

Area of  
Focus #1

## The Design of the IRS's Private Debt Collection (PDC) Program Will Disproportionately Burden Taxpayers in Economic Hardship and Impose Unnecessary Costs on the Public Fisc

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

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

### DISCUSSION

In 2015, Congress enacted legislation that requires the IRS to assign certain delinquent taxpayer debts to private collection agencies (PCAs).<sup>2</sup> The IRS is authorized to pay the PCAs a fee of up to 25 percent of the amount they collect, and the IRS itself is permitted to retain up to 25 percent of the amount PCAs collect.<sup>3</sup> The IRS assigned the first group of taxpayer liabilities to PCAs on April 10, 2017.<sup>4</sup> Although the IRS does not assign liabilities designated as Currently Not Collectible (CNC) – Hardship, it assigned other debts of taxpayers who are likely experiencing economic hardship.<sup>5</sup> As of May 17, 2017, the IRS had assigned to PCAs the debts of approximately 9,600 taxpayers, approximately 5,900 of whom filed a recent return.<sup>6</sup> The returns show:

- These taxpayers' median annual income is \$31,689;
- More than half have incomes below 250 percent of the federal poverty level;<sup>7</sup> and

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Fixing America's Surface Transportation (FAST) Act, Pub. L. No. 114-94, Div. C, Title XXXII, § 32102, 129 Stat. 1312, 1733-36 (2015) (FAST Act), (adding subsections (c) and (h) to IRC § 6306). As discussed below, IRC § 6306(c)(1) requires the IRS to enter into qualified tax collection contracts for the collection of "inactive tax receivables."

3 IRC §§ 6306(e)(2), 6307.

4 After sending about 400 cases to Private Collection Agencies (PCAs) each week for the first month of the program, the IRS plans to increase the weekly volume to about 4,000 cases for June and July, then increase the weekly volume to 8,000 cases in August and September, the end of the 2017 fiscal year. (Email from Supervisory Tax Analyst, Small Business/Self-Employed Collection – Private Debt Collection, Mar. 31, 2017).

5 Liabilities in Currently Not Collectible (CNC) - Hardship status are not "tax receivables" within the meaning of IRC § 6306(c)(2)(B).

6 Accounts Receivable Dollar Inventory (ARDI), Individual Returns Transaction File (IRTF), Information Returns Master File (IRMF), Compliance Data Warehouse (CDW), data accessed May 17, 2017. TAS Research identified 9,599 taxpayers whose accounts were assigned to PCAs as of May 17, 2017, of whom 5,947 filed a return for 2014 or later.

7 *Id.* Out of 5,947 taxpayers, 3,146 (53 percent) had incomes below 250 percent of the federal poverty level.

- More than a fifth have incomes below the federal poverty level.<sup>8</sup>

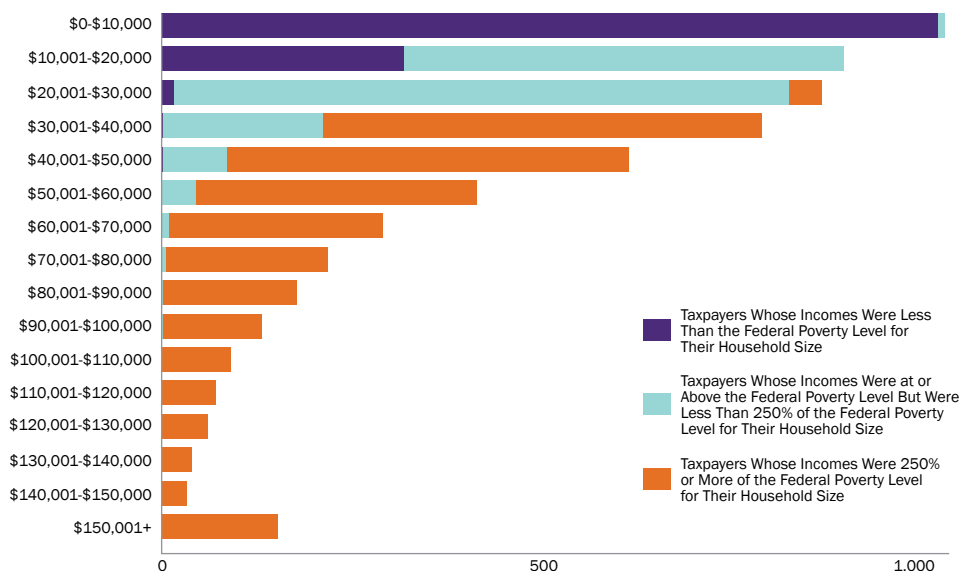
In addition to assigning “inactive tax receivables” to PCAs as required by statute, the IRS plans to use its discretionary authority to assign to PCAs the recent debts of taxpayers who already have a prior debt assigned to a PCA.<sup>9</sup> Regular IRS collection processes, which in fiscal year (FY) 2016 generated about \$4.7 billion of receipts, will be circumvented.<sup>10</sup> PCAs will thus receive commissions on payments the IRS could have collected merely by sending its usual notices, and the IRS will be able to retain up to 25 percent of collections that normally would go directly to the public fisc. Thus, under this procedure, up to half of the collections that would normally go to the public treasury will now be retained by PCAs and the IRS.

### The IRS Is Assigning to Private Collection Agencies (PCAs) the Debts of Taxpayers Who Are Likely Experiencing Economic Hardship

TAS Research identified 5,947 taxpayers whose debts had been assigned to a PCA as of May 17, 2017 and who had filed tax returns for 2014 or later.<sup>11</sup> Figure 3.1.1 shows the income distribution of these taxpayers.

FIGURE 3.1.1<sup>12</sup>

**Income Distribution of Taxpayers Whose Debts Were Assigned to PCAs Compared to the Federal Poverty Level, According to Their Last Filed Returns (Tax Year 2014 or Later)**



8 ARDI, IRTF, IRMF, CDW, data accessed May 17, 2017. Out of 5,947 taxpayers, 1,373 (23 percent) had incomes below the federal poverty level.

9 Since 2004, IRC § 6306(a) has authorized the IRS to enter into qualified tax collection contracts with PCAs. See The American Jobs Creation Act of 2004, Pub. L. 108-357, Title VIII, § 881(a)(1), 118 Stat. 1418, 1625-27 (2004) (enacting IRC § 6306).

10 IRS Collection Activity Report (CAR) NO-5000-2/242, Balance Due Notices (Oct. 3, 2016), discussed below.

11 IRS, ARDI, IRTF, IRMF, CDW, data accessed May 17, 2017. These debts carry a Transaction Code of 971 and an Action Code of 54 on the IRS’s Master File database.

12 U.S. Dept. of Health and Human Resources, *Poverty Guidelines* (2017), <https://aspe.hhs.gov/poverty-guidelines>. The federal poverty level is based on family size and varies from year to year. Federal poverty level determinations shown in the chart correspond to the family size and tax year for the taxpayer’s most recently filed return. As discussed below, 250 percent of the federal poverty level is a proxy for economic hardship for purposes of excluding some taxpayers’ federal payments from the Federal Payment Levy Program (FPLP).

As Figure 3.1.1 shows, more taxpayers belong to the income category of less than \$10,000 than any other category. These 1,041 taxpayers comprise 18 percent of the total, and the incomes of all but eight of them are below the federal poverty level. Almost half of the taxpayers — 2,827, or 48 percent — have incomes of \$30,000 or less. Of these taxpayers, only 45 have incomes equal to or more than 250 percent of the federal poverty level.

To its credit, the IRS ultimately agreed with the National Taxpayer Advocate that it is inappropriate to assign to PCAs the liabilities of taxpayers who receive Social Security Disability Income (SSDI).<sup>13</sup> Because of the IRS's earlier refusal to exclude these debts, however, the necessary programming was not in place by April 10, 2017. Thus, as of May 17, 2017:

- The debts of 445 taxpayers who received SSDI in 2016 were assigned to PCAs; and
- Of these 445 taxpayers, 160 filed recent returns; the median income shown on these returns was less than \$10,600.<sup>14</sup>

The National Taxpayer Advocate also expressed concern about assigning to PCAs the liabilities of taxpayers who were not subject to levies on their Social Security Administration (SSA) retirement payments pursuant to the Federal Payment Levy Program because their incomes were at or below 250 percent of the federal poverty level.<sup>15</sup> In response, the IRS decided that for the first six months of the PDC program, these taxpayers' debts would be included in the PCA inventory. During that time, the IRS could explore how to identify taxpayers in this group who also have substantial assets. The IRS did not take any steps to develop such a method and ultimately informed TAS that it will not exclude these taxpayers' debts from assignment to PCAs.<sup>16</sup> In the meantime:

- The IRS assigned to PCAs the liabilities of 875 taxpayers who received SSA in 2016; and
- Of these 875 taxpayers, 326 filed recent returns; the median income shown on these returns was less than \$13,200.<sup>17</sup>

13 Taxpayers receiving Social Security Disability Income (SSDI) by definition generally cannot earn over \$1,170 per month (\$1,950 if he or she is blind) without having their SSDI payments reduced. See Social Security Administration (SSA), *Update 2017*, <https://www.ssa.gov/pubs/EN-05-10003.pdf>.

14 IRS, ARDI, IRTF, IRMF, CDW, data accessed May 15, 2017. The 160 returns were filed for tax year 2014 or later. The IRS adjusted its guidance to PCAs, the PCA Policy and Procedures Guide (PPG), to require the return of cases in which the taxpayer states he or she is a recipient of SSDI or Supplemental Security Income.

15 See Internal Revenue Manual (IRM) 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (Oct. 20, 2016). The 250 percent measure operates as a proxy for economic hardship.

16 SB/SE response to TAS information request (Apr. 5, 2017); SB/SE response to TAS information request (May 15, 2017), (stating that "[t]axpayers receiving SSA retirement income will not be screened from the PDC program.").

17 IRS, ARDI, IRTF, IRMF, CDW, data accessed May 17, 2017. The 326 returns were filed for tax year 2014 or later.

### The IRS Plans to Assign New Receivables to Private Collection Agencies (PCAs), Thus Allowing PCAs to Collect Amounts the IRS Could Collect by Sending Its Usual Notices

Once a taxpayer's liability is assigned to a PCA, the IRS will assign that taxpayer's new assessments, if any, to the PCA. The IRS describes the process as follows:

- A taxpayer owes income taxes for 2012 and the IRS transfers that liability to a PCA on April 10, 2017;
- The same taxpayer files a return for 2016 on April 15, 2017. The return shows a liability of \$5,000 but the liability is not paid with the return;
- If the taxpayer does not pay the 2016 liability by May 15, 2017, the IRS issues Notice CP 14, a demand for payment of the \$5,000 liability; and
- If payment is not received, the IRS assigns the \$5,000 to the PCA, notifies the taxpayer of the assignment, and will pay commissions to the PCA on payments the taxpayer makes with respect to the 2016 liability on or after July 14, 2017.<sup>18</sup>

The taxpayer's 2016 liability in the example above would not be an "inactive tax receivable."<sup>19</sup> Thus, the IRS may, but is not required by statute, to assign it to a PCA.<sup>20</sup> As explained below, it is questionable whether doing so is a good business decision.

