and FBAR requirements, at* http://www.irs.gov/businesses/article/0,,id=255986,00.html (last updated Mar. 26, 2012). Temporary regulations under IRC § 6038D eliminate duplicative reporting of assets on Form 8938 if the asset is reported or reflected on certain other timely-filed international information returns (*e.g.*, Forms 3520, 3520A, 5471, 8621, 8865, or 8891), provided the Form 8938 indicates the filing of the form on which the asset is reported. *See* Temp. Reg. §§ 1.6038D-7T(a); IRS Form 8938, *Statement of Specified Foreign Financial Assets* and Form Instructions (Nov. 2011). *See also Information Reporting: FATCA Worsening Tension Surrounding FBAR, Form 8938 Reporting Abroad, Group Says*, BNA Daily Tax Report (Apr. 11, 2012).

151 In March 2012, the IRS sought TAS comments on proposed new procedures for U.S. taxpayers abroad who have recently become aware of their international information reporting obligations and now seek to come into compliance with the law. The National Taxpayer Advocate provided specific recommendations to the IRS. Email from the National Taxpayer Advocate to the Deputy Commissioner for Services and Enforcement, and Commissioner, Large Business and International Division (Mar. 9, 2012); TAS email to Assistant Deputy Commissioner for Services and Enforcement (May 18, 2012) (reiterating recommendations).

position. The IRS should publish a single, comprehensive document in the IRB that incorporates (not by reference, but in full) a full and complete approach to FBAR and information reporting compliance. Anything less will confuse taxpayers, lead to errors by IRS employees, and not achieve the certainty so desperately needed in this area.

- *Requesting comments from the public and tax practitioner community.* To ensure that the single, comprehensive document is thorough, clear, and complete, the IRS should provide public notice and ask for comment under the Administrative Procedure Act. We recommend the IRS also conduct a roundtable discussion with the tax practitioner community to hear practitioners' concerns and sound out ways to address them. Such transparency will improve compliance and increase confidence in the tax system.
- *Developing procedures tailored for different groups of noncompliant taxpayers.* Procedurally, the IRS should not employ a one-size-fits-all approach. Taxpayers who have not timely filed an FBAR and other information returns should not be herded into one approach developed for tax evaders and then be required to opt-out if they believe they do not have those characteristics. Such an approach may stigmatize "benign" actors and discourage future compliance. The National Taxpayer Advocate recommends establishing broad but clearly defined categories for these taxpayers, based on the level of non-compliance, each of which is described below. The amount of the penalty (or relief from penalty) would depend on the taxpayer's category, with a broad anti-abuse rule.[152] These categories include:

Category 1. Full relief from FBAR and information reporting penalties.

(a) The taxpayer has properly reported taxable income on the subject returns, but failed to file information returns such as FBAR. This taxpayer should just file the information returns for the related years and the IRS would not impose penalties.[153] This exception would apply to both resident and nonresident U.S. taxpayers.

(b) The taxpayer has not properly reported all taxable income, but the tax liability is less than or equal to a threshold amount. We encourage the IRS to adopt a threshold set forth in IRC § 6662(d) (i.e., the greater of ten percent of the tax required to be shown on the return for the taxable year or $5,000 for individuals).[154] This exception should apply to both residents and nonresidents. These taxpayers should file amended returns, pay the tax due, interest, and in the absence of reasonable cause, accuracy-related penalties, but the IRS should not impose any FBAR or information reporting penalties.

152 The IRS can review submissions under categories described above, and if the taxpayer did not properly disclose all information and thus came in to the wrong category, full FBAR penalties will apply.

153 This is similar to the policy enunciated in the 2011 Offshore Voluntary Disclosure Initiative, FAQs 17 and 18, *at* http://www.irs.gov/businesses/international/article/0,,id=235699,00.html (last visited June 7, 2012).

154 Under FATCA, the period of limitation on assessment and collection of taxes increases when gross income in excess of $5,000 attributable to an asset for which information is required to be reported under IRC § 6038D is omitted for the year. *See* IRC § 6501(e)(1)(A)(ii). In addition, if any portion of an underpayment is attributable to any undisclosed foreign financial asset understatement, the IRC § 6662 penalty increases from 20 percent to 40 percent of the portion. *See* IRC § 6662(j).

Category 2. Taxpayers who have reasonable cause or acted non-willfully.[155]

(a) Nonresident U.S. taxpayers who do not qualify under Category 1, because they did not file tax returns and owe more in tax than the threshold amount in at least one year. This category would include the "accidental citizen." These taxpayers have little or no contact or substantial physical presence in the United States (excluding vacations and short visits to friends or family), and thus may have been unaware of their filing requirements. These taxpayers should provide an explanation of their circumstances, file delinquent returns, pay tax due, interest, accuracy-related penalties, and Title 26 information reporting penalties. However, no FBAR penalty would be imposed.

(b) Individuals, whether resident or nonresident, who had more significant contact with the U.S. and thus should have known about their filing requirements, did not report all or part of their foreign income, and owe more in tax than the threshold amount in at least one year, yet the IRS could not prove the FBAR violations were willful. These taxpayers should file either original or amended returns, pay tax due, interest, accuracy-related penalties and Title 26 information reporting penalties. Depending on the circumstances and explanation, these taxpayers would be required to either pay no FBAR penalty under the reasonable cause exception or pay the non-willful FBAR penalty.

Category 3. Taxpayers not included in category 1 or 2.

These taxpayers should file delinquent or amended returns, pay tax due, interest, accuracy-related penalties and a 27.5 percent offshore penalty.[156] In addition to working with the IRS on the formal guidance in the penalty area, TAS will advocate for the IRS to allow an extension for FATCA Form 8938 or relief from penalties during the first year of enforcement.[157] We will suggest that the IRS increase the threshold for FBAR reporting from

155 The published guidance should define what constitutes "reasonable cause" for the purposes of FBAR and provide examples about the difference between willful and nonwillful violations, based on the taxpayer's background, education level, cultural concerns, etc. In developing a broader "reasonable cause" standard to apply to FBAR violations, the *Ratzlaf* standard of "a voluntary intentional violation of a known legal duty" is a good starting point. *See Ratzlaf v. U.S.*, 510 U.S. 135(1994) (U.S. Supreme Court case discussing Bank Secrecy Act violations; however, not dealing with FBAR directly). The *Ratzlaf* analysis involves both the "knowledge of the reporting requirement" and a "specific intent," *i.e.*, "a purpose to disobey the law." *Ratzlaf*, 510 U.S. at 141 (internal citations omitted). *See also Cheek v. U.S.*, 498 U.S. 192 (1991) (holding that an airline pilot did not have the requisite "willfulness" for criminal tax evasion because he had a sincere belief that his income was not taxable; no matter how unreasonable that belief might be).

