III. Filing Season Review

For the 2011 filing season, the IRS again processed millions of tax returns in the relatively small window of about three months. While the IRS responded well to some late tax law changes, it continues to use incomplete measures to gauge filing season success and failed to plan for some issues for which it had years to prepare. These lapses created significant taxpayer burden and even harm, and resulted in a sharp increase in TAS case receipts.

A. IRS Administration of the First-Time Homebuyer Credit Became a Debacle

1. Background

The IRS failed to properly plan, implement, and communicate the recapture and repayment requirements of the First-Time Homebuyer Credit (FTHBC) this filing season.[160] This lapse created burdens and unnecessary delays for taxpayers. For example, FTHBC repayments delayed taxpayers' ability to file electronically.[161] Some became so frustrated they created Facebook pages to express their outrage, commiserate, and publish the direct phone numbers and email addresses for IRS executives.[162] These postings generated a number of emails to the National Taxpayer Advocate, describing the extreme hardships caused by refund processing delays and asking for her immediate intervention.

2. Problems Before and During the Filing Season

Congress provided a $7,500 credit for individuals who purchased a primary residence between April 9 and December 31, 2008.[163] This credit is similar to an interest-free loan, requiring repayment in equal installments over 15 years beginning in 2010. The IRS designed and issued a notice to detail the repayment requirements and amount due.[164] Almost immediately after the notice came out, TAS began receiving Systemic Advocacy

160 The $7,500 FTHBC allowed under the Housing and Economic Recovery Act of 2008 requires repayment of the credit over 15 years. Pub. L. No. 110-289, § 3011, 122 Stat. 2654, 2888 (July 30, 2008). The FTHBC allowed under the American Recovery and Reinvestment Act of 2009 (Pub. L. No. 111-5, § 1006. 123 Stat. 115, 316 (Feb. 17, 2009)) and continued under the Worker, Homeownership, and Business Assistance Act of 2009 (Pub. L. No. 111-92, § 11, 123 Stat. 2984, 2989 (Nov. 6, 2009)), increased the credit to $8,000 and eliminated the repayment requirement.

161 IRS Newsroom, Forms Affected By the Extender Provisions, http://www.irs.gov/newsroom/article/0,,id=232773,00.html, (last visited Mar. 30, 2011).

162 Facebook, *2011 Tax Refund Delays*, http://www.facebook.com/2011TaxRefundDelays (last visited June 3, 2011, at which time 3,415 people "liked" the page).

163 *See* Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 3011, 122 Stat. 2654, 2888 (July 30, 2008) as revised by the American Recovery and Reinvestment Act of 2009 (Pub. L. No. 111-5, § 1006. 123 Stat. 115, 316 (Feb. 17, 2009))

164 In late 2010, the IRS issued 1.5 million Notices CP03a, *Repaying Your First-Time Homebuyer Credit*, to taxpayers identified as FTHBC recipients in tax year 2008.

Management System (SAMS) inquiries from taxpayers who did not claim the credit, but received a repayment notice.[165]

The IRS also included FTHBC repayments and dispositions reflected on Page 2 of Form 5405, *First-Time Homebuyer Credit and Repayment of the Credit*, in its list of forms delayed by the late legislation passed on December 17, 2010, even though the legislation had no impact on the credit.[166] While the IRS knew for more than two years that FTHBC repayment programming was necessary, it did not start the program changes until the 2011 filing season was already underway. This last-minute implementation prevented the IRS from properly testing the programming to identify and correct flaws. These flaws in turn prevented the IRS from processing (1) returns filed jointly by couples attempting to repay the first installment of the FTHBC, (2) returns filed by anyone attempting to pay more than the required minimum; and (3) returns filed by anyone completing Part III of Form 5405, dealing with sales or dispositions of the home. In late March 2011, the IRS estimated the number of taxpayers falling into the latter two categories at 128,000.[167]

Initially, IRS employees had no way to fix all these problems, and the tax returns remained unprocessed. Although the IRS had multiple opportunities to share news of the problems and proposed fixes with taxpayers early in the filing season, the IRS did not issue its first update until March 18, 2011, and then only to software developers and authorized e-file providers.[168] The IRS provided the first update on the processing problems to taxpayers just three weeks before the filing season ended, on March 30.[169] The lack of information was not limited to external customers; IRS employees were equally uninformed. Programming problems made the computer codes that provide updates unreliable, which led the IRS to provide incorrect refund dates to taxpayers on its toll-free line, on IRS.gov, and on the new smart-phone application IRS2GO.