When taxpayers incur delinquent tax liabilities, the IRS demands payment over a period which spans about six months in a series of four notices. IRS Notice CP 14 is the first such notice, and is the only notice the IRS intends to issue in the example above.<sup>21</sup> In FY 2016, the Notice CP 14 resulted in \$3.8 billion of payments.<sup>22</sup> Notices generated *after* the CP 14, however, resulted in \$4.7 billion of payments.<sup>23</sup> The IRS plans to suppress those notices, allow the PCAs to solicit payments that might have been made in response to them, and pay the PCAs a commission on the amounts collected. Figure 3.1.2 shows the amounts the IRS receives for each of the four notices it issues to taxpayers whose debts are not assigned to PCAs.

18 SB/SE response to TAS information request (Apr. 5, 2017).

19 IRC § 6306(c)(2)(A) provides that "[t]he term 'inactive tax receivable' means any tax receivable if (i) at any time after assessment, the Internal Revenue Service removes such receivable from the active inventory for lack of resources or inability to locate the taxpayer, (ii) more than 1/3 of the period of the applicable statute of limitation has lapsed and such receivable has not been assigned for collection to any employee of the Internal Revenue Service, or (iii) in the case of a receivable which has been assigned for collection, more than 365 days have passed without interaction with the taxpayer or a third party for purposes of furthering the collection of such receivable."

20 IRC § 6306(c) provides: "Notwithstanding any other provision of law, the Secretary shall enter into one or more qualified tax collection contracts for the collection of all outstanding inactive tax receivables." IRC § 6306(a) is the source of the IRS's general authority to assign receivables to PCAs, providing "In general.—Nothing in any provision of law shall be construed to prevent the Secretary from entering into a qualified tax collection contract."

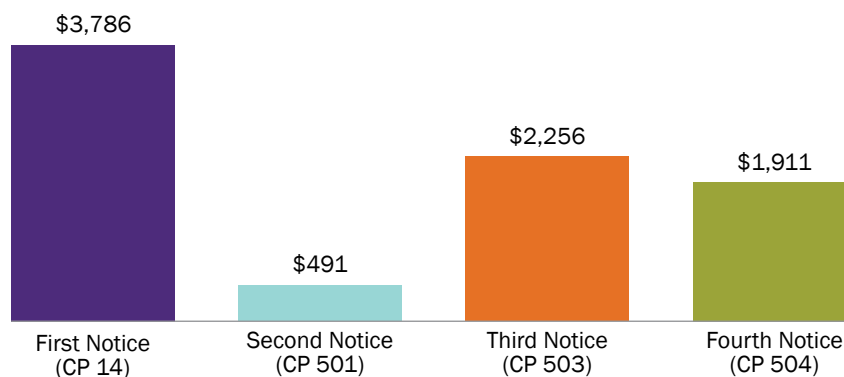
21 SB/SE response to TAS information request, (Apr. 5, 2017).

22 CAR NO-5000-2/242, *Balance Due Notices* (Oct. 3, 2016). The data does not distinguish between collections from taxpayers who had liabilities for periods that preceded the notice stream and those who did not.

23 *Id.*, showing that the second, third, and fourth notices in the notice stream (CP 501, CP 503, and CP 504) combined resulted in payments of about \$4.7 billion. The data does not distinguish between collections from taxpayers who had liabilities for periods that preceded the notice stream and those who did not.

FIGURE 3.1.2<sup>24</sup>

### Amounts Collected From Taxpayers Whose Debts Are Not Assigned to PCAs and Who Are Issued Four IRS Collection Notices (in Millions of Dollars)



Treating the same taxpayer's liabilities differently may not be justified in the light of actual taxpayer behavior. For example, even though the older debt of the taxpayer in the example above has been assigned to a PCA, the amount of the taxpayer's recent debt (\$5,000 in the example) may be less than the older debt. The taxpayer may therefore be able to pay the additional tax while it is still in the notice stream. Moreover, the new \$5,000 liability in the example above is self-assessed, not the result of an audit or other assessment process.<sup>25</sup> As a recent TAS study demonstrated, the IRS is more likely to collect self-reported liabilities than other types of assessments. For example, it collects self-assessed liabilities at a rate at least twice as great as it collects audit assessments.<sup>26</sup>

Therefore, by bypassing the notice stream, the IRS:

- Circumvents its normal procedures for collecting new debts which have proven to be effective;
- Treats taxpayers whose debts were assigned to PCAs differently than taxpayers whose debts were not assigned;
- Treats the same taxpayer's tax liabilities differently depending on when they arose; and
- Imposes unnecessary costs on taxpayers and the public fisc in the form of commissions it pays PCAs.

The IRS, however, benefits from this approach because it retains up to 25 percent of the amount PCAs collect to be used for hiring and training Compliance employees.<sup>27</sup> Thus, the PCAs and IRS benefit from this truncated procedure; the public fisc, on the other hand, does not.

<sup>24</sup> IRS, CAR NO-5000-2/242, *Balance Due Notices* (Oct. 3, 2016). The data does not distinguish between collections from taxpayers who had liabilities for periods that preceded the notice stream and those who did not.

<sup>25</sup> Other sources of assessment include Automated Underreported assessments, trust fund recovery penalty assessments, and assessments based on a substitute for return. See National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 45 (Research Study: *IRS Collectibility Curve*).

<sup>26</sup> *Id.*

<sup>27</sup> IRC §§ 6306(e)(2), 6307.

### The Private Debt Collection (PDC) Program Raises Concerns About the Adequacy of Authentication Procedures, Training of Private Collection Agency (PCA) Employees, and Transparency of PCA Practices

The IRS letter that notifies a taxpayer his or her tax debt has been assigned to a PCA contains the name, address, and phone number of the PCA and includes a ten-digit Taxpayer Authentication Number (TAN).<sup>28</sup> The first letter the PCA sends the taxpayer confirms that the debt was assigned to it, and contains the same TAN as the one listed on the IRS notice. When the PCA later speaks with the taxpayer by telephone, each party to the call can provide five digits of the TAN (the first five or the last five) as part of the authentication process. This allows each party to confirm the identity of the other. However, if the taxpayer cannot provide the TAN, the authentication process may, if the taxpayer is willing, be completed by having the taxpayer provide his or her Social Security number (SSN) or Taxpayer Identification number (TIN).<sup>29</sup> Thus, the IRS cannot advise taxpayers that legitimate PCAs will never request their SSNs or TINs.<sup>30</sup>

Permitting authentication to proceed on the basis of the taxpayer's SSN or TIN (rather than using the TAN) heightens the potential for taxpayers to be victimized by scammers posing as PCA employees. Moreover, additional IRS resources will be needed downstream to assist taxpayers who are victims of identity theft as a result of having used their SSN or TIN to authenticate their identities with what they believed was a PCA.

In January 2017, a TAS executive and TAS program analyst travelled to Austin, Texas to deliver in-person training to PCA managers. The training included a 45-minute video of the National Taxpayer Advocate explaining how the Taxpayer Bill of Rights applies to PCA employees and activities. TAS requested that all PCA employees be required to view the video as part of their training, but the IRS refused to impose this training requirement.<sup>31</sup>

Transparency about how PCAs intend to interact with taxpayers also remains a concern. The PCAs have shared their calling scripts and the letters they plan to send to taxpayers with the IRS, as required, and the IRS shared these materials with TAS.<sup>32</sup> However, some scripts reference job aids that appear to provide more detailed instructions about how to interact with taxpayers, and it is not clear whether the IRS requested the job aids from the PCAs.<sup>33</sup> In any event, the IRS did not share those job aids with TAS. Additionally, there may be other job aids that are not explicitly referenced in the scripts. These job aids have not been shared with TAS, and it appears that the IRS has not reviewed or conducted any

28 IRS Notice CP 40.

29 If the taxpayer does not agree to provide his or her Social Security number or Taxpayer Identification number, the PCA will offer to resend the PCA initial contact letter which contains the TAN, and suspend further discussion for five calendar days to allow time for the taxpayer to receive the PCA initial contact letter. See PPG section 6.4.2, *Additional Authentication Code*. In any event, the PCA cannot continue to collect the debt until authentication is completed.

30 In contrast, the IRS in the past advised taxpayers: “**The IRS will never:** ...Call or email you to verify your identity by asking for personal and financial information.” (emphasis in original). See IR-2016-40, *Consumer Alert: Scammers Change Tactics, Once Again*, <https://www.irs.gov/uac/newsroom/consumer-alert-scammers-change-tactics-once-again> (Mar. 14, 2016).

31 SB/SE response to TAS information request, (Apr. 5, 2017). The video, *National Taxpayer Advocate Message to PCA Contractors - Taxpayer Bill of Rights*, <https://www.irsvideos.gov/Individual/Resources/NTAMessageToPCACContractors-TaxpayerBillOfRights>. However, one PCA appears to be including the video in its training. Another PCA, to its credit, committed to displaying IRS Publication 5170, *Taxpayer Bill of Rights*, throughout its workplace, including in each PCA employee cubicle. Publication 5170 is a bilingual (English and Spanish) brochure that displays as a poster and lists and explains the ten taxpayer rights in the TBOR.

32 PPG section 5, *PCA Letters*.

33 When TAS requested the job aids, the IRS at first responded that “Job aids are not a part of the PCA Deliverables and not something the PDC Project Office will be requesting nor reviewing prior to Go Live.” Email from Supervisory Tax Analyst, SB/SE Collection – Private Debt Collection (Mar. 13, 2017). The IRS later indicated that the job aids might be forthcoming.

oversight with respect to them.<sup>34</sup> Another development of concern is the IRS's change in position about allowing TAS representatives to listen to calls between PCA employees and taxpayers. While the IRS initially agreed to allow TAS to participate in this oversight, it now refuses.<sup>35</sup>

## CONCLUSION

As the National Taxpayer Advocate predicted, the design of the PDC program will disproportionately affect taxpayers who appear to be experiencing economic hardship. The IRS plans to assign new liabilities to PCAs without first attempting to collect them through the usual notice stream, thereby unnecessarily paying significant amounts of commissions to PCAs. The IRS has not taken the necessary steps to ensure that PCAs adequately protect taxpayers, train their employees, and operate transparently.

## FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Accept PDC cases under existing TAS criteria, including criterion nine (applicable when the National Taxpayer Advocate determines compelling public policy warrants assistance to an individual or group of taxpayers) and analyze the issues presented and resolution of those cases;
- Analyze a representative sample of taxpayers who receive Social Security retirement payments who are not subject to FPLP levies because their incomes are less than 250 percent of the federal poverty level but whose debts were assigned to a PCA to determine the extent to which these taxpayers have substantial assets;
- Analyze the accounts of taxpayers who made a payment or entered into an installment agreement while their liabilities were assigned to PCAs to determine these taxpayers' median income, the proportion of taxpayers whose income was less than the poverty level or 250 percent of the federal poverty level, and the proportion for whom allowable living expenses exceed their total positive income; and
- With respect to taxpayers with debts already assigned to PCAs whose new liabilities were assigned to PCAs, measure the proportion that subsequently fully paid or entered into a payment arrangement for those new liabilities.

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34 For a description of inappropriate PCA practices that appeared in materials other than scripts in the previous PDC initiative, see Letter from Nina Olson, National Taxpayer Advocate, to Sen. Ron Wyden, Chairman, Committee on Finance; Sen. Orrin G. Hatch, Ranking Member, Committee on Finance; Rep. Dave Camp, Chairman, Committee on Ways and Means; Rep. Sander Levin, Ranking Member, Committee on Ways and Means; Rep. Charles W. Boustany, Jr., Chairman, Subcommittee on Oversight, Committee on Ways and Means; Rep. John Lewis, Ranking Member, Subcommittee on Oversight, Committee on Ways and Means (May 13, 2014).

35 Email from Supervisory Tax Analyst, SB/SE Collection – Private Debt Collection (Mar. 22, 2017).

## Area of Focus #2 **The IRS's Certification Program Related to Denial or Revocation of Passports Impairs Taxpayer Rights**

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

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

### DISCUSSION

#### Background

In 2015, Congress passed the Fixing America's Surface Transportation (FAST) Act, which among other items, requires the Department of State (DOS) to deny an individual's passport application and allows the DOS to revoke or limit an individual's passport if the IRS has certified the individual as having a seriously delinquent tax debt.<sup>2</sup> The law provides an exception allowing the DOS to issue a passport to a certified individual in emergency circumstances or for humanitarian reasons.<sup>3</sup> A seriously delinquent tax debt is an "unpaid, legally enforceable federal tax liability of an individual," which:

- Has been assessed;
- Is greater than \$50,000;<sup>4</sup> and
- Meets either of the following criteria: (1) a notice of lien has been filed under Internal Revenue Code (IRC) § 6323 and the Collection Due Process (CDP) hearing rights under IRC § 6320 have been exhausted or lapsed; or (2) a levy has been made under IRC § 6331.<sup>5</sup>

The statute provides the following exceptions to the term "seriously delinquent tax debt":

- A debt that is being timely paid through an installment agreement (IA) or offer in compromise (OIC);
- A debt for which collection is suspended because the taxpayer requested a CDP hearing or a CDP hearing is pending; and
- A debt for which collection is suspended because the taxpayer has requested relief from joint liability (known as innocent spouse relief).<sup>6</sup>

If a certification is found to be erroneous, the debt is fully satisfied, or it ceases to be a seriously delinquent tax debt due to a statutory exception, the IRS must reverse the certification and notify the

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified as IRC § 7803(a)(3)).

2 Fixing America's Surface Transportation (FAST) Act, Pub. L. No. 114-94, Div. C, Title XXXII, § 32101, 129 Stat. 1312, 1729-32 (2015) (codified as IRC § 7345) (hereinafter FAST Act). The law allows the Department of State (DOS) to limit an individual's passport for only return to the United States or issue a limited passport for only return to the United States. FAST Act, § 32101(e)(2)(B).

3 FAST Act, § 32101(e)(1)(B).

4 This amount will be adjusted for inflation after calendar year 2016. FAST Act, § 32101(f).

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

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



DOS.<sup>7</sup> The IRS must notify the taxpayer of any certification or reversal at the same time as it transmits the certification or reversal to Treasury. The notice must include an explanation of the taxpayer's right to bring suit in U.S. Tax Court or a U.S. district court to determine whether the certification was erroneous or whether the IRS has failed to reverse it.<sup>8</sup> The statute also requires the IRS to include in its CDP hearing notices, information about the certification of seriously delinquent tax debts and the denial, revocation, or limitation of passports.<sup>9</sup>

The IRS plans to initially certify the seriously delinquent tax debts of one percent (estimated to be between 3,500 and 4,000) of the entire population of taxpayers eligible to be certified when it begins implementation during 2017.<sup>10</sup> After monitoring the response to the certifications and evaluating the resources needed, the IRS will then proceed to certify the rest of the eligible population over time. Initially, the DOS will only be denying passport applications for certified individuals. TAS understands the IRS is still developing plans to determine for which taxpayers it will recommend the DOS revoke passports. Since the IRS began planning for implementation of the passport provisions, the Small Business/Self-Employed (SB/SE) Division has held periodic conference calls with TAS to update TAS on its progress, answer TAS's questions, and provide documents such as correspondence and Internal Revenue Manual (IRM) sections for TAS review. This collaboration has been very effective in allowing TAS to raise concerns and in providing TAS with information it needs to plan for and respond to future taxpayer issues.

### The IRS Has Not Exercised Its Broad Discretion by Excluding Already Open TAS Cases and Collection Due Process Equivalent Hearing Cases From Certification

Notwithstanding the willingness of the IRS to work with TAS on this program, the IRS has failed to address several of the National Taxpayer Advocate's significant concerns. For example, the National Taxpayer Advocate has repeatedly raised to the Commissioner of Internal Revenue the need to exclude taxpayers with already open TAS cases from the inventory of taxpayers whose tax debts the IRS will certify as seriously delinquent.<sup>11</sup> As acknowledged by IRS Chief Counsel, the IRS has significant discretion to choose which taxpayers are excluded from certification.<sup>12</sup> For example, the IRS has decided to exclude taxpayers whose tax debt is currently not collectible (CNC) due to the taxpayer's inability to pay<sup>13</sup> and taxpayers whose tax debt is included in a pending IA under IRC § 6159 or OIC under IRC § 7122.<sup>14</sup> As a policy matter, taxpayers with already open TAS cases should likewise be excluded.

7 FAST Act § 32101(a) (codified as IRC § 7345(c)(1)). There are various statutory timeframes for when the IRS must notify the Secretary of Treasury of a reversal of certification. FAST Act § 32101(a) (codified as IRC § 7345(c)(2)). A taxpayer may qualify for expedited decertification if the taxpayer is eligible for decertification, has foreign travel scheduled within 45 days, and has a passport application pending. IRM 5.19.1.4.19.5.1, *Expedited Decertification* (draft version shared with TAS dated Nov. 16, 2016) and IRM 5.1.12.27.6, *Reversal of Certification* (draft version shared with TAS dated Nov. 16, 2016).

8 FAST Act § 32101(a) (codified as IRC § 7435(d)).

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

10 Conference Call with TAS and Small Business/Self-Employed (SB/SE) Division (Mar. 6, 2017).

11 See, e.g., Email from National Taxpayer Advocate to Commissioner of the IRS (Mar. 7, 2017) (on file with TAS).

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

13 The IRS removes taxpayer accounts from the collection inventory when they are reported as currently not collectible (CNC). Accounts can be reported as CNC for a variety of reasons, such as collection would create a hardship and leave the taxpayer unable to meet necessary living expenses or the IRS cannot locate the taxpayer. See *generally* IRM 5.16.1, *Currently Not Collectible* (Jan. 1, 2016).

14 IRM 5.19.1.4.19.2.4, *Discretionary Certification Exclusions* (draft version shared with TAS dated Nov. 16, 2016) and IRM 5.1.12.27.4, *Discretionary Exclusions from Certification* (draft version shared with TAS dated Nov. 16, 2016).

As of May 3, 2017, there were 2,411 open TAS cases where the liability exceeded \$50,000, which is approximately 6.6 percent of all open TAS cases.<sup>15</sup> Almost by definition, taxpayers with delinquent tax debts who have open cases in TAS are trying to resolve their debts. Pursuant to IRC § 7803(c)(2), Congress has charged TAS with helping taxpayers resolve their problems with the IRS. TAS accepts cases only when taxpayers who have *significant hardship*<sup>16</sup> come to TAS for help, and TAS only keeps cases open as long as taxpayers are working with us to achieve a resolution.<sup>17</sup> In the context of passport revocation or denial, taxpayers may have sought TAS assistance because they are having difficulty providing proper documentation and proving they qualify for CNC status; they may need assistance completing financial statements and submitting an OIC; or they may believe they do not owe the tax. Neither the law nor sound tax administration principles require certifying these taxpayers while they are working with TAS to resolve their tax debts. Indeed, doing so would exacerbate any hardship they may be experiencing and undermine taxpayer rights, most notably the *right to challenge an IRS position and be heard* and the *right to a fair and just tax system*.

Although initially there were logistical concerns about whether it was feasible to identify open TAS cases, these concerns have now been resolved. TAS has created a mechanism for systemically identifying and excluding open TAS cases from the Private Debt Collection program, and the IRS can use the same mechanism to identify and exclude TAS cases from passport certification. More specifically, all modules of taxpayers with cases in TAS have a Transaction Code and an Action Code, which can be used to identify and remove them from the inventory of taxpayers whose seriously delinquent tax debt the IRS plans to certify.

Although the statute excludes debt for which collection is suspended due to a pending CDP hearing, the IRS has concluded that an Equivalent Hearing (EH) does not meet the criteria for this statutory exception and has not made a discretionary exception.<sup>18</sup> EHs hold the same purpose as CDP hearings — to provide the taxpayer with the opportunity to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy, including the appropriateness of the collection action, collection alternatives, spousal defenses, and under certain circumstances, the underlying tax liability.<sup>19</sup> Because taxpayers only have one year after the date of the CDP hearing notice to request an EH, providing an exception for EHs would not create significant delay. Proceeding to certify taxpayers with a pending EH may lead to taxpayers being unable to effectively raise collection alternatives or even challenge the underlying liability before the IRS makes a passport certification.

15 The 2,411 cases include open TAS cases with an aggregate assessed account balance exceeding \$50,000 as of May 3, 2017. IRS, *Account Receivable Dollar Inventory File* (May 3, 2017). Because some of these cases may meet the criteria for a statutory or discretionary exception to passport certification, not all of the taxpayers in these cases would necessarily be certified.

16 “The term significant hardship means a serious privation caused or about to be caused to the taxpayer as the result of the particular manner in which the revenue laws are being administered by the IRS. Significant hardship includes situations in which a system or procedure fails to operate as intended or fails to resolve the taxpayer’s problem or dispute with the IRS. A significant hardship also includes, but is not limited to: (A) An immediate threat of adverse action; (B) A delay of more than 30 days in resolving taxpayer account problems; (C) The incurring by the taxpayer of significant costs (including fees for professional representation) if relief is not granted; or (D) Irreparable injury to, or a long-term adverse impact on, the taxpayer if relief is not granted.” Treas. Reg. § 301.7811-1(a)(4).