156 See IR-2012-5 (Jan. 9, 2012), discussing the reopening of the Offshore Voluntary Disclosure Program (OVDP) for 2012, and in particular the rate of penalties imposed under the program as extended with respect to the highest aggregate balance in previously undisclosed foreign bank accounts/entities, or the value of previously undisclosed foreign assets, in each case during the eight full tax years prior to the disclosure (up from 25 percent in the 2011 program).

157 Similar to the relief the IRS provided to Foreign Financial Institutions (FFIs) under FATCA by phasing in the FATCA requirements for FFIs in Notice 2011-53. For example, due diligence requirements for identifying new and pre-existing U.S. accounts (including certain high-risk accounts) will begin in 2013. Reporting requirements will begin in 2014. Organizations of U.S. citizens abroad request an extension for mandatory filing of the new Form 8938, *Statement of Specified Foreign Financial Assets* (commonly known as FATCA) for individual taxpayers. In the alternative, they request a relief from penalties during the first year of Form 8938 enforcement. National Taxpayer Advocate meeting with representatives of the Federation of American Women's Clubs Overseas (FAWCO) and American Citizens Abroad (ACA) (Jan. 31, 2012).

$10,000 at any time during the year to the levels contemplated in the FATCA regulations[158] by changing Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts* (commonly known as FBAR) instructions[159] or through changes to FinCEN regulations.[160]

G. TAS Will Continue to Advocate that the IRS Modify the Offshore Voluntary Disclosure Program so that People Who Made Honest Mistakes Can Correct them Without Fear of Excessive Penalties

In the past few years, the IRS actively promoted the 2009 Offshore Voluntary Disclosure Program (OVDP) and the 2011 Offshore Voluntary Disclosure Initiative (OVDI).[161] These initiatives allowed people who failed to file a Form TD F 90—22.1, Report of Foreign Bank and Financial Accounts (FBAR), reporting foreign accounts and the income from those accounts to settle with the IRS by paying a single "offshore" penalty instead of several other penalties that the IRS might seek to apply, including severe civil and criminal penalties designed for willful violators. However, these initiatives were not promulgated through issuance of published guidance in the Internal Revenue Bulletin or even in the Internal Revenue Manual (IRM).[162] Instead, the IRS published and then often updated and revised the terms of these initiatives on its website.[163] In the 2011 Annual Report to Congress, the National Taxpayer Advocate discussed her concerns about the "bait and switch" approach the IRS took in administering the 2009 OVDP and recommended several actions to restore IRS's credibility among taxpayers and practitioners and promote fair tax administration based on the generally accepted concepts of due process, transparency, and procedural fairness.[164]

Specifically, the IRS announced 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,"

158 A taxpayer with a foreign tax home and who meets certain additional foreign presence tests must report specified foreign assets, the total value of which exceeds $400,000 on the last day of the tax year, or more than $600,000 at any time during the year, for married filing jointly ($200,000 and $300,000 respectively for filing statuses). Reporting thresholds for taxpayers living in the U.S are substantially lower – more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year for unmarried taxpayers and married filing separate returns, and more than $100,000 on the last day of the tax year or more than $150,000 at any time during the tax year for married filing joint returns. See Temp. Reg. § 1.6038D-2T; Instructions to Form 8938, *Statement of Specified Foreign Financial Assets* (Nov. 2011).

159 Unlike other IRS form instructions, FBAR reporting instructions may carry the force of law. *See* 31 C.F.R. § 1010.350; *U.S. v. Clines*, 958 F.2d 578 (4th Cir. 1992), *cert. denied*, 505 U.S. 1205 (1992).

160 *See generally* 31 CFR Part 1010.

161 *See, e.g.*, IRS, *Voluntary Disclosure: Questions and Answers*, http://www.irs.gov/newsroom/article/0,,id=210027,00.html (Feb. 9, 2011) (first posted May 6, 2009) (hereinafter 2009 OVDP); IRS, *2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers*, http://www.irs.gov/businesses/international/article/0,,id=235699,00.html (first posted Feb. 8, 2011) (hereinafter OVDI).

162 *Cf.* Rev. Proc. 2003-11, 2003-4 I.R.B. 311 (2003 Offshore Voluntary Compliance Initiative); IRM 4.26.16.4.6.4 (July 1, 2008) (Last Chance Compliance Initiative (LCCI)).

163 *E.g.*, the 2009 Offshore Voluntary Disclosure Program Frequently Asked Questions (FAQs) were "updated" five times: on Jan. 8, 2010 - added Q&As 53-54; on Aug. 25, 2009 - added Q&A 52; on July 31, 2009 – modified A6, A21 and A22; on June 24, 2009 – modified A26 and added Q&A 31-51; on May 6, 2009 – posted Q&A 1-30, *at* http://www.irs.gov/newsroom/article/0,,id=210027,00.html (last visited Apr. 24, 2012). The 2011 OVDI FAQs were revised online eight times, last time on March 5, 2012 (while the program ended on Sept. 9, 2011), *at* http://www.irs.gov/businesses/international/article/0,,id=235699,00.html (last visited Apr. 24, 2012).

164 National Taxpayer Advocate 2011 Annual Report to Congress 206-272.

prompting those whose violations were not willful to enter the program.[165] On March 1, 2011, more than a year after the 2009 OVDP ended, the IRS issued a memo suggesting it would no longer consider whether a taxpayer would pay less under existing statutes.[166] Those with inadvertent violations could either agree to pay more than they should or "opt out." Given the confusion surrounding what penalty would apply outside of the program, many agreed to the offshore penalty. Continuing concern that the IRS may apply excessive penalties for inadvertent violations has generated public outrage among those with foreign accounts, such as U.S. citizens living in Canada.

The National Taxpayer Advocate also issued a Taxpayer Advocate Directive (TAD) recommending that the IRS take steps to address her concerns.[167] The Small Business/Self-Employed and Large Business and International Divisions appealed the TAD to the Deputy Commissioner for Services and Enforcement, who modified it without providing a satisfactory explanation or rationale.[168] Following the Deputy Commissioner's memo, the National Taxpayer Advocate elevated her concerns to the Commissioner of Internal Revenue for a formal response.[169] The Commissioner has not provided a formal written response.[170] However, the National Taxpayer Advocate has personally discussed her concerns and recommendations with the Commissioner.

TAS has also continued to assist taxpayers by issuing Taxpayer Assistance Orders (TAOs) when the IRS has failed to follow its public guidance with respect to the 2009 OVDP or 2011 OVDI.[171] In response to one such TAO, the SB/SE Commissioner recently challenged the National Taxpayer Advocate's authority to issue a TAO that directed the IRS to follow its procedures, review its determination at a higher level, and reconsider facts that it seemed to have overlooked.[172]

165 OVDP FAQ #35.

166 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).