As a result of these delays, TAS unpostable/rejected return receipts rose by 3,387 cases, with all of the gain caused by an increase in FTHBC "unpostable/rejected" cases.[170]

165 TAS uses a variety of sources to identify systemic problems, including TAS employees, other IRS employees, tax practitioners, members of Congress, Low Income Taxpayer Clinics, the Taxpayer Advocacy Panel, and the public. These stakeholders submit systemic issues to TAS through a variety of channels, including the Systemic Advocacy Management System (SAMS) on the IRS employee intranet and the TAS site on IRS.gov (http://www.irs.gov/advocate).

166 IRS Newsroom, *Forms Affected By the Extender Provisions,* http://www.irs.gov/newsroom/article/0,,id=232773,00.html (last visited Mar. 30, 2011).

167 IRS, Wage and Investment Operating Division data received Mar. 25, 2011.

168 IRS Quick Alerts for Tax Professionals, IMF-1040 e-file (Legacy) – Form 5405, Mar. 18, 2011.

169 IRS Update on First Time Homebuyer Credit and Tax Refund, http://www.irs.gov/newsroom/article/0,,id=237695,00.html (last visited June 4, 2011).

170 TAMIS data from a Business Objects report run on May 5, 2011, comparing fiscal year 2010 to 2011 through April 30.

FIGURE III.1, TAS FTHBC RECEIPTS (THROUGH APRIL 30, 2011)[171]

Issue	FY 2010 Receipts	FY 2011 Receipts	FY 2010 FTHBC Receipts	FY 2011 FTHBC Receipts	Receipts Increase	Receipts Increase Due to FTHBC
Unpostable/ Rejected Returns	5,669	9,056	669	4,299	3,387	3,630

To handle the volume of cases involving the FTHBC, TAS temporarily (for up to 120 days) moved TAS Intake Advocates into Case Advocate positions (*i.e.*, caseworkers), solely to handle these cases.[172] TAS also adjusted its work distribution to spread the cases out more evenly between offices.

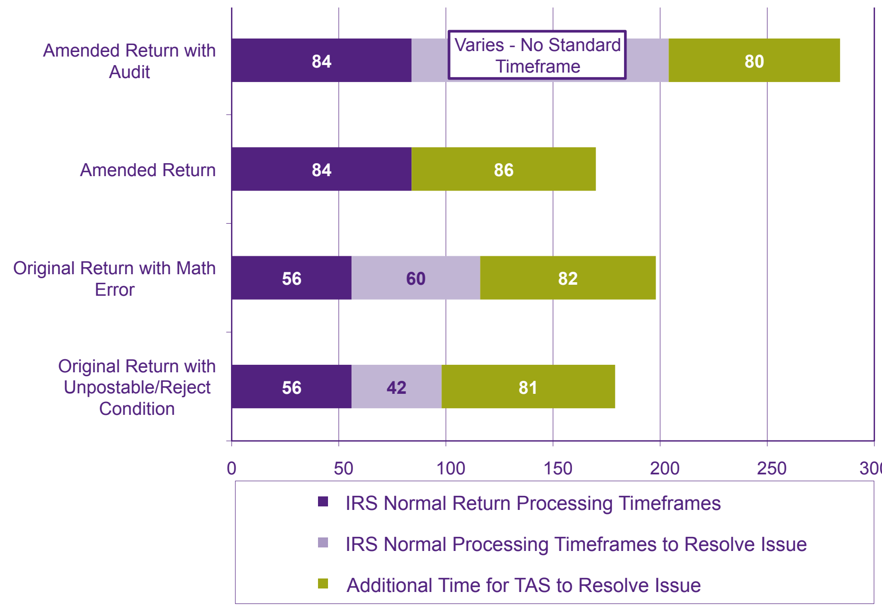
The chart below shows the additional processing time required to resolve cases involving the FTHBC during FY 2011. The first section of each bar represents the IRS's maximum normal timeframes, in days, for processing an original or amended return.[173] The second section of each bar reflects the IRS's normal processing timeframe, in days, for the next issue involving the account—a math error, rejected or unpostable return, or an audit of the return or claim. The last section of the bar represents the average number of days it took TAS to resolve cases involving these issues for taxpayers with FTHBC who came to TAS for assistance after already waiting the normal timeframe for processing (cases received by TAS under systemic burden criteria). TAS taxpayers experienced, on average, *an additional 11 weeks beyond normal processing timeframes* to resolve their issues, even with TAS involvement.