17 TAS cases originate from contacts made by taxpayers themselves or on behalf of taxpayers by taxpayer representatives, third parties, congressional representatives, or IRS Operating Divisions or Functions employees. IRM 13.1.16.3, *Receipt of Potential TAS Cases* (Feb. 1, 2011), IRM 13.1.21.1.3.19, *No or Partial Reply from Taxpayer* (Feb. 2, 2011).

18 FAST Act § 32101(a) (codified as IRC § 7345(b)(2)(B)(i)). IRM 5.19.1.4.19.2.4, *Discretionary Certification Exclusions* (draft version shared with TAS dated Nov. 16, 2016).

19 IRC § 6330(c)(2). IRM 5.19.8.4.3, *Equivalent Hearing (EH) Requests and timeliness of EH Requests* (Nov. 1, 2007).

### The IRS Is Infringing on Taxpayer Rights by Not Notifying All Affected Taxpayers Prior to Certification in a Stand-Alone Notice

As explained above, the statute only requires two forms of notice to affected taxpayers: a contemporaneous notice issued to the taxpayer at the time of the certification or reversal of a certification, and notice via text inserted in the taxpayer's CDP notice. The contemporaneous notice, issued within days of the certification, does not provide taxpayers with an opportunity to come into compliance before the IRS makes the certification and in fact advises the taxpayer that the certification has already occurred.<sup>20</sup> The IRS should provide notice at least 30 days prior to certification to warn taxpayers of the consequences, creating an incentive for taxpayers to act quickly in order to avoid those consequences.

While including the passport information in the CDP notice is important because of the opportunity for an administrative and judicial hearing, this should not be the taxpayer's only direct notice prior to certification. The issue of resolving the tax debt to avoid certification may be lost in the broader CDP letter, which spans at least four pages and includes other information such as how to request a CDP hearing, other actions the IRS may take (such as a lien or levy), and interest and penalty charges.<sup>21</sup> Furthermore, taxpayers who have already received their CDP notices prior to the implementation of the passport provisions did not have the passport information included in their CDP notices and will not be notified until the certification is taking place. The failure to notify these taxpayers at all prior to the government taking their right to travel violates the Taxpayer Bill of Rights.

Furthermore, because “[t]he right of a citizen to travel is a part of the ‘liberty’ of which he cannot be deprived, except by due process of law,” the failure to notify taxpayers prior to certifying the tax debt weakens taxpayers’ right to due process, guaranteed under the Fifth Amendment of the U.S. Constitution.<sup>22</sup> Although the IRS’s efforts to communicate the passport provisions to taxpayers in a general way through a forthcoming published notice and a press release<sup>23</sup> are useful, these forms of notice are too general and fail to communicate to taxpayers that the government will soon be taking or limiting their passports. The IRS is violating taxpayers’ *right to be informed* and *right to challenge the IRS’s position and be heard* by not providing them with adequate notice and time to protest before the government initiates a taking of the right to travel.<sup>24</sup>

TAS understands that once the DOS receives notification of a seriously delinquent tax debt from the IRS, it will provide a 90-day period during which a taxpayer may resolve his or her seriously delinquent

20 IRS, CP508C, *Passport Denied or Revoked Due to Serious Tax Delinquency*. Placing the relevant transaction code and activity code on the taxpayer’s account systemically generates the notice to the taxpayer. IRS, *The Fixing America’s Surface Transportation (FAST) Act, Passport Certification Training* (undated training document, on file with TAS). The IRS systemically informs the DOS of newly certified taxpayers on a weekly basis. IRM 5.19.1.4.19.3, *Certification Process* (draft version shared with TAS dated Nov. 16, 2016).

21 IRS, Letter 1058, *Notice of Intent to Levy and Notice of Your Right to a Hearing* (Jan. 2017).

22 *Zemel v. Rusk*, 228 F. Supp. 65, 69 (D. Conn. 1964), *aff’d*, 381 U.S. 1 (1965). See also *Aptheker v. Sec’y of State*, 378 U.S. 500, 505-06 (1964); *Kent v. Dulles*, 357 U.S. 116, 125 (1958). Article 13 of the Universal Declaration of Human Rights states “Everyone has the right to leave any country, including his own, and to return to his country.” United Nations, *Universal Declaration of Human Rights*, GA Res. 217A (III), UN Doc A/810 (1948).

23 The notice and press release will be published approximately 15-30 days prior to the implementation. Email from SB/SE to TAS (May 1, 2017) (on file with TAS).

24 See *Weinstein v. Albright*, 2000 WL 1154310 at 5 (S.D.N.Y. 2001), *aff’d*, 261 F.3d 127 (2nd Cir. 2001) (finding the statute and regulations requiring denial of a passport in the case of unpaid child support did not violate the Due Process Clause because the statute provides for notice and an opportunity for the person to be heard before a state agency certifies the unpaid child support to the federal government).

tax debt before the DOS will deny the passport application.<sup>25</sup> However, in the case of a taxpayer who already has a passport, TAS is not aware of any similar grace period for a taxpayer to protest the certification or resolve the tax debt prior to the DOS immediately revoking the taxpayer's passport. Furthermore, 90 days may not provide enough time for taxpayers to resolve their tax debts. During the 2017 filing season, the level of service on the IRS's Balance Due phone line was only 40 percent and the average hold time was 47 minutes.<sup>26</sup> Taxpayers may be desperately trying to resolve their debts, but unable to reach the IRS.

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**In order to protect taxpayers' right to be informed, the IRS should expand the notices sent to taxpayers, warning them of the consequences if they do not take action regarding their seriously delinquent tax debts.**

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Regardless of whether the taxpayer received or will receive a CDP notice with the passport information included, the IRS should provide an additional notice immediately before it certifies the seriously delinquent tax debt. This stand-alone notice would focus on the actual tax debt and the specific consequences, such as a restriction on the right to travel, that will occur should the taxpayer not resolve it. Such a notice, issued approximately 30 days before the certification, would get taxpayers' attention and prompt taxpayers to take immediate action. This notice should explain that the IRS may certify their seriously delinquent tax debts, leading to the DOS revoking or denying their passports, and provide a date by which the taxpayer must act to avoid the certification. For taxpayers residing abroad, the IRS should issue the notice 90 days prior to certification, which provides an additional 60 days, similar to the extra time allotted taxpayers abroad for petitioning Tax Court following a statutory notice of deficiency.<sup>27</sup> Providing adequate notice to taxpayers abroad is even more important because if these taxpayers lose their passports, they will be overseas with limited ability to travel.

### **The IRS Must Ensure Certified Taxpayers Whom the IRS Refers to a Private Collection Agency (PCA) Have an Opportunity to Resolve Their Tax Debts Through Collection Alternatives**

TAS understands the IRS may refer taxpayers whose tax debts the IRS has certified as seriously delinquent to a Private Collection Agency (PCA) pursuant to IRC § 6306.<sup>28</sup> Currently, PCAs, unlike IRS employees, do not secure financial information and do not have authority to determine whether the taxpayer should be placed in CNC hardship status, or considered for an OIC, a partial payment IA, or a non-streamlined IA.<sup>29</sup> Because PCAs can solicit a voluntary payment from a taxpayer (*i.e.*, a payment that does not satisfy the liability and is not made pursuant to an IA), the National Taxpayer Advocate was initially concerned that a certified taxpayer may feel pressured to make a payment (which may even reduce the tax debt to or below \$50,000), without entering into an IA or OIC that would reverse the

25 "After 90 days, a new passport application and fee payment will be required." DOS, <https://www.usa.gov/passport-problems> (last updated Feb. 28, 2017). See also IRS, *Revocation or Denial of Passport in Case of Certain Unpaid Taxes*, <https://www.irs.gov/businesses/small-businesses-self-employed/revocation-or-denial-of-passport-in-case-of-certain-unpaid-taxes> (last updated Feb. 6, 2017).

26 See IRS, Joint Operations Center, *Snapshot Reports: Product Line Detail: Installment Agreement/Balance Due* (week ending April 22, 2017).

27 IRC § 6213(a) requires a taxpayer to petition the U.S. Tax Court within 90 days, or 150 days if the notice is addressed to a person outside the United States, after the IRS mails the notice of deficiency.

28 The IRS has informed TAS that it will not be sending cases over \$50,000 over to Private Collection Agencies (PCAs) until later this fiscal year or early next fiscal year. Email from SB/SE to TAS (Mar. 17, 2017) (on file with TAS).

29 By statute, PCAs can locate and contact the taxpayer, request full payment or an installment agreement (IA) not to exceed five years, and obtain financial information specified by the IRS. IRC § 6306(b)(1)(B). However, the PCA Policy and Procedures Guide (Mar. 2, 2017) allows PCAs to offer IAs for more than five years in some circumstances and does not authorize PCAs to collect financial information from taxpayers.

certification.<sup>30</sup> However, the IRS recently updated the PCA Policy and Procedures Guide to instruct PCAs to direct taxpayers to the Automated Collection System (ACS) and return the case to the IRS if the taxpayer wants to resolve a passport issue but cannot full pay or enter into a payment arrangement.<sup>31</sup> Furthermore, the Guide now instructs PCAs to facilitate expedited passport decertification by contacting the appropriate IRS office when a taxpayer has foreign travel scheduled within 45 days.<sup>32</sup> Ensuring PCAs understand the passport certification provisions and know when to refer taxpayers to the IRS is vital to protecting taxpayer rights.

## CONCLUSION

Under the law, the IRS has broad discretion to exclude cases, and excluding already open TAS cases would be in accordance with both the role Congress assigned to TAS and the spirit of the law on passport certifications, which is to ensure taxpayers work with the IRS to resolve their delinquent tax liabilities. In order to protect taxpayers' *right to be informed*, the IRS should expand the notices sent to taxpayers, warning them of the consequences if they do not take action regarding their seriously delinquent tax debts. TAS will monitor the initial phase of passport certifications to ensure taxpayers receive the customer service needed in order to resolve their seriously delinquent tax debts and are able to have their certifications reversed in a timely manner when eligible.

## FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Conduct and prepare a Taxpayer Rights Impact Statement to the IRS, analyzing how the IRS's refusal to provide an additional stand-alone notice prior to passport certification harms taxpayers and infringes on their rights;
- Continue to review and make recommendations to documents related to the passport certification program, including: published and unpublished guidance; IRM sections, and correspondence;
- Quantify the population of certified taxpayers with open TAS cases, including how many are decertified while working with TAS, and prepare a Taxpayer Rights Impact Statement analyzing the harm these taxpayers experience by not being excluded from certification while working with TAS;
- Issue an Interim Guidance Memorandum, providing guidance to TAS Case Advocates on how to assist and advocate for certified taxpayers with:
  - Requesting CNC status, including providing proper substantiating documentation;
  - Submitting an OIC request, including completing financial statements;
  - Submitting a request for innocent spouse relief where appropriate;
  - Challenging a liability if the taxpayer believes he or she does not owe the seriously delinquent tax debt;

30 Paying the liability to or below \$50,000 after the taxpayer is certified does not make the taxpayer eligible for reversal. However, if the IRS reverses a certification (for example, if the taxpayer enters into an IA) and the taxpayer pays the debt below \$50,000, the IRS could not recertify the debt, even if the reason for the reversal is no longer applicable (for example, the taxpayer defaulted on the IA). See IRM 5.19.1.4.19.5, *Reversal of Certification* (draft version shared with TAS dated Nov. 16, 2016) and IRM 5.1.12.27.6, *Reversal of Certification* (draft version shared with TAS dated Nov. 16, 2016).