167 *See* National Taxpayer Advocate 2011 Annual Report to Congress 242-51 (Taxpayer Advocate Directive 2011-1 (*Implement 2009 Offshore Voluntary Disclosure Program FAQ #35 and comply with the Freedom of Information Act*) (Aug. 16, 2011)).

168 *See* National Taxpayer Advocate 2011 Annual Report to Congress 252-72 (Memorandum for Deputy Commissioner for Services and Enforcement from Commissioner, LB&I and Commissioner, SB/SE, *Appeal of Taxpayer Advocate Directive 2011-1 (Implement 2009 Offshore Voluntary Disclosure Program FAQ #35 and comply with the Freedom of Information Act)* (Aug. 30, 2011); Memorandum for Deputy Commissioner for Services and Enforcement from National Taxpayer Advocate, *Appeal of Taxpayer Advocate Directive 2011-1 (Implement 2009 Offshore Voluntary Disclosure Program FAQ #35 and comply with the Freedom of Information Act)* (Sept. 22, 2011); Memorandum for National Taxpayer Advocate from Deputy Commissioner for Services and Enforcement, *Taxpayer Advocate Directive 2011-1*). The Deputy Commissioner agreed to release the March 1 memo to the public, but disagreed with the National Taxpayer Advocate's other recommendations.

169 Memorandum for Commissioner of Internal Revenue from National Taxpayer Advocate, *Recommendations Regarding Taxpayer Advocate Directive 2011-1* (Sept. 26, 2011), *available at* http://www.irs.gov/pub/irs-utl/recommendations_tad2011-1.pdf.

170 For a more detailed discussion, see *Improve Tax Administration through Taxpayer Advocate Directives, supra.*

171 The National Taxpayer Advocate (or a Local Taxpayer Advocate) may assist a taxpayer by issuing a Taxpayer Assistance Order (TAO) to the IRS, if the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered. IRC § 7811.

172 Memorandum for Nina E. Olson, National Taxpayer Advocate, from Faris R. Fink, Commissioner, Small Business/Self-Employed Division, *Appeal of Taxpayer Assistance Order (TAO)* [taxpayer name redacted] (Mar. 22, 2012).

While the Deputy Commissioner may modify or rescind a TAO, the scope of what a TAO may direct is necessarily broad.[173] A TAO may order the IRS to "cease any action, take any action as permitted by law, or refrain from taking any action, with respect to the taxpayer" under enumerated chapters of the IRC dealing with collection or bankruptcy, or "any other provision of law which is specifically described by the National Taxpayer Advocate in such order."[174] Accordingly, a properly constructed TAO can order the IRS to take "ANY" action.[175] However, the IRS may not always be willing and able to comply — and because of the TAO appeal process, the IRS retains the final decision-making authority.

Because the IRS retains the authority (and duty) to make substantive determinations, a TAO will only prompt the IRS to take actions that it is legally permitted to take based on its own determinations (not TAS').[176] For example, a TAO could not actually cause the IRS to change a tax assessment unless the IRS determined the change was legally permissible based on its own factual and legal determinations. In this way, TAS avoids becoming a second Appeals function.

The SB/SE Commissioner argued that the National Taxpayer Advocate had no authority to issue the TAO (described above) because guidance posted to the IRS website indicated that if a taxpayer disagreed with the IRS's determination, his or her only option was to "opt out" of the settlement initiative.[177] Thus, he reasoned, TAS could not issue a TAO requiring the IRS to reconsider its decision at a higher level or to consider facts that it appeared to have overlooked.

The National Taxpayer Advocate finds this reasoning flawed. Some IRS procedures allow taxpayers to appeal the determination to Appeals or to Tax Court, but none expressly authorize taxpayers to seek TAS assistance if they disagree. As the Treasury Regulations explain, a TAO is "not intended to be a substitute for an established administrative or judicial review procedure, but rather is intended to supplement existing procedures."[178] In this case, the TAO is not seeking special relief outside of the established process. Instead, it seeks exactly what the regulations contemplate — a supplement to the existing procedures by having the IRS review at a higher level its preliminary determination under an established administrative procedure (OVDP). The fact that other administrative or judicial procedures might be available to the taxpayer in the future, *i.e.*, opting out, is of no consequence at this time. Based on the posture of the case, *i.e.*, a TAO seeking review at a higher level, the

173 IRC § 7811(b).

174 *Id;* Treas. Reg. § 301.7811-1(c)(2). *See also Hyler v. Comm'r*, T.C. Memo. 2002-321.

175 Specifically, a TAO may state the National Taxpayer Advocate's substantive recommendation and order the IRS to review, reconsider, or elevate its own determination in light of the National Taxpayer Advocate's recommendation. Recently published regulations illustrated this point. See Treas. Reg. § 301.7811-1(c)(2) and (3).

176 *See* Treas. Reg. § 301.7811-1 ("A TAO is also not intended to be a substitute for an established administrative or judicial review procedure, but rather is intended to supplement existing procedures…"); IRM 13.1.20.3 (2007) ("A TAO only requires actions that are otherwise permitted by law, regulations, or other guidance. They may not be issued to determine the merits of a taxpayer's liability or to overturn or circumvent an established process for administrative or judicial review of a taxpayer's case.").

177 For further discussion of this problem, see National Taxpayer Advocate 2011 Annual Report to Congress 206-72.

178 Treas. Reg. § 301.7811-1(b).

current administrative procedure (OVDP) is appropriate. If the taxpayer later opted out and the IRS conducted a full examination, TAS could issue a TAO at that time elevating consideration of that administrative procedure, the examination.

Accordingly, if the IRS could so restrict National Taxpayer Advocate's statutory authority to issue a TAO, it could prevent TAS from assisting taxpayers in any IRS process by simply issuing a statement on a website. The National Taxpayer Advocate strongly disagrees with the SB/SE Commissioner's interpretation of her statutory authority and will seek to address it in FY 2013, including acting in accordance with her office's understanding of the National Taxpayer Advocate's statutory authority.

In addition, the National Taxpayer Advocate is looking forward to meaningful TAS participation in developing procedures for the new Offshore Voluntary Disclosure Program the IRS announced on January 9, 2012.[179] TAS believes any such procedures should be published in the IRM or the IRB as formal guidance upon which taxpayers can rely.[180] As described above, the National Taxpayer Advocate has provided specific recommendations about the general principles of how the formal guidance should be drafted as well as how to treat different categories of taxpayers.[181] The amount of the penalty (or relief from penalty) would depend on the taxpayer's category, with a broad anti-abuse rule.[182]

In FY 2013, TAS will also continue advocating for taxpayers who were harmed by the IRS's refusal to consider whether a taxpayer would qualify for less penalties under existing statutes according to FAQ#35 of the 2009 OVDP.