171 TAMIS data from a Business Objects report run on May 5, 2011.

172 TAS Intake Advocates serve as the first point of contact for taxpayers who call TAS for assistance, and they determine if TAS can help. Case Advocates work with taxpayers to solve tax problems, and advocate for the taxpayer to the IRS.

173 IRM 21.4.1.3, *Refund Inquiry Response Procedures* (May 10, 2010), indicates the expected date for receiving a refund from a paper return is six to eight weeks, three weeks from an electronically-filed return, and 8-12 weeks from an amended return. IRM 21.4.1.3.1.2.4, *Error Resolution System (ERS) Status Codes* (June 29, 2010), indicates a four-week timeframe for resolution, and IRM 21.5.4.1, *General Math Error Procedures Overview* (Oct. 1, 2010), provides a 60-day timeframe to receive a response from the taxpayer to a math error notice. There is no standard timeframe for completion of an audit, and taxpayers may come to TAS during different times in the audit process.

FIGURE III.2, IRS PROCESSING TIMEFRAMES (IN DAYS) AND TAS FTHBC CASE CLOSURE TIMEFRAMES, FY 2011, THROUGH APRIL 30[174]



As of June 2, 2011, TAS has 995 Reject/Unpostable cases where taxpayers still had not received their refunds, many of whom filed in late January or early February and whose refunds were held up because the taxpayers were following the correct procedure of *re-paying* a loan from the government.[175] These taxpayers have been financially harmed by the IRS's failure to timely program for a provision it knew for over three years was going to happen. To add insult to injury, these taxpayers are required to repay the credit, even though similarly situated taxpayers who just happened to buy a home a bit later had *no* obligation to repay.[176]

Taxpayers affected by these delays include those with pending foreclosures or eviction, utility shut-offs, or imminent combat deployment. It is inexcusable that the IRS did not consider the consequences to these taxpayers when it scheduled its programming changes. TAS will closely review all filing season plans to ensure that this type of harm is not imposed on taxpayers again.

174 TAS timeframes obtained from TAMIS Business Objects Report run on May 16, 2011, that identified average days to close a Criteria 5-7 case closed between Oct. 1, 2010, and Apr. 30, 2011, involving FTHBC and a math error, unpostable/rejected return, or an audit of an original or amended return claiming FTHBC.

175 TAS Reject/Unpostable cases involving FTHBC received in 2011 and still open as of June 2, 2011. Data is from a Business Object – TAMIS report run on June 2, 2011.

176 The American Recovery and Reinvestment Act of 2009 (Pub. L. No. 111-5, § 1006. 123 Stat. 115, 316 (Feb. 17, 2009)) eliminated the repayment requirement for qualifying homes purchased after 2008.

3. TAS Actions in FY 2012

TAS will meet with the IRS Modernization and Information Technology Services (MITS) to verify that FTHBC repayment programming will work correctly for the 2012 filing season and subsequent years. TAS will assess and report on the downstream impact and burden of credits requiring documentation that prohibit electronic filing. TAS will also try to determine the costs associated with the administration of a credit with a 15-year repayment requirement and the impact on the IRS budget. A TAS advocacy project will also examine the downstream impact of the use of math error authority when the IRS reviews refundable credits like the FTHBC.[177] The project will determine if taxpayer rights are protected, and whether the resources required to address post-disallowance taxpayer inquiries outweigh any perceived "efficiencies" from math error.

B. Legislation Passed Late in 2010 Impacted the 2011 Filing Season

On December 17, 2010, Congress enacted legislation that extended deductions for state and local sales taxes, higher education tuition and fees, and educator expenses.[178] On January 4, 2011, the IRS advised taxpayers affected by this "extender" legislation not to file their returns until mid-February so the IRS could update its systems.[179] The IRS was forced to ask electronic return originators not to transmit 6.5 million e-file returns until February 14 when the IRS finished reprogramming its computers and held approximately 100,000 paper returns.[180]

Since the IRS accurately updated its systems to restore these deductions, TAS received few related systemic burden cases. However, TAS did receive a few economic burden cases from taxpayers whose hardships could not wait for the IRS to implement the changes required by the late legislation. TAS successfully worked with the Wage and Investment operating division to allow TAS to issue refunds to these taxpayers prior to the actual processing of their returns.