31 PCA Policy and Procedures Guide 56 (Apr. 4, 2017).

32 *Id.*

- Ensuring the IRS timely decertifies the taxpayer's account when he or she meets one of the statutory or discretionary exclusions; and
- Requesting and receiving expedited decertification when eligible.

## Area of Focus #3 **The Offshore Voluntary Disclosure (OVD) Programs Still Lack Transparency, Violating the *Right to Be Informed***

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

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

### DISCUSSION

Beginning in 2009, the IRS established a series of Offshore Voluntary Disclosure Programs (OVDs), which allow certain people who have not reported all of their foreign assets and income to settle with the IRS by paying taxes, interest, penalties, plus a “miscellaneous offshore penalty” (MOP). It also established a “streamlined” program for those who could certify their violations were not willful. These programs are governed by frequently asked questions (FAQs) posted on the IRS website.<sup>2</sup> The Large Business and International (LB&I) Division Withholding and International Individual Compliance (WIIC) Director can approve minor changes to the FAQs, but the Commissioner or Deputy Commissioner must approve significant ones.<sup>3</sup> IRS examiners interpret the FAQs with assistance from technical advisors and Small Business/Self-Employed (SB/SE) Counsel.<sup>4</sup> They may also access training materials and job aids posted to a secure SharePoint intranet site.<sup>5</sup>

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 IRS, *Options Available for U.S. Taxpayers with Undisclosed Foreign Financial Assets*, <https://www.irs.gov/individuals/international-taxpayers/options-available-for-u-s-taxpayers-with-undisclosed-foreign-financial-assets> (last visited March 2, 2017) (providing links to all of the FAQs referenced in this discussion). For concerns about the Offshore Voluntary Disclosure Programs (OVDs), see, e.g., National Taxpayer Advocate 2017 Objectives Report to Congress 164-76 (discussing prior reports). Although the 2009 OVD was succeeded by the 2011 Offshore Voluntary Disclosure Initiative, for purposes of this discussion we refer to it as an OVD.
- 3 Large Business and International (LB&I) response to TAS information request (Apr. 18, 2017) (“Minor corrections or updates [to FAQs] may be authorized at the Director level. Modifications or additions impacting policy or materially changing existing guidance require authorization by the Deputy Commissioner/Commissioner with input from the Deputy Chief Counsel Operations. Recommendations for modifications, updates, or additions are worked by a cross functional team made up of management and executives from LB&I and [Small Business/Self Employed] SB/SE, a technical advisor/senior revenue agent, and SB/SE Counsel. For purposes of this response, we will refer to this group as the ‘Elevated Issues Team.’”).
- 4 *Id.* (“In general, case specific information is communicated via e-mail from the technical advisor to the revenue agent working the case. On rare occasion, SB/SE Counsel (field) assigned to the OVD Biweekly Team provides written input on specific cases. Guidance on routine issues raised by the field or a general issue not related to a specific case is typically discussed at monthly conference calls organized by PN [Practice Network] Senior Revenue Agents detailed to OVD. Occasionally, SB/SE Counsel (field) will participate in those calls.”).
- 5 *Id.*

### The IRS Does Not Disclose Interpretations of OVDP Frequently Asked Questions (FAQs)

Chief Counsel Advice from (or coordinated with) national office attorneys must be disclosed under IRC § 6110.<sup>6</sup> Other “instructions to staff” that affect the public must be disclosed under the Freedom of Information Act (FOIA).<sup>7</sup> However, the IRS does not disclose its interpretations of FAQs. For example, when the IRS first established the 2009 OVDP, it did not disclose how it interpreted FAQ #35, which addressed how to compute the “offshore penalty.” The guidance memo was only disclosed in response to a Taxpayer Advocate Directive.<sup>8</sup> Practitioners have highlighted other undisclosed and counterintuitive FAQ interpretations.<sup>9</sup>

While the IRS may be required to disclose FAQ interpretations under FOIA, it is generally not required to disclose legal advice regarding the OVDP FAQs under IRC § 6110. IRC § 6110 requires disclosure of certain advice provided by or coordinated with the national office, but legal advice concerning the interpretation of the FAQs is generally provided by an SB/SE attorney in the field who is an OVDP expert.<sup>10</sup> Moreover, some of this advice may be privileged, even if it reveals principles that the IRS will apply in other cases.

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The IRS’s lack of transparency about how taxpayers fare inside and outside the Offshore Voluntary Disclosure Programs makes it more difficult for anyone to recognize when the result in a particular case is outside the norm.

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The IRS could voluntarily disclose important interpretations of OVDP FAQs, but does not. For example, 2012 OVDP FAQ #10 is particularly important because, like 2009 FAQ #35, it concerns the amount taxpayers must agree to pay under the OVDP. FAQ #10 describes an “alternative mark-to-market” (MTM) method that OVDP participants can only use to file or amend returns inside the program. Under this method, participants are taxed on unrealized gains reduced by unrealized losses. Notably, FAQ #10 does not inform participants that they cannot offset unrealized gains with unrealized losses from years for which the refund statute expiration date (RSED) has passed.<sup>11</sup> Rather, it implies the opposite by warning only that unused losses cannot be carried forward beyond the OVDP disclosure period. If unrealized losses can be claimed for some years during this period and not others (*i.e.*, because the RSED has passed), it is misleading not to include that warning as well. Yet, that is how the IRS interprets FAQ #10 — as not permitting taxpayers to offset unrealized gains with losses from years for which the RSED had passed. Members of the Tax Section of the American Bar Association — who somehow learned of the

6 IRC § 6110 (requiring disclosure of Chief Counsel Advice (CCA)); Chief Counsel Notice 2014-009 (Sept 22, 2014) (requiring disclosure of certain legal advice provided by or coordinated with the national office).

7 5 U.S.C. § 552(a)(2)(C) (generally requiring disclosure of “administrative staff manuals and instructions to staff that affect a member of the public”).

8 See Taxpayer Advocate Directive (TAD) 2011-1 (Aug. 16, 2011), <https://www.irs.gov/advocate/taxpayer-advocate-directives-and-related-documents>.

9 See, e.g., New York State Bar Association (NYSBA) Tax Section, *NYSBA Tax Section Comments on FAQ for 2011 Offshore Voluntary Disclosure Initiative*, 2011 TNT 153-13 (Aug. 9, 2011); Marie Saphire, *More Written Guidance Needed As OVDI Deadline Nears*, 132 TAX NOTES 1001 (Sept. 5, 2011).

10 LB&I response to TAS information request (Apr. 18, 2017) (“We are not aware of any written advice interpreting OVDP FAQs from any employee assigned to a national office component of Chief Counsel issued to any technical advisor, program manager, or other LB&I employee.... We are aware of written advice provided by one SB/SE Counsel (field) attorney to technical advisors, OVDP managers, and other IRS personnel... We are aware of no written interpretation of OVDP FAQs mentioned in our earlier responses being released to the public.”). LB&I later said that “several attorneys from SBSE Counsel and Headquarter Counsel provide assistance to OVDP.” LB&I response to TAS fact check (June 7, 2017). But, LB&I did not provide TAS with written advice from any other attorneys.

11 IRC § 6511(a).



IRS's undisclosed interpretation of FAQ #10 — suggested that the IRS is not legally required to deny offsets from barred years and that doing so is unnecessarily punitive.<sup>12</sup>

Although the IRS's interpretation of FAQ #10 may be implied by IRS training materials,<sup>13</sup> these training materials were not posted to the IRS website, as seemingly required by FOIA. Rather, a private firm acquired them by making a FOIA request and then made them available to the public on its private website.<sup>14</sup> They are not indexed or organized.<sup>15</sup> The firm could remove them or impose an access charge at any time. Moreover, neither the public nor other IRS employees (*e.g.*, TAS employees) should have to search a private website for information about an IRS program.<sup>16</sup>

### More Routine Disclosure of Advice Would Be Helpful

In the years before the IRS was required to release its private letter rulings and other legal advice to the public, a 1926 report found that:

[R]ulings were known only to insiders ... This system ha[d] created, as a favored class of taxpayers, those who ha[d] employed 'tax experts.' It ha[d] created a special class of tax practitioners, whose sole stock in trade [was] a knowledge of the secret methods and practices of the Income Tax Unit. Knowledge of secret precedents had made Bureau employees extremely valuable to corporate taxpayers, fostering a damaging rate of turnover. Only the regular publication of BIR [Bureau of Internal Revenue] decisions could halt this outflow and ensure equal treatment for all taxpayers.<sup>17</sup>

While the IRS is more transparent today, a lack of transparency in connection with undisclosed FAQ interpretations could present the same risks. To assess those risks, TAS reviewed a sample of ten items of undisclosed advice about OVDP FAQs issued between March 1, 2016 and March 8, 2017.<sup>18</sup> According to the IRS, these documents were not checked or reviewed by any disclosure expert to determine if they should be disclosed.<sup>19</sup> However, TAS's review uncovered information that could be helpful to taxpayers, such as following:

- When the MOP is assessed pursuant to a closing agreement, the tax year recited in the closing agreement is the tax year that controls the analysis of whether it is too late to issue a refund of the MOP (*i.e.*, if the refund statute of limitation under IRC § 6511 has expired). The tax year recited in these agreements is generally the last tax year in the disclosure period.

12 Letter from American Bar Association (ABA), to John Koskinen, Commissioner of Internal Revenue, *Comments on 2014 Offshore Voluntary Disclosure Program and the Streamlined Programs* 18 (Oct. 14, 2015), <http://www.americanbar.org/content/dam/aba/administrative/taxation/policy/101415comments.pdf> (“...in the context of OVDP, where the IRS makes rules, disallowing losses because of a closed statute serves little purpose other than being punitive. We believe the IRS should reconsider its position here ...”).

13 See Bragger Tax Law Group, *Previously Unreleased IRS Guidelines for FBAR Audits, Offshore Voluntary Disclosure Workshop Houston, TX 09/11*, 192 <https://www.bragertaxlaw.com/previously-unreleased-irs-guidelines-for-fbar-audits.html> (last visited Apr. 28, 2017).

14 See *id.* See also Andrew Velarde, *FOIA Response Shows Hints of IRS Thinking on OVDP*, 2015 TNT 192-1 (Oct. 5, 2015).