179 IRS News Release, IR-2012-5 (Jan. 9, 2012). The IRS reopened the OVDP for an indefinite period. In the new program, which would be similar in terms to the 2011 OVDI, a penalty of 27.5 percent of the highest aggregate balance in foreign bank accounts or value of foreign assets during the eight full tax years prior to the disclosure would apply, which is up from 25 percent in the 2011 OVDI. The IRS will have five and 12.5 percent penalty brackets for eligible taxpayers. *Id.*

180 For more details, see *TAS Will Continue Advocating for American Taxpayers Abroad Expressing Fear and Frustration about FBAR, FATCA and Other International Penalties, supra.*

181 In March 2012, the IRS sought TAS comments on proposed new procedures for U.S. taxpayers abroad who have recently become aware of their international information reporting obligations and now seek to come into compliance with the law. The National Taxpayer Advocate provided specific recommendations to the IRS. Email from the National Taxpayer Advocate to the Deputy Commissioner for Services and Enforcement, and Commissioner, LB&I Division (Mar. 9, 2012); TAS email to Assistant Deputy Commissioner for Services and Enforcement (May 18, 2012) (reiterating recommendations).

182 The IRS can review submissions under categories described above, and if the taxpayer did not properly disclosed all information and thus came in to the wrong category, full FBAR penalties will apply. For a detailed discussion of proposed principles and categories of taxpayers, see *TAS Will Continue Advocating for American Taxpayers Abroad Expressing Fear and Frustration about FBAR, FATCA and Other International Penalties, supra.*

H. TAS Will Work with the IRS on Improving Taxpayer Service Options for International Taxpayers and Alleviating Their Compliance Challenges

In recent years, the IRS has devoted substantial resources to improving international tax administration and responding to the challenges of globalization.[183] However, this strategy continues to focus on stepped-up enforcement without adequate IRS-wide coordination or a corresponding increase in service.[184] The National Taxpayer Advocate is concerned that the lack of adequate taxpayer service may undermine international enforcement initiatives and discourage future compliance by taxpayers dealing with the complexity and procedural burden of international tax rules. The inability of international taxpayers to access IRS services from abroad contributes to growing confusion and frustration about U.S. tax administration.

The National Taxpayer Advocate's 2011 Annual Report to Congress addressed the challenges facing millions of international taxpayers in understanding and meeting their federal tax obligations. These taxpayers include U.S. individuals working, living, or doing business abroad; U.S. entities doing business abroad; foreign individuals working or doing business in the United States; and foreign entities doing business in the United States.[185] The report identified six Most Serious Problems related to international issues, emphasized the increasing need for IRS services for these taxpayers, and proposed innovative and cost-efficient solutions for many of the challenges.[186]

The National Taxpayer Advocate commends the IRS for continued research on the filing behaviors, needs, and preferences of individual taxpayers living abroad, including

183 In FY 2011, the IRS requested an enforcement account increase of $293.4 million, an increase of about $121 million allocated to international compliance and only about $1.7 million to international taxpayer services. IRS, *The Budget in Brief*, FY 2011. Similarly, in FY 2010, the IRS requested an increase of $332.2 million "for investments in strong compliance programs, including a robust portfolio of international enforcement initiatives." Of the $332.2 million increase, about $128 million was requested for international compliance, of which $3.1 million was for international service. IRS, *The Budget in Brief*, FY 2010. It appears that the IRS requests for enforcement spending for FYs 2010 and 2011 were funded in full (for FY 2011 – on FY 2010 levels). *See* Pub. L. No. 111-117 (Dec. 16, 2009); Pub. L. No. 112-10 (Apr. 15, 2011).

184 The FY 2013 IRS Budget Proposal requests additional 700 full time equivalents (FTEs) and over $110.7 million in additional funding for offshore compliance programs, and additional 223 FTEs and $38.9 million in additional funding for international compliance programs (in addition to funding international investigations, international examinations, and international collections that are not listed as separate lines in the enforcement budget). IRS, *The Budget in Brief*, FY 2013. The FY 2010 budget included an additional 742 full time equivalents and $104.11 million to support international enforcement, and only 42 FTE and $3.12 million to support international taxpayer service. The FY 2011 budget did not fund the requested additional 30 FTE and $1.78 million for international taxpayer service. IRS response to TAS research request (Nov. 22, 2011).

185 *See* National Taxpayer Advocate 2011 Annual Report to Congress 129-272. These challenges include the overwhelming complexity of international tax law; the complexity, level of detail, and sometimes the duplication present in international reporting requirements; penalties that may be disproportionately steep; the IRS's focus on stepped-up enforcement without adequate coordination and a corresponding increase in service; and most importantly, the lack of targeted taxpayer service for each group of international taxpayers.

186 *See* Most Serious Problems (MSPs): MSP 7, *Foreign Taxpayers Face Challenges in Fulfilling U.S. Tax Obligations*, at 137-150; MSP 8, *Individual Taxpayers Working, Living, or Doing Business Abroad Require Expanded Service Targeting Their Specific Needs and Preferences*, at 151-165; MSP 9, *Small Businesses Involved in International Economic Activity Need Targeted IRS Assistance*, at 166-175; MSP 10, *Globalization Requires Greater Internal IRS Coordination of International Taxpayer Service*, at 176-190; MSP 11, *U.S. Taxpayers Abroad Face Challenges in Understanding How the IRS Will Apply Penalties to Taxpayers who are Reasonably Trying to Comply or Return into Compliance*, at 171-205; and MSP 12, *The IRS's Offshore Voluntary Disclosure Program "Bait and Switch" May Undermine Trust for the IRS and Future Compliance Programs*, at 206-272.

the excellent survey W&I Research & Analysis concluded in 2012.[187] In March 2012, the National Taxpayer Advocate met with the Commissioner, Large Business & International Division, and Deputy LB&I Commissioner International, and discussed recommendations to improve taxpayer service for international taxpayers. The Commissioner, LB&I, and the Deputy LB&I Commissioner (International) agreed to create a team including LB&I, TAS, and W&I representatives to review the findings of the recent W&I survey and develop international taxpayer service initiatives based on that information.