C. IRS Implements a Revised Procedure for Processing Unsigned Returns that Results in a Loss of Valuable Taxpayer Data

In FY 2010, the IRS changed its procedures for unsigned tax returns. Instead of returning them to the taxpayers for signature, the IRS suspended the returns in the Rejects function and corresponded with the taxpayer to obtain the signature. This change increased the

177 TIGTA recommended that the IRS seek greater math error authority to disallow refundable credits under certain conditions as a way to streamline credit reviews. *See* TIGTA, Ref. No. 2011-41-035, *Administration of the First-Time Homebuyer Credit Indicates a Need for Improved Controls Over Refundable Credits* 6 (Mar. 31, 2011).

178 Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (Dec. 17, 2010).

179 IRS News Release IR-2011-1 (Jan. 4, 2011), http://www.irs.gov/newsroom/article/0,,id=233910,00.html.

180 TIGTA, Ref. No. 2011-40-032, *Interim Results of the 2011 Filing Season* (Mar. 31, 2011).

inventory for Rejects, causing delays for taxpayers whose returns had errors of any kind, not just missing signatures.[181] For the 2011 filing season, the IRS implemented a revised procedure where if the tax return is missing only a signature, the IRS returns it to the taxpayer with a "check the box" form.[182] This new procedure solved the Reject inventory problem by reducing the time IRS employees spend dealing with unsigned tax returns, but created other problems.

When the IRS sends the unsigned tax return back to the taxpayer, it does not retain an image of the tax return it mails back, or even track that the IRS received an unsigned return. In the case of balance due tax returns, the IRS cashes any attached payment, but loses all the information on the unsigned return, with no guarantee that the taxpayer will sign and re-mail the tax return back to the IRS. The taxpayer may not bother mailing the return a second time, especially since the taxpayer is filing a tax return to show a balance due, not a refund. The tax return may include income not reported by payers on information returns to the IRS. We are concerned that the IRS is choosing not to keep that valuable information.

If the taxpayer does sign and mail a balance due tax return back to the IRS, the received date used to compute penalties and interest (if the taxpayer did not timely full pay the balance) will never be the original received date of the unsigned return. At best, if the taxpayer mails the tax return back to the IRS within 30 days, the IRS uses the date it sent the tax return back for signature as the received date.[183] Without any tracking of the unsigned returns, the IRS must rely on what the taxpayer mails back to the IRS to make this determination, which introduces many opportunities for error. The National Taxpayer Advocate is concerned that this process will result in taxpayers with balances owed being assessed incorrect penalties and interest if:

- The taxpayer submits a new copy of the return;
- The taxpayer removes the IRS correspondence before mailing it back;
- The IRS encounters delays in sending the unsigned tax return back to the taxpayer; or
- Submission Processing erroneously processes the return as received when returned.

The IRS received date stamp on refund tax returns is important because it establishes the timeliness of the return under the refund statute of limitations. When the IRS mails back an unsigned refund return, it has nothing left in its possession to review if the taxpayer disputes that the signature was missing on a timely filed refund tax return. The IRS must rely solely on whatever documentation the taxpayer can provide, even though it previously possessed the document in dispute. If the IRS kept an image of the tax return, the image would include

181 National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress 44-46.

182 *See* IRM 3.11.3.14.10, *Signature* (Jan. 1, 2011); IRM 3.11.3.6.2.1, *Correspondence When Sending Returns Back to the Taxpayer* (Jan. 1, 2011).

183 IRM 3.11.3.5.2, *Determining the Received Date* (Jan. 1, 2011).

the IRS received date stamp and the signature section of the tax return, which would allow the IRS to verify easily whether the taxpayer filed a timely signed return.

1. TAS Actions in FY 2012

TAS will continue to work with the IRS to develop a better solution for unsigned tax returns, including using technology to capture images of these unsigned tax returns without processing them.

D. IRS Measures of Filing Season Success Are Limited

The IRS traditionally measures filing season success by reporting:

- Number of returns received;
- Refunds issued;
- Visits to the IRS website (www.irs.gov); and
- Total assistor calls answered and the accuracy rates of those calls.[184]

The National Taxpayer Advocate has previously identified the limitations of these measures.[185] For example, to answer the increased volume of phone calls, the IRS must pull employees from working written correspondence. This improves the number of calls answered, but sacrifices timely responses to taxpayer correspondence and amended return processing.