15 Under the Freedom of Information Act, if an item is not properly posted and indexed by the IRS, it may not be “relied on, used, or cited as precedent” by the IRS against a taxpayer unless the taxpayer has actual and timely notice of its terms. See 5 U.S.C. § 552(a)(2)(flush).

16 Some TAS employees gained access to LB&I's secure SharePoint site for the first time in 2017.

17 See Joseph J. Thorndike, *Annual Regulation of Business Focus: Reorganization of the Internal Revenue Service: Reforming the Internal Revenue Service: A Comparative History*, 53 ADMIN. L. REV. 717, 751 (2001) (Internal citations omitted).

18 The sample was drawn from a universe of only 16 items. LB&I response to TAS information request (Apr. 18, 2017).

19 LB&I response to TAS information request (June 1, 2017).

- If a taxpayer makes a payment for the MOP and then is removed from or opts out of the OVDP, the statute of limitation under IRC § 6511 for all tax years in the OVDP submission must be analyzed in determining if it is too late to issue a refund. If the period is open for any tax year in the submission, then a claim for refund of the MOP may be considered under IRC § 6511.
- When determining if the taxpayer had less than \$10,000 in U.S. source income, as necessary to qualify for the five percent penalty under 2012 OVDP FAQ #52, the IRS considers gross income (not net income). In limited circumstances where the taxpayer receives flow-through income from an entity not controlled by the taxpayer, however, the IRS may apply a cash flow analysis for purposes of determining if the taxpayer exceeds this \$10,000 threshold.
- The IRS is legally permitted to consider an offer in compromise before there is an assessment pursuant to a closing agreement in the OVDP.
- A Swiss “libre passage” account is not excluded from the OVDP penalty base when computing the MOP on the basis that it is a tax-favored retirement account under Swiss law.
- OVDP Hotline personnel can assist taxpayers in determining whether a foreign retirement account (other than a Canadian retirement plan) must be included in the OVDP offshore penalty base by collecting information and elevating the matter to an OVDP Coordinator for consideration.
- OVDP Hotline personnel can assist taxpayers who have signed a Form 906 closing agreement and are due a refund if the examiner who handled the certification is unavailable to assist (*e.g.*, has separated from service, is on maternity leave, etc.).
- OVDP Hotline personnel can assist taxpayers who erroneously omitted an account/asset from their original disclosure by collecting the information and elevating the taxpayer’s request to make a supplemental disclosure.

While taxpayers could glean some of this information from other sources (*e.g.*, a representative with significant OVDP experience), disclosing answers to questions about the FAQs — whether by disclosing internal training and guides or advice currently being provided to IRS employees by email — could help taxpayers (and practitioners) understand the OVDP even if they are unrepresented, reduce unnecessary calls to the Hotline, increase confidence that the IRS is handling cases consistently, reduce internal requests for advice, and reduce unnecessary requests for assistance from TAS.<sup>20</sup>

### The IRS Does Not Always Disclose the Basis for Its OVDP-Related Decisions

When an OVDP examiner makes an OVDP-related decision based on guidance from a field attorney, technical advisor, or committee, he or she is not required to explain the resulting “take it or leave it” decision to the participant or allow the participant to speak with the decision maker.<sup>21</sup> For example, the IRS announced in 2014 that certain OVDP participants could apply to transition into a more favorable “streamlined” program if they certified their conduct was non-willful.<sup>22</sup> However, it would only allow them into the program if technical advisors, and in some cases, a secret “Central Review Committee”

20 See, *e.g.*, Organization for Economic Co-operation and Development (OECD), *Update on Voluntary Disclosure Programmes: A Pathway To Tax Compliance* 18 (Aug. 2015), <http://www.oecd.org/ctp/exchange-of-tax-information/Voluntary-Disclosure-Programmes-2015.pdf> (“The terms of the [OVD] programme or initiative should be clearly set out in guidance accessible both to the eligible population and to others, to avoid both ambiguity and any charge of a lack of even-handedness on the part of the tax authority.”).

21 See, *e.g.*, 2014 OVDP FAQ #49.

22 IRS, *Transition Rules: FAQs*, <https://www.irs.gov/individuals/international-taxpayers/transition-rules-frequently-asked-questions-faqs> FAQ #7 (last visited Mar. 2, 2017).

agreed (*i.e.*, taxpayers did not know who was on the committee and could not communicate with it).<sup>23</sup> Participants would have no way to know if the examiner miscommunicated the facts to the technical advisor or to the committee, or what standards were being applied. Thus, a taxpayer had no way to know if the IRS's decision in his or her case was consistent with its decisions in other similar cases.

### The IRS Does Not Release Summary Statistics

The IRS's release of certain statistics, such as the average or median tax, interest, and penalties paid inside and outside an OVDP could help assure taxpayers they are not being unfairly singled out and the programs are being administered in a rational manner. Both TAS and the Government Accountability Office have computed and publicly reported such statistics in the past.<sup>24</sup> However, LB&I recently stated that TAS should not publish an update.<sup>25</sup> LB&I computes OVDP results using a different methodology, which TAS has obtained and redacted (at LB&I's request) in the Appendix below. LB&I explained:

Statistics with details beyond those publicly released in press releases by the Commissioner (most recently in IR-2016-137) may impair tax administration and are exempt from release under FOIA. LB&I's response to FOIA request # [REDACTED] from [REDACTED] [REDACTED] limited the information provided under the request to high level statistics. TAS should not release statistics more granular than those provided by the Commissioner in press releases.

We disagree. "May impair tax administration" is not the legal standard for withholding information under FOIA.<sup>26</sup> Even if it were, the IRS has provided no basis to support its conclusion that releasing this data may impair tax administration. Moreover, if the IRS could prevent the National Taxpayer Advocate from publishing data more granular than data provided by the IRS Commissioner in press releases, her reports would be much less effective in highlighting problems, such as those caused by the IRS's initial one-size-fits all approach to the OVDPs.

In addition to penalties assessed inside OVDP-related programs, the Treasury Department also compiles a summary of the penalties assessed outside the OVDPs against those who failed to file a *Report of Foreign Bank and Financial Accounts* (FBAR) for reports to Congress.<sup>27</sup> However, the IRS has not disclosed this summary to the public, notwithstanding repeated requests by TAS.<sup>28</sup> After years of

23 IRS, *Transition Rules: FAQs*, <https://www.irs.gov/individuals/international-taxpayers/transition-rules-frequently-asked-questions-faqs> FAQ #8.

24 See, e.g., National Taxpayer Advocate 2017 Objectives Report to Congress 164-76; Government Accountability Office (GAO), GAO-13-318, *IRS Has Collected Billions of Dollars, but May Be Missing Continued Evasion* 13 (Mar. 2013).

25 IRS response to TAS information request (Apr. 18, 2017).

26 Under FOIA exemption 5 U.S.C § 552(b)(7)(E), the IRS can withhold information that "could reasonably be expected to risk circumvention of the law." Similarly, the IRS is generally required to withhold return information (not data) the disclosure of which would "seriously impair" federal tax administration. See IRC §§ 6103(c), (e)(7).

27 See Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (USA PATRIOT Act) of 2001, Pub. L. No.107-56 § 361(b) (2001) (requiring the reports). The Financial Crimes Enforcement Network (FinCEN) initially published these reports on its website. See, e.g., Department of Treasury, *A Report to Congress in Accordance with § 361(B) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001* (2004), [http://www.fincen.gov/news\\_room/rp/files/fbar\\_report\\_2004.pdf](http://www.fincen.gov/news_room/rp/files/fbar_report_2004.pdf).

28 TAS began advocating for the IRS to release these reports in 2013 and made its advocacy public in 2016. See National Taxpayer Advocate 2017 Objectives Report to Congress 164, 176.

working with the IRS to release these reports, the IRS recently stated for the first time to TAS that “Treasury is the owner of the annual FBAR report and thereby controls the release of that report.”<sup>29</sup>

The IRS’s lack of transparency about how taxpayers fare inside and outside the OVDPs makes it more difficult for anyone to recognize when the result in a particular case is outside the norm. Moreover, this lack of transparency makes it impossible for impartial and independent observers to assess the effectiveness of the OVDPs.

## CONCLUSION

According to a tax historian, “corruption, favoritism, secrecy, and taxpayer mistreatment” have prompted political leaders to try to restructure the IRS four times over the last 145 years.<sup>30</sup> Given the IRS’s history, it may be easier for taxpayers to believe that if the agency is not transparent, it must have something to hide. The IRS and Congress’s recent adoption of the Taxpayer Bill of Rights (TBOR) could help restore faith in the agency.

However, secrecy in the OVDPs violates the TBOR. The TBOR provides that taxpayers “have the *right to be informed* of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.” Blindsiding only those taxpayers who do not have special access to the IRS’s undisclosed interpretations of FAQs is inconsistent with this right, as well as the *rights to quality service* and *to a fair and just tax system*. Similarly, when the IRS does not provide for any appeal or review of “take it or leave it” offers (or even provide an explanation of them), it erodes the *right to challenge the IRS’s position and be heard*.

Transparency could also promote efficiency by reducing disputes.<sup>31</sup> When the IRS’s lack of transparency makes people feel singled out for arbitrary and capricious treatment, they are more likely to try to elevate the IRS’s determinations, delaying resolution of their cases. Although the IRS does not disclose how long it takes to resolve OVDP cases, the Treasury Inspector General for Tax Administration recently reported “the IRS has taken nearly two years to complete 20,587 [OVDP] case certifications, with 241 cases taking at least four years to complete.”<sup>32</sup> Some cases are probably delayed because participants feel they are being treated unfairly. Moreover, trust for the IRS is correlated with voluntary tax

29 LB&I response to TAS information request (Apr. 18, 2017). LB&I subsequently stated: “IRS has consistently indicated the annual [FBAR] report to Congress must be cleared by Treasury before the report can be released. As clarification, IRS is delegated the authority to prepare the report. But Treasury releases the report. For example: FinCEN is responsible for issuing the annual FBAR report but FinCEN has delegated that authority to the IRS. The IRS prepares the annual FBAR report, coordinates with FinCEN, and then submits the reports to Main Treasury. Main Treasury is ultimately responsible for submitting the report to Congress.” LB&I response to TAS fact check (June 7, 2017).

30 See Joseph J. Thorndike, *Annual Regulation of Business Focus: Reorganization of the Internal Revenue Service: Reforming the Internal Revenue Service: A Comparative History*, 53 ADMIN. L. REV. 717, 718 (2001) (emphasis added).

31 For example, the Coalition for Effective and Efficient Tax Administration (CEETA) agrees with the statement in IRS Pub. 5125, *LB&I Examination Process* (2016), that examinations “can be efficient if the examination team and the taxpayer work together in a spirit of cooperation, responsiveness, and transparency.” CEETA, *CEETA Addresses Changes Under Way in LB&I Division*, 2016 TNT 140-13 (July 21, 2016). Similarly, the OECD has noted that to improve regulation, member countries should “[E]nsure that administrative procedures for applying regulations and regulatory decisions are transparent...” Regulatory and Policy Division of the OECD, *OECD Guiding Principles on Regulatory Quality and Performance* 5 (Apr. 25, 2005), <http://www.oecd.org/dataoecd/24/6/34976533.pdf>.