In FY 2013, the National Taxpayer Advocate will continue to hold periodic meetings with LB&I leadership and collaborate on key international taxpayer service initiatives. These initiatives include Virtual Service Delivery, seminars and Tax Forums (for tax practitioners) via webcasts, piloting secure e-service applications, such as SMS text and email communications, and access to the MyIRS account application, and establishing Local Taxpayer Advocate positions overseas. Because TAS is the only IRS function exclusively devoted to assisting taxpayers in resolving their issues with the IRS, the international taxpayers' right to TAS assistance is constrained by the lack of Taxpayer Advocate offices overseas.[188] Therefore, to meet the international taxpayers' need for TAS assistance, the National Taxpayer Advocate recommends that the IRS establish International LTA offices by funding nine positions at the IRS's four tax attaché offices abroad in FY 2014.[189]

In addition, in FY 2012 TAS is participating in the IRS Virtual Services Delivery pilot.[190] TAS proposes expanding VSD, web-based videoconferencing overseas, and secure email messaging as a cost-effective way to serve U.S. taxpayers abroad and foreign taxpayers who have a U.S. filing requirement.[191]

187 *See* W&I Research & Analysis, *WIRA Portfolio of International Taxpayer Research: Filing Behaviors, Service Preferences, and Use of Service*, Presentation for the Services Committee Meeting (Jan. 2012). IRS, Wage & Investment Division (W&I) Research & Analysis, *Understanding the International Taxpayer Experience: Service Awareness, Use, Preferences, and Filing Behaviors, Research Study Report* (Feb. 2010); *W&I International Taxpayer Topline Report* 5, Pacific Consulting Group (Dec. 2009); W&I, Research & Analysis, Fo*cus Group Testing Report: Customer Service Needs of U.S. Taxpayers Living Abroad*, Project # 3-08-07-S-017T (Dec. 2008).

188 TAS is statutorily required to assist taxpayers in resolving problems with the IRS, to identify areas in which taxpayers have problems in dealing with the IRS and, to the extent possible, propose changes in the administrative practices of the IRS to mitigate the problems identified. IRC § 7803(c)(2)(A)(i) – (iii). While TAS has at least one office in all 50 states, the District of Columbia, and Puerto Rico, the international taxpayers' right to TAS assistance is constrained by the lack of Local Taxpayer Advocate (LTA) offices overseas. *See generally* IRC §§ 7803; 7811. *See also* IRS Pub. 1, *Your Rights as a Taxpayer*. The law requires at least one LTA be made available for each state. International taxpayers cannot access TAS toll-free from abroad.

189 The IRS posts are in Frankfurt, Germany; London, United Kingdom; Paris, France; and Beijing, China. *See* IRM 4.30.3 (Oct. 1, 2010), *Overseas Posts*. TAS estimates the total annual cost for nine full-time equivalents (FTEs) including four LTAs, four support staff, and one W&I Accounts Management (indirect) support position at $2.8 million. *Cf.* The IRS FY 2013 budget proposal which requests an additional 700 FTEs and over $110.7 million in additional funding for the offshore compliance program, and an additional 223 FTEs and $38.9 million in additional funding for international compliance programs (in addition to funding international investigations, international examinations, and international collections that are not listed as separate lines in the enforcement budget). IRS, *The Budget in Brief*, FY 2013.

190 VSD uses video communications technology to (1) provide a service delivery alternative outside of IRS facilities; (2) enhance utilization of IRS resources; (3) smooth staffing and workload imbalances; and (4) increase access to face-to-face service where it is currently unavailable. *Virtual Service Delivery - Delivering Taxpayer Services Using Video Communications Technology, IRS Commissioner Briefing* (Sept. 26, 2011). In the pilot, the Jacksonville, Florida TAS office is connected to a Taxpayer Assistance Center in Tampa, Florida, where TAS does not have its own office, to provide service to taxpayers using VSD. Low Income Taxpayer Clinics (LITCs) in Washington State and Tennessee are also testing VSD to connect their clients with Appeals offices in the Fresno and Memphis campuses to conduct Collection Due Process hearings and Offer in Compromise appeals, respectively.

191 For additional information on TAS' participation in the VSD pilot and secure email and text messaging capabilities, see *TAS Is Participating in the IRS's Virtual Services Delivery (VSD) Pilot* and *TASIS Will Deliver Significant Benefits to Taxpayers, Employees, and Partners in Tax Administration, infra.*

I. Collection Update: IRS "Fresh Start" Initiatives – Significant Changes Have Been Made, but Further Improvements Are Needed

Over the past 18 months, the IRS significantly changed a number of its Collection policies:

- In FY 2011, the IRS modified the criteria used in filing Notices of Federal Tax Lien (NFTL), enabling taxpayers to request and obtain lien withdrawals from the IRS, expanding the criteria under which small businesses pay past due taxes in installments, and formalizing the "streamlined" offer in compromise (OIC) procedures used by the IRS's centralized OIC operation.[192]
- In FY 2012, the IRS announced expanded criteria for individual taxpayers to qualify for "streamlined" installment agreements, and provided an opportunity for a six-month grace period on failure-to-pay penalties for certain wage earners and self-employed taxpayers.[193]
- In May 2012, the IRS expanded its "Fresh Start" initiative further by offering more flexible terms to the OIC program in an effort to allow some of the most financially distressed taxpayers to clear up their tax problems.[194] The new procedural changes focus on the financial analysis used to determine which taxpayers qualify for an OIC, and provide much more flexibility to certain Collection employees in determining the acceptability of offers. The revised financial analysis guidance provides allowances for repayment of student loans, payments on tax debts to state and local governments, and expanded allowances for payments on unsecured debt.

As of March 2012, perhaps because of the changes in the lien-filing criteria, the IRS has filed 41 percent fewer NFTLs than in the same period in FY 2011, including a corresponding 61 percent reduction in liens filed by the Automated Collection System (ACS).[195] We also note that the IRS has accepted 26 percent more offers in compromise than in March 2011, and that the actual number of accepted offers has doubled when compared to the first two quarters of FY 2010.[196] As of March 2012, the offer acceptance rate of 38 percent is the highest we have seen in many years.[197] Through March 2012, thousands of financially struggling taxpayers have successfully obtained lien withdrawals to help regain their financial viability.[198] These results indicate that components of the "Fresh Start" initiative have produced significant changes in IRS collection actions, which in turn have had positive, meaningful results for many taxpayers.

192 IRS, IR-2011-20, IRS Announces New Effort to Help Struggling Taxpayers Get a Fresh Start; Major Changes Made to Lien Process (Feb. 24, 2011).

193 IRS, IR-2012-31, IRS Offers New Penalty Relief and Expanded Installment Agreements to Taxpayers under Expanded Fresh Start Initiative (Mar. 7, 2012).

194 IRS, IR-2012-53, IRS Announces More Flexible Offer-in-Compromise Terms to Help a Greater Number of Struggling Taxpayers Make a Fresh Start (May 21, 2012).

195 IRS, Collection Activity Report NO-5000-25, *Liens Report* (Apr. 2012).

196 IRS, Collection Activity Report NO-5000-108, *Monthly Report of Offer in Compromise Activity* (Apr. 2012).

197 *Id.*

198 IRS, Collection Activity Report NO-5000-25, *Liens Report* (Apr. 2012). Through March 2012, the IRS issued 5,781 lien withdrawals.