The IRS has increased and improved its online tools for taxpayers to find out if they qualify for credits and obtain refund information. But the increase in rejected returns during the 2010 and 2011 filing seasons is a clear indication that taxpayers are still confused by the ever-changing nature of eligibility for certain tax credits and may still make errors that cause processing problems with their returns.[186]

Filing season measures should include more than just return receipts and phone call statistics. The annual aging of amended return processing and correspondence overage are equally important indicators of filing season "success" because they measure the IRS's level of service to taxpayers.

184 Wage and Investment Division, Filing Season Weekly Report (Mar. 14, 2011).

185 National Taxpayer Advocate 2008 Annual Report to Congress 554-556.

186 As of May 19, 2011, the IRS had rejected 23.6 million e-filed returns during FY 2011 and 23 million e-filed returns during FY 2010. The top ten reasons for reject included data entry issues and mismatches of key eligibility data, including Social Security numbers, name controls, and dates of birth. Daily Error Reject Codes, http://efile.enterprise.irs.gov/DailyError.asp.

E. TAS Is Concerned that IRS Implementation of the Adoption Credit May Unduly Burden Eligible Taxpayers

The Patient Protection and Affordable Care Act increased the maximum adoption credit amount from $12,150 to $13,170 to adopt an eligible child (IRC § 36C),[187] and made the credit fully refundable for 2010 and 2011. The eligibility rules are different for domestic, foreign, and special needs child adoptions. However, in all three categories, taxpayers claiming the credit are no longer eligible to file electronically because the IRS requires filing of paper documentation with Form 8839, *Qualified Adoption Expenses*.

1. Background

Through April 16, 2011, the IRS processed 59,052 tax returns claiming the adoption credit for tax year 2010 and selected 41,540 of these returns for audit.[188] The IRS scrutinizes these returns because the credit is large and refundable, and as in examinations of other refundable credits, the IRS holds the adoption credit portion of the refund until the audit determines whether the taxpayer is eligible for the credit.[189] Over 40 percent (24,394) of all adoption credit tax returns had no adoption documentation whatsoever and were sent to the Examination function for further review.[190] On March 31, 2011, the IRS posted a reminder on its website for taxpayers to include the documentation.[191]

Because the IRS held the refund of the adoption credit, taxpayers once again shared their frustration on Facebook, blogs, and tax software forums – and came to TAS for assistance. Although the IRS held the adoption credit refunds to combat fraud, such decisions do have a downstream effect on taxpayers who are eventually deemed eligible for the credit, and these cases should be provided timely review.

TAS identified the following concerns stemming from IRS administration of the refundable adoption credit:

- During audits, IRS examiners sent letters to taxpayers asking them to provide documentation before reviewing what information the taxpayers had included with the original returns; thus, taxpayers who submitted documentation with their returns had to send it in twice;
- The IRS did not clearly inform taxpayers about how long it would take to audit their returns and when they could expect their refunds;

187 Pub. L. No. 111-148, § 10,909, 124 Stat. 119, 1021 (Mar. 23, 2010).

188 IRS, 2011 Adoption Credit Selected Returns by BOD and Cycle (through cycle 16).

189 IRM 21.5.10.4.1.2, Examination Refund Hold Projects, (Oct. 1, 2010).

190 IRS, 2011 Adoption Credit Selected Returns by BOD and Cycle (through cycle 16).

191 IRS, Adoptive Parents: Don't Delay Your Adoption Credit Refund, *available at* http://www.irs.gov/newsroom/article/0,,id=236883,00.html (last visited May 27, 2011).

- IRS examiners were not knowledgeable about the expanded adoption credit under the Patient Protection and Affordable Care Act and how to handle the credit claimed for special needs children; and

- The hold on issuing the adoption credit portion of the refund caused financial burden for some taxpayers.

2. TAS Actions in FY 2012

TAS will review its cases to determine if the substantiation IRS examiners request to support the adoption tax credit is appropriate and not overly burdensome. TAS will also review the IRS guidance provided in forms, publications, and online to verify appropriate information is available to taxpayers to file correct and complete returns to claim the credit.