32 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2016-30-030, *Improvements Are Needed in Offshore Voluntary Disclosure Compliance and Processing Efforts* 12 (June 2, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201630030fr.pdf>.

compliance.<sup>33</sup> Thus, additional transparency could help restore faith in the IRS, promote consistent results, speed case resolutions, and promote voluntary compliance.

## FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Advocate for the IRS to disclose all of the OVDP-related rules and procedures it is following, along with any interpretations of them (*e.g.*, the OVDP Hotline Guide, training materials, and IRS Counsel's responses to questions about the OVDP FAQs), even if disclosure is not legally required;
- Advocate for the IRS to allow taxpayers to communicate directly with decision makers (*e.g.*, OVDP Technical Advisors and the Central Review Committee) to verify that they have considered all of the relevant facts, and can articulate a reasonable basis for their decisions; and
- Advocate for the IRS to disclose detailed summary statistics for the OVDP and streamlined programs (*e.g.*, the FBAR report to Congress and the OVDP Closed Case Reports) to help taxpayers determine if they are being treated like everyone else and to help stakeholders evaluate these programs.

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33 National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-70 (Research Study: *Factors Influencing Voluntary Compliance By Small Businesses: Preliminary Survey Results*).

**APPENDIX A: OVD AND STREAMLINED DATA THAT THE IRS DOES NOT WANT TO RELEASE: RESULTS AS OF DECEMBER 5, 2016**<sup>34</sup>

	2009 OVDP (as of Nov. 2013)	2011 OVDP (as of Sept. 2016)	2012 OVDP (as of Sept. 2016)	2014 OVDI (July 2014 to Sept. 2016)	Subtotal	Streamlined (as of Oct. 18, 2016)	Total
Cases							
Taxpayers							
Returns							
Tax							
Interest							
Accuracy Penalty							
Offshore Penalty							
Total Assessed							
Total Collected on Closed Cases							
Total Collected on Open and Closed Cases							

<sup>34</sup> LB&I response to TAS information request (Dec. 5, 2016). TAS could not tie these figures to the amounts announced by the IRS Commissioner on October 21, 2016. IRS, IR-2016-137, *Offshore Voluntary Compliance Efforts Top \$10 Billion; More Than 100,000 Taxpayers Come Back into Compliance* (Oct. 21, 2016), <https://www.irs.gov/uac/newsroom/offshore-voluntary-compliance-efforts-top-10-billion-more-than-100000-taxpayers-come-back-into-compliance>. Because the IRS does not regularly update this data, the information above is still the most current available.

## Area of Focus #4 Taxpayers Continue to Be Burdened by the IRS's Approach to International Tax Administration

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

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

### DISCUSSION

The National Taxpayer Advocate has previously raised a number of issues regarding implementation of the Foreign Account Tax Compliance Act (FATCA) and the IRS's international withholding and refund policies.<sup>2</sup> Some of these problems were reiterated by taxpayers and their representatives in Public Forums recently held by the National Taxpayer Advocate.<sup>3</sup> Lacking either statistically valid data or analytical justification, the IRS has adopted a coercive approach to international taxpayers, reflecting an assumption that all such taxpayers are suspect of fraudulent activity.<sup>4</sup>

The National Taxpayer Advocate continues to be concerned that:

- The IRS's processes for reviewing and validating Chapter 3 and Chapter 4 refund requests unnecessarily burden taxpayers;<sup>5</sup>
- Contemplated IRS policy changes would make the availability of Form 1042-S credits and refunds to covered taxpayers contingent on the actions of withholding agents;
- U.S. expatriates are especially vulnerable to FATCA-related hardships; and
- Businesses incur costs and risk exposures that could be minimized if the IRS adopted a more efficient and user-friendly approach to international tax administration.

### The IRS's Processes for Reviewing and Validating Chapter 3 and Chapter 4 Refund Requests Unnecessarily Burden Taxpayers

Beginning January 1, 2015, the IRS systemically froze all Chapter 3 refunds.<sup>6</sup> The intent was to freeze all refund claims until the accuracy of a refund request could be verified by matching the taxpayer's Form

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 National Taxpayer Advocate 2016 Annual Report to Congress 220-29; National Taxpayer Advocate 2015 Annual Report to Congress 346-52; National Taxpayer Advocate 2013 Annual Report to Congress 238-48. Foreign Account Tax Compliance Act (FATCA) was passed by the Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010).

3 National Taxpayer Advocate Public Forum, Washington D.C. (May 17, 2016) 25-26.

4 National Taxpayer Advocate 2016 Annual Report to Congress 221.

5 Under IRC §§ 1441-1443 (Chapter 3), the IRS imposes withholding on payments made to non-resident aliens and foreign corporations and allows credits and refunds of the amounts to which these taxpayers are entitled. Likewise, IRC §§ 1471-1474 (Chapter 4) mandates withholding under FATCA on payments to foreign financial institutions (FFIs) or similar institutions in specified circumstances and refers taxpayers to Chapter 3 for rules governing the credit or refund of those withheld amounts.

6 Internal Revenue Manual (IRM) 21.8.1.11.14.2, *FATCA - Programming Beginning January 2015 Affecting Certain Forms 1040NR* (Aug. 1, 2016).

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**Lacking either statistically valid data or analytical justification, the IRS has adopted a coercive approach to international taxpayers, reflecting an assumption that all such taxpayers are suspect of fraudulent activity.**

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1042-S against the withholding agent's copy that had been filed with the IRS.<sup>7</sup> Originally, the freeze window was established as six months from the time the return was due or filed, whichever was later, but that window was subject to unilateral extension by the IRS.<sup>8</sup>

The IRS developed an automated matching tool designed to classify likely valid and invalid claims, but tests showed that the system generated a 94 to 98 percent error rate and it was determined to be inoperable.<sup>9</sup> Thereafter, the IRS switched to an interim semi-automated tool,<sup>10</sup> which likewise yielded an unacceptably high rate of false positives and kept some taxpayers waiting for their refunds for over a year by the time the IRS suspended the matching program and announced the release of the remaining frozen refunds in June 2016.<sup>11</sup> At various points, more than 100,000 taxpayers had become subject to refund freezes.<sup>12</sup> A number of low-risk taxpayers, such as foreign students studying in the U.S., experienced particular hardship from these freezes.<sup>13</sup>

To its credit, the IRS is undertaking a long-term redesign of its Form 1042-S refund processes and has included TAS in the discussions. Currently, the IRS is using interim procedures under which it freezes some, but not all, Form 1042-S refunds for review prior to their release.<sup>14</sup> Under these interim procedures, as with domestic taxpayers, the IRS places the responsibility for correcting reporting errors by withholding agents on the shoulders of taxpayers. This approach, however, has severe consequences for international taxpayers, because, unlike in the domestic context, the IRS will not accept alternative proofs of withholding, and because withholding agents are not always willing or able to resolve documentation mismatches, regardless of whether the errors are attributable to actual misreporting on their part, or false positives on the part of the IRS. This circumstance has caused taxpayers, particularly those who are unsophisticated or unrepresented, a range of difficulties.<sup>15</sup>

Beyond causing unnecessary taxpayer burden, the Form 1042-S approach could create litigation risks for the IRS. In *Portillo v. Commissioner*, the Fifth Circuit Court of Appeals held that by failing to substantiate a Form 1099, the accuracy of which was challenged by the taxpayer, the IRS made a “naked assessment,” acted arbitrarily, and failed its burden of proof.<sup>16</sup> Courts generally have limited *Portillo* to

<sup>7</sup> IRM 21.8.1.11.14.2, *FATCA - Programming Beginning January 2015 Affecting Certain Forms 1040NR* (Aug. 1, 2016).

<sup>8</sup> *Id.* National Taxpayer Advocate Fiscal Year (FY) 2017 Objectives Report to Congress 81.

<sup>9</sup> Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2016-20-077, *Foreign Account Tax Compliance Act Program Withholding and Refund Release 2.0 Project Development and Testing* 6 (Aug. 2016).

<sup>10</sup> IRS, *IRS Takes Steps to Help Students; Outlines Interim Process for Obtaining Refunds of Withholding Tax Reported on Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding* (June 6, 2016), <https://www.irs.gov/uac/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042s-foreign-persons-us-source-income-subject-to-withholding>.

<sup>11</sup> National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 81.

<sup>12</sup> IRS response to TAS fact check (Oct. 31, 2016).

<sup>13</sup> National Taxpayer Advocate FY 2017 Objectives Report to Congress 82–83.

<sup>14</sup> IRM 21.8.1.11.14.3, *FATCA- 1042-S Matching Program - General Information - Identifying Related Letters, Transaction Codes, Reason Codes, 1042-S Data Fields* (Oct. 1, 2016, Feb. 9, 2017).

<sup>15</sup> National Taxpayer Advocate 2016 Annual Report to Congress 222–24.

<sup>16</sup> *Portillo v Comm'r*, 932 F.2d 1128 (5th Circuit, 1991). The burden of proof in tax cases generally rests with the taxpayer. In a deficiency proceeding, however, when a taxpayer establishes that an assessment is “arbitrary and erroneous,” the burden shifts to the IRS to prove the correct amount of any taxes owed. *Id.*, 1133.



unreported income cases arising in the domestic context.<sup>17</sup> Nevertheless, the IRS faces the risk that, in a case involving the creation of a deficiency attributable to a Form 1042-S mismatch, a court could extend *Portillo* and rule that IRS reliance on a withholding agent's Form 1042-S while rejecting a taxpayer's sworn Form 1040NR is arbitrary, particularly where the program's false positive rate is high. Such a finding could result in immediate dismissal of the IRS's case.

Further, even in a refund case, a taxpayer could come before a court and, using any available evidence, demonstrate that the withholding for which the refund is claimed actually occurred. Such a showing would open to judicial scrutiny the IRS's policy of relying solely on withholding agents' Forms 1042-S without any other validation, an approach treated as arbitrary in the Form 1099 context by the *Portillo* line of cases. Additionally, it would enable a taxpayer to challenge the IRS's current legal view that the IRS has no obligation to provide refunds unless it actually receives full remittances from withholding agents.<sup>18</sup>

To minimize taxpayer hardship and limit potential litigation, TAS encourages the IRS to focus its scrutiny on the relatively small percentage of Form 1042-S filers posing a high risk for noncompliance or fraud. This group can be identified through analysis of data available to the IRS, a step that would allow for a streamlining of resources and the tailoring of enforcement programs. Just as importantly, it would allow the IRS to reduce the burdens imposed on the vast majority of Form 1042-S taxpayers, who appear to be more compliant than U.S. taxpayers overall.<sup>19</sup>

### Contemplated IRS Policy Changes Would Make the Availability of Form 1042-S Credits and Refunds to Covered Taxpayers Contingent on the Actions of Withholding Agents

The IRS is also considering Chapter 3 and Chapter 4 guidance that would allow full credits or refunds only if the IRS can confirm that the withholding agent remitted the full amount of the aggregate liabilities for which the withholding agent is responsible.<sup>20</sup> If a withholding agent has only partially satisfied their deposit requirements with the IRS, the guidance would provide for a *pro rata* allocation of the amount deposited among taxpayers seeking to claim credits or refunds for the withholding in question.<sup>21</sup> This guidance does contemplate some exceptions, but none would allow taxpayers to demonstrate entitlement to their credit or refund by establishing that withholding at source had actually occurred.