1. Small Business Taxpayers Have Received Little Relief Through the "Fresh Start" Initiative

On the other hand, the expanded criteria for "express" installment agreements have not succeeded in providing more small business taxpayers with access to this very important payment option. In fact, notwithstanding today's difficult economic climate, through March 2012, the number of business taxpayers receiving agreements has actually declined by approximately one percent, and the number of "streamlined" business agreements has declined by four percent.[199] Business-related installment agreements continue to account for only four percent of all agreements issued through March 2012.[200] The IRS needs to identify the barriers that deny small business taxpayers the opportunity to resolve tax problems through installment agreements and offers in compromise.

2. Further Improvements Are Needed in the Criteria Used by the IRS to File Notices of Federal Tax Liens

While the overall reduction in lien filings may be a positive change for many taxpayers, the National Taxpayer Advocate continues to believe that lien filings should be based on the facts and circumstances of each case, not simply determined by an arbitrary dollar figure representing unpaid liabilities. In the 2011 Annual Report to Congress, we shared with the IRS the results of a TAS research study that shows how indiscriminate lien filings may actually have a negative influence on revenue collection and future filing compliance.[201] TAS will continue to work with the IRS to develop more meaningful, fair, and realistic criteria for determining the need for NFTLs in collection cases.[202] Further, although the new procedures for lien withdrawals have been helpful and productive, TAS continues to receive reports that some IRS employees are not aware of the new policies, and tax professionals have found them difficult to locate on the IRS website. The IRS has recently updated the IRM material reflecting the new procedures. When published, the revised IRMs should alleviate these concerns, although we believe the IRS should be more proactive in its internal training and external outreach efforts to communicate these important changes.

3. Prudent Use of IRS Collection Resources Will Be a Key Factor in Realizing the Benefits of the "Fresh Start" Changes

In March 2012, the Treasury Inspector General for Tax Administration reported that inadequate staffing and increased demand in the OIC program have created inventory backlogs and processing delays that could affect a significant number of taxpayers.[203] The National Taxpayer Advocate shares these concerns, and has questioned the IRS about the very small

199 IRS, Collection Activity Report NO-5000-6, *Installment Agreement Cumulative Report* (Apr. 2012).

200 *Id.*

201 National Taxpayer Advocate, 2011 Annual Report to Congress vol. 2, 91-112 (Research Study, *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*).

202 For a more detailed discussion of the work TAS is doing in this area, see *Estimating the Impact of Liens on Taxpayer Compliance Behavior, infra*.

203 TIGTA, Ref No. 2012-30-033, Increasing Requests for Offers in Compromise Have Created Inventory Backlogs and Delayed Responses to Taxpayers, (March 30, 2012).

number of Collection employees authorized to work OIC cases, especially in light of the high volumes of cases routinely assigned to the Collection Queue inventory, and those systemically reported as uncollectible prior to any personal contact with the IRS.[204] Over the past two years, the IRS has made very significant improvements to the OIC program. It would be equally unfortunate for tax administration if the benefits of these changes were under-realized due to internal limits on the Collection resources available to handle OIC applications.

The National Taxpayer Advocate is concerned that the IRS is not using Collection resources in a manner that properly emphasizes personal service, problem resolution, and the long-term compliance of taxpayers with delinquencies. TIGTA's observation regarding the inadequate number of Collection employees available to work OIC cases is an excellent example of this concern. The offer in compromise is an important Collection tool, and is especially effective in resolving difficult collection cases. Yet very few Revenue Officers are empowered to recommend acceptance of a taxpayer's offer to resolve outstanding tax debts, which would also provide a reasonable path for the taxpayer to return to compliance.

Collection cases involving complex issues, *e.g.*, determining the viability of a small business struggling with employment tax debt or accurately evaluating the reasonable collection potential in a case involving a self-employed taxpayer with complicated financial circumstances, can often benefit from the timely intervention of a local Revenue Officer. In FY 2013, TAS plans to work closely with the SB/SE division to explore opportunities to identify and recapture the value of the Revenue Officer occupation in effective, compliance-oriented collection work. In particular, TAS and SB/SE will develop a study that will explore and quantify the potential benefits of using revenue officers to selectively and timely address complex collection cases in a service-oriented manner. Possible study methodologies include the analysis of historic data, and the development of a "field experiment" using alternative collection methods on comparable groups of collection cases. Our principal goal is to determine if the selective application of this holistic collection approach is more productive than the highly automated, enforcement-oriented methods upon which the IRS increasingly relies. This will entail measuring a variety of outcomes, such as revenue protected and subsequent taxpayer compliance, in addition to the direct cost per dollar collected.

4. The IRS Needs to Reevaluate and Adjust the Imbalanced Focus of the Collection Field Operation

Collection's use of the field-based Revenue Officer position appears to be reverting to an over-emphasis on technically complex enforcement actions. This approach does not balance the service-related needs of taxpayers, as well as the effectiveness of Collection

204 IRS, Collection Activity Reports NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Apr. 2012). As of March 2012, approximately 3.6 million Taxpayer Delinquent Accounts (TDAs), involving over one million taxpayers and $59.3 billion in delinquent revenue were assigned to the Collection Queue. Approximately 33 percent of these accounts have been assigned to the Queue for 16 months or longer. Additionally, approximately $3 billion of the Queue inventory was systemically reported as uncollectible during the first six months of FY 2012. A more flexible approach to using collection payment alternatives, such as the offer in compromise, should assist the IRS in resolving more of these accounts, and consequently collecting more of these debts.

treatments on long-term taxpayer compliance, with the impact of the powerful enforcement tools available to Revenue Officers.

For example, TAS has recently been involved in a number of cases involving IRS recommendations to the Department of Justice to initiate judicial foreclosure actions on taxpayers' homes. Usually, these cases have involved old tax debts that had been assigned to the Collection Queue or reported as uncollectible for several years, but were reassigned to the Collection Field operation shortly before the expiration of the collection statute. The National Taxpayer Advocate is very concerned that although the foreclosure actions in these cases would have created severe economic hardship for the taxpayers, IRS procedures for recommending these actions do not provide for adequate consideration of the potential harm for the taxpayers or other affected parties.[205] While the end result of a judicial foreclosure is essentially the same as that of an administrative seizure of a taxpayer's primary residence, IRS procedures for the suit to foreclose recommendations do not provide similar consideration of the taxpayer's circumstances as do the procedures for administrative seizure.[206] In FY 2013, TAS will work with the IRS to develop procedures in this area that adequately protect taxpayer rights.

With the focus on liens and collection payment options, the National Taxpayer Advocate acknowledges the efforts of the IRS to address collection issues that are highly significant to taxpayers struggling to resolve delinquent tax debts. These issues have been repeatedly discussed in past Annual Reports to Congress, and significant portions of the "Fresh Start" initiatives reflect recommendations by the National Taxpayer Advocate.[207] Additionally, TAS has worked extensively with the IRS on the development of the "Fresh Start" implementation guidance. In the upcoming year, the National Taxpayer Advocate will look closely at the policy and procedural changes implemented within the "Fresh Start" initiative and analyze their impact on taxpayers serviced by the Collection operations. TAS will carefully analyze IRS program data related to the new policies, as well as resources allocated to support the "Fresh Start" efforts, and recommend meaningful actions the IRS can take to realize maximum benefits from this important initiative.

205 See IRM 5.17.4.8, *Foreclosure of Federal Tax Lien,* for more information regarding judicial foreclosure actions recommended by the IRS.

206 See IRM 5.10.1, *Pre-Seizure Considerations*, for detailed information regarding the actions required of Revenue Officers prior to initiating a seizure action. This IRM section includes a reference to IRS Policy Statement P-5-34, which states, "Collection to be enforced through seizure and sale of assets of a taxpayer only after thorough consideration of all factors and alternative collection methods."

207 National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 39-70 (*An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission)*; National Taxpayer Advocate 2010 Annual Report to Congress 302-310 (Most Serious Problem: *The IRS Has Been Slow to Address the Adverse Impact of its Lien Filing Policies on Taxpayers and Future Tax Compliance*) National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*).

J. Coordinating Tax Issues Involving Classes of Taxpayers with Government Oversight Agencies Besides the IRS

In recent years, TAS has assumed responsibility for assisting groups of taxpayers who have been harmed by one person or entity. Typically, federal, state, or local government officials bring these taxpayer classes to the attention of the National Taxpayer Advocate. TAS not only ensures that the IRS has adequate processes in place to address the taxpayers' problems but also accepts many of these taxpayers' cases into its inventory and informs the taxpayers about the availability of assistance from Low Income Taxpayer Clinics.[208]

1. TAS Assists Taxpayers Impacted by Receivership of the Deutch Law Firm

On August 23, 2010, the State of California filed suit against the law firm Roni Deutch, a professional tax corporation, and Roni Lynn Deutch individually (the defendants), alleging they swindled thousands of dollars from taxpayers who had collection problems with the IRS. The complaint alleged that the defendants engaged in a scheme to cheat taxpayers, including senior citizens and the disabled, who could not afford to pay their tax debts by enticing them to hire the defendants to assist in negotiating a resolution of their debts with the IRS.[209] On May 20, 2011, Roni Deutch surrendered her law license.[210] The court appointed a receiver to wind down the firm's affairs. The receiver and the attorney general's office provided TAS with a list of 929 taxpayers identified as having "critical needs" and a second list of 3,994 impacted taxpayers, and asked the National Taxpayer Advocate to provide the firm's clients with information about TAS and work with the IRS to resolve their problems.

TAS sent the taxpayers letters with information on how to get their collection issues worked in the IRS and provided IRS and Low Income Taxpayer Clinic phone assistance numbers. TAS and LITCs contacted taxpayers who appeared to have current IRS levies, established special internal processes for working these cases, and negotiated with the IRS to refrain from any automated collection activity through September 30, 2011. Additionally, the IRS agreed to refrain from returning or rejecting any offers in compromise the taxpayers submitted and instead work with them to try to perfect the offers or arrive at another resolution.

208 See *generally* IRC § 7526. The LITC program serves individuals whose income is below a certain level and require assistance with the IRS. LITCs are independent from the IRS and most LITCs can provide representation before the IRS or in court on audits, tax collection disputes, and other issues for free or for a nominal fee. IRC § 7526 authorizes the IRS to award matching grants of up to $100,000 per year to qualifying clinics that represent low income taxpayers involved in controversies with the IRS, or that provide education and outreach on the rights and responsibilities of U.S. taxpayers who speak English as a second language.

209 Complaint filed in The People of the State of California v. Roni Deutch, a Tax Corporation and Roni Lynn Deutch, an individual, Docket No. 34-2010-00085933 (Sup. Ct. Cal.), available at http://ag.ca.gov/cms_attachments/press/pdfs/n1978_complaint.pdf.

210 The State Bar of California website, available at http://members.calbar.ca.gov/fal/Member/Detail/152429.

Through April 30, 2012, TAS has received 356 inquiries from the former Roni Deutch clients, all of which resulted in new TAS cases. TAS provided some form of relief in 52 percent of the 313 cases closed so far.[211]

2. TAS Assists Taxpayers Allegedly Victimized by Mo' Money Taxes

On March 14, 2012, the Illinois Attorney General's office sued Mo' Money Taxes, a tax preparation service and lender based in Memphis, Tennessee.[212] The suit accuses the company of filing unauthorized federal income tax returns and charging undisclosed and exorbitant fees for tax preparation services. The Attorney General alleged the returns were riddled with errors and the company failed to provide some customers with their promised refund checks. The Attorney General's office contacted the National Taxpayer Advocate and TAS worked with the office to:

- Provide information to alleged victims on seeking assistance from the IRS;
- Ensure the IRS was aware that taxpayers would need assistance; and
- Coordinate actions such as holds on collection activity on the taxpayers' accounts.

The IRS's guidance for handling return preparer complaint issues applies in assisting those who had unauthorized returns filed as described in the suit. It calls for the taxpayer to submit, depending on the situation, a Form 14157, *Complaint: Tax Return Preparer*, or Form 14157-A, *Tax Return Preparer Affidavit*, to the IRS for assistance.[213] Taxpayers victimized by a return preparer may be able to use the services of an LITC.[214] TAS also issued guidance to its Case Advocates on recognizing refund theft by preparers and advocating for the taxpayers.[215] The National Taxpayer Advocate also directed her employees to issue Taxpayer Assistance Orders immediately when the IRS does not have procedures to address corrections to these taxpayer accounts.[216]

To date, TAS has received 76 inquires related to Mo' Money issues, all of which resulted in new TAS cases. TAS provided some form of relief in 56.6 percent of the 56 cases closed.[217]

211 Data obtained from TAMIS (Apr. 30, 2012).

212 Illinois Attorney General, Madigan Sues National Tax Preparer Mo' Money, Lawsuit Highlights Need to Crack Down on High Costs, Fees of Refund Anticipation Loans (Mar. 14, 2012), available at: http://illinoisattorneygeneral.gov/pressroom/2012_03/20120314.html.

213 SERP Alert 12A0238 (Apr. 10, 2012).

214 LITCs may provide professional representation on federal tax issues to individuals whose income is below a certain level. Some LITCs can provide information about taxpayer rights and responsibilities for individuals who speak English as a second language. LITCs must provide services for free or a small fee. *See* IRC § 7526.

215 *See* TAS Interim Guidance Memorandum TAS-13-0212-008, *Interim Guidance on Advocating for Taxpayers When a Return Preparer Appears to Have Committed Fraud* (Feb. 7, 2012), *available at* http://www.irs.gov/pub/foia/ig/tas/tas-13-0212-008.pdf.

216 See TAS Interim Guidance Memorandum TAS-13-0512-017, *Interim guidance for Preparing Taxpayer Assistance Orders (TAOs) Involving Return Preparer Fraud* (May 23, 2012), *available at*: http://www.irs.gov/pub/foia/ig/tas/tas-13-0512-017.pdf.

217 Data obtained from TAMIS (June 17, 2012).

3. TAS Assists Former Customers of TaxMasters

On March 18, 2012, TaxMasters, Inc., filed for bankruptcy subsequent to a lawsuit by the Attorney General of Texas. The U.S. Bankruptcy Court appointed a Chapter 7 trustee to wind down the firm's affairs. Concerned about the well-being of thousands of TaxMasters customers who were left without representation, the Texas Attorney General's Office contacted the TAS in late April 2012.

TAS has been working with the trustee and the Deputy Attorney General to help these customers resolve their outstanding tax issues. TAS is in the process of developing communications to customers and worked with the IRS to develop procedures for handling their cases.

4. Federal Emergency Management Agency (FEMA) Disaster-Related Assistance Overpayments

The Federal Emergency Management Agency (FEMA) made overpayments of assistance for disasters that occurred between August 28, 2005, and December 31, 2010, and some taxpayers were obligated to repay the excess distributions. For some cases in which the overpayments were the result of FEMA error and did not involve fraud, the presentation of a false claim or misrepresentation, and in which collection of the debt would be against equity and good conscience, FEMA was authorized to waive the debts pursuant to the Disaster Assistance Recoupment Fairness Act of 2011.[218] FEMA notified approximately 89,000 taxpayers that they might be eligible for a waiver. However, this waiver would expose taxpayers to possible tax liability on cancellation of debt income.[219] On March 9, 2012, IRS Chief Counsel advised FEMA that the waivers would not result in cancellation of debt income. The determination was based on the IRS's general welfare exception pursuant to which "discharge of indebtedness does not result in taxable income when the repayment would cause economic hardship and the discharge was granted for the promotion of the general welfare."[220]

Unfortunately, most of the taxpayers who might be eligible for a waiver of their debt to FEMA have not applied for it. Therefore, these taxpayers' IRS refunds will be subject to offset under the Treasury Offset Program.[221] If FEMA is still authorized to grant the

218 Disaster Assistance Recoupment Fairness Act of 2011 (DARFA), Pub. L. No. 112-74 § 565(b)(2), 125 Stat. 786, 982 (2011).

219 A taxpayer whose debt is canceled must generally include the amount canceled in his or her income when filing a tax return, while a creditor that cancels a debt is generally required to report that amount to the IRS on Form 1099-C, *Cancellation of Debt.* IRC §§ 61(a)(12), 6050P(a). The National Taxpayer Advocate has long identified cancellation of debt and attendant reporting requirements as serious problems faced by taxpayers (National Taxpayer Advocate 2010 Annual Report to Congress 149-159; National Taxpayer Advocate 2007 Annual Report to Congress 13-34; National Taxpayer Advocate 2006 Annual Report to Congress 13), and has recommended legislation to modify creditors' reporting obligations (National Taxpayer Advocate 2010 Annual Report to Congress 383-386) and to simplify the tax treatment of cancellation of debt income (National Taxpayer Advocate 2007 Annual Report to Congress 391).

220 See *Debt Waived by FEMA Isn't Taxable, Chief Counsel Say,* Tax Notes Today (June 4, 2012), *available at* 2012 TNT 107-94. TAS is working with IRS Chief Counsel and FEMA to determine whether compromises of FEMA debt in 2011 would be subject to a similar exception.

221 IRC § 6402(d) generally requires the IRS to reduce the amount of taxpayers' refunds by the amount of debt owed to other federal agencies.

waivers that would allow these taxpayers to recoup their offset refunds, TAS will provide the proper information and assistance to any who come to TAS for help.[222]

5. Discrimination Class Action Settlements Against the USDA (Pigford I, Pigford II, Keepseagle and Cobell)

In the *Pigford v. Glickman* case (*Pigford I*), African American farmers alleged that the United States Department of Agriculture discriminated against them from 1983 to 1997. The acts of discrimination occurred when African American farmers were unfairly denied federal loans and other federal assistance to start and maintain farms. Upon settlement of the case, claimants could choose between two tracks for settlement payments. Most chose the track that entitled them to receive a one-time award of $50,000 and up to an additional $12,500 estimated tax payment made on their behalf to cover taxes resulting from the settlement income. In addition to the monetary award, claimants were entitled to debt relief.

In the *Pigford I* settlement, claimants encountered multiple issues when attempting to file tax returns showing receipt of settlement payments and when claiming the estimated tax payments that were part of those settlements. Outreach and education to the claimants regarding the tax consequences of the settlement were inadequate. Further, the USDA did not effectively issue tax payments to the IRS or timely issue Forms 1099 to the claimants.

Many potential claimants missed the application deadline for a settlement payment in *Pigford I*. To address this issue, Congress enacted The Claims Resolution Act of 2010 on December 8, 2010.[223] The 2010 Act enables African American farmers who did not receive their portion of the original settlement to file claims and appropriates $1.15 billion for the eligible farmers (*Pigford II*).[224] The bill also includes a settlement of the $3.4 billion *Cobell v. Salazar* trust fund lawsuit brought forth by American Indian tribes against the United States government for mismanaging royalty payments for natural resources on tribal land. Finally, in *Keepseagle v. Vilsack*, a separate case not involving congressional action, Native American farmers and ranchers settled a class action against the USDA alleging that the agency discriminated against Native Americans in its farm loan and farm loan servicing programs.[225]

TAS has taken a proactive role in minimizing the burden faced by claimants from all of the settlement classes. TAS has worked with the Class Monitor[226] and attorneys for the *Pigford I* claimants since 2004 and in December 2006 TAS helped coordinate a streamlined

222 If the taxpayer responds to an offset notice and demonstrates, by Oct. 1, 2012, that he or she never received notification of the waiver program, a waiver may still be available. FEMA's authority to issue waivers pursuant to DARFA after Oct. 2012, however, may depend on agency appropriations for the 2013 fiscal year.

223 Pub. L. No. 111-291 § 201, 124 Stat. 3064, 3070 (2010).

224 *Id*.

225 USDA Press Release, *Agriculture Secretary Vilsack and Attorney General Holder Announce Settlement Agreement with Native American Farmers Who Claim to Have Faced Discrimination by USDA in Past Decades* (Oct. 19, 2010).

226 The Class Monitor reports to the court and to the Secretary of Department of Agriculture on the implementation of the settlement as provided in the Consent Decree.

process to get all payments applied so affected taxpayers could file timely. TAS worked closely with the Class Monitor and Class Counsel to ensure that all parties understand tax consequences and reporting obligations. TAS also contacted and met with the class counsels for the various other settlements.

In FY 2013, TAS will continue to elevate emerging issues that need special handling to identify ways to reduce taxpayer burden and protect taxpayer rights.