The IRS's intentions regarding Chapter 3 and Chapter 4 refunds, as evidenced in Notice 2015-10 and related activities, are troubling. This policy would force many relatively powerless taxpayers, rather than the IRS, to police withholding agents and to bear the risk of noncompliance. Instead of attempting to shift burdens to taxpayers, IRS efforts would be better served by focusing on recalcitrant populations of taxpayers and withholding agents, and vigorously enforcing compliance within these groups. Such a targeted approach would have the added benefit of avoiding legal challenges to the IRS's current position, as discussed above, that it has the right to withhold credits and refunds from taxpayers anytime it does not receive full remittances from withholding agents.

17 See *Parker v. Comm'r*, 117 F.3d 785 (5th Circuit, 1997); *Pittman v. Comm'r*, 100 F.3d 1308 (7th Circuit, 1996); *Tinsman v. Comm'r*, 2000 Tax Ct. Memo LEXIS 62. See also *U.S. v. Janis*, 428 U.S. 433 (1976).

18 Notice 2015-10, 2015-20 I.R.B. 965.

19 National Taxpayer Advocate 2016 Annual Report to Congress 221.

20 Notice 2015-10, III.A., 2015-20, I.R.B. 965; Department of the Treasury 2016-2017 Priority Guidance Plan (Oct. 31, 2016).

21 Notice 2015-10, III.B., 2015-20, I.R.B. 965.

### U.S. Expatriates Are Especially Vulnerable to Foreign Account Tax Compliance Act (FATCA)-Related Hardships

The enforcement-oriented outlook resulting in and perpetuated by the passage of FATCA generated the Form 1042-S issues discussed above. The legislation and its administration by the IRS also have had a detrimental impact on the well-being of many U.S. expatriates. Because of the record-keeping and reporting requirements of FATCA, many foreign financial institutions (FFIs) have stopped providing banking services to U.S. citizens.<sup>22</sup> As a result of this banking “lock-out” and the additional tax reporting burdens placed on individuals by FATCA, record numbers of expatriates have been renouncing their U.S. citizenship.<sup>23</sup>

The National Taxpayer Advocate and others have proposed a “same country exception” as a means of solving these problems and minimizing the burden of FATCA compliance for both individual U.S. taxpayers and FFIs.<sup>24</sup> This exception would exclude from FATCA coverage financial accounts held in the country in which a U.S. taxpayer is a *bona fide* resident, would mitigate concerns about the collateral consequences of FATCA raised by U.S. nonresidents, and would reduce reporting burdens faced by FFIs. Neither the IRS nor Congress has yet implemented this recommendation.

### Businesses Incur Costs and Risk Exposures That Could Be Minimized If the IRS Adopted a More Efficient and User-Friendly Approach to International Tax Administration

Financial organizations face substantial record-keeping burdens and economic risks as a result of the manner in which the IRS has implemented FATCA. This has prompted some financial organizations and their representatives to energetically seek repeal of the legislation.<sup>25</sup> Other financial institutions have worked more quietly with the IRS in an effort to simplify reporting requirements and clarify the definition of “good faith efforts.”<sup>26</sup> A return by the IRS from its current withholding and enforcement orientation to its prior information gathering approach would reduce the burdens placed on FFIs and potentially minimize some of the remaining FATCA opposition.

## FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Analyze data to determine the validity of IRS assumptions about noncompliance and risk with respect to nonresidents receiving Forms 1042-S;
- Explore the validity of the IRS’s legal justification for treating nonresidents receiving Forms 1042-S differently from other taxpayers subject to withholding;
- Assess whether the results of these inquiries justify issuance of a Taxpayer Rights Impact Statement, which would serve as the predecessor of a Taxpayer Advocate Directive;

22 Andrew Velarde, *Will the FATCA Same-Country Exception Become the Rule?* 152 TAX NOTES 1073 (Aug. 17, 2016).

23 Andrew Velarde, *U.S. Quarterly Expat List Tops Record, Includes U.K.’s Johnson*, 154 TAX NOTES 809 (Feb. 8, 2017). These numbers appear to have dipped in the quarter ending March 31, 2017, although the reasons for that drop and whether it represents the beginning of a new trend are unclear. Zoe Sagalow, *Half as Many Expatriated as Last Quarter, Latest U.S. List Shows*, 2017 TNT 89-6 (May 10, 2017).

24 National Taxpayer Advocate Public Forum, Washington D.C. (May 17, 2016) 25-6; Andrew Velarde, *Will the FATCA Same-Country Exception Become the Rule?* 152 TAX NOTES 1073 (Aug. 17, 2016).

25 Nigel Green *Launches Campaign to Repeal Obama-Era FATCA Law*, TAX ANALYSTS DOC. 2017-1863 (Feb. 7, 2017).

26 IRS, *IRS FATCA Roundtable: Industry Concerns and Suggestions* 3 (Nov. 16, 2015).

- Work with the IRS to improve the policies and procedures associated with the redesigned Form 1042-S withholding and verification program;
- Advocate for U.S. taxpayers and businesses experiencing hardships and burdens flowing from IRS administration of the FATCA regime; and
- Provide TAS employees, taxpayers, and tax practitioners with enhanced training and guidance regarding the most commonly arising FATCA-related issues.

**Area of  
Focus #5**

## **The IRS's Heavy Reliance on the Online Account Benefits Taxpayers Who Can Access the Application and Prefer Digital Interaction, But It Burdens Taxpayers Who Need or Prefer More Personalized Service**

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

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Confidentiality*

### **DISCUSSION**

For years, the National Taxpayer Advocate has recommended that the IRS develop an online account application.<sup>2</sup> An online account application benefits those taxpayers who are able to access the digital system and who have the background, knowledge, experience, and preference to navigate through various complex transactions online. For that limited taxpayer population, the online account, in its current state and planned future releases, provides a convenient method to look up tax information, such as balance due, refund status, and case updates.

The IRS has developed some useful tools for taxpayers on the online account. However, we continue to have the following concerns.<sup>3</sup>

- While the first phase of the online taxpayer account provides balance due information, it does not provide guidance to taxpayers about how to resolve a dispute of the balance due amount provided;
- The IRS should initially limit third party access to the online account to those practitioners subject to Circular 230 oversight, with a goal of ultimately expanding access to unenrolled preparers who obtain a record of completion from the Annual Filing Season Program (AFSP) once the voluntary program requirements are strengthened;
- Approximately 33 million U.S. taxpayers have no broadband access at all, making it difficult for these individuals to access large files or conduct complex transactions on the online account;<sup>4</sup> and

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

3 In the 2016 Annual Report to Congress, the National Taxpayer Advocate raised concerns about the IRS "Future State" strategy's heavy reliance on service delivery through the online account. National Taxpayer Advocate 2016 Annual Report to Congress 1-41 (Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*); National Taxpayer Advocate 2016 Annual Report to Congress 121-37 (Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*).

4 See National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 1-30 (Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*). The TAS survey research also found that such vulnerable groups as low income, seniors, and taxpayers with disabilities are less likely to have broadband access at home.

- If only approximately 30 percent of individuals satisfy the crucial e-authentication requirements, a significant portion of the individual taxpayer population is prevented from accessing the online account program.

Most importantly, the IRS “Future State” strategy fails to acknowledge that taxpayers need, not just prefer, to engage in a conversation with the IRS at many points in their transactions to understand how the complex rules and procedures apply to their particular facts and circumstances. Likewise, the IRS needs to talk with taxpayers to understand their unique situations. While the online account application is a good information retrieval tool, it is not a substitute for personalized service where an IRS employee actually takes the time to hear an explanation of the taxpayer’s unique facts and circumstances, and either explains the complex rules and procedures to the taxpayer or makes the appropriate adjustments to the taxpayer’s account. Accordingly, depriving taxpayers of adequate personalized service options jeopardizes many taxpayer rights, but most importantly the taxpayer’s *right to challenge the IRS’s position and be heard*.

### Background

The IRS launched the first release of the online taxpayer account on November 16, 2016, and announced the launch to the public on December 1, 2016.<sup>5</sup> Only individual taxpayers can create an account during the initial release, and they access the online account through the payments tab of the IRS official website. Once individual taxpayers pass the multi-factor e-authentication standards, they can view their current account balance, if applicable, and up to 18 months of payment history. They can also select payment options such as IRS Direct Pay, debit or credit card payments, or an application for an installment agreement.<sup>6</sup> The IRS recently added the ability to access the IRS Get Transcript application through the online account, so taxpayers can obtain a transcript without logging in again to a separate application.<sup>7</sup> Finally, by the end of 2017, the IRS tentatively plans to add more payment features as well as a fully-integrated transcript with search capabilities.<sup>8</sup>

### TAS Continues to Work With the IRS As It Implements the Online Account for Individual Access

The first phase of the online account is very basic. It provides taxpayers with an account balance, 18 months of payment history, and three payment options.<sup>9</sup> Taxpayers who have the ability to access the program may not necessarily be able to use it to resolve their particular need or issue. Others may become even more confused.

For example, consider a taxpayer who accesses the account landing page only to find a balance that seems substantially more than expected. The taxpayer will not want to merely choose one of the payment options. In the current phase of the application, the taxpayer would be forced to seek more personal assistance, such as in a walk-in center or by telephone. The National Taxpayer Advocate has suggested that the IRS provide a button indicating “I don’t think I owe this amount.” Once the taxpayer clicks on that button, the site should provide information on different options available to dispute the balance,

5 IRS News Release 2016-155, *IRS Launches New Online Tool to Assist Taxpayers with Basic Account Information* (Dec. 1, 2016).

6 IRS, *View Your Account Balance and Payment History*, <https://www.irs.gov/uac/view-your-tax-account> (last visited May 8, 2017).

7 IRS, *View Your Tax Account Information*, <https://www.irs.gov/uac/view-your-tax-account>; Luca Gattoni-Celli, *IRS Adds Get Transcript to Online Taxpayer Accounts*, *Tax Notes Today* (May 11, 2017).

8 Wage and Investment (W&I) response to TAS information request (Sept. 1, 2016); Services and Enforcement (S&E) ESC, *Online Account Status Briefing 5* (Nov. 17, 2016); IRS 10-day response to MSP fact check (Dec. 20, 2016).

9 The online account can be accessed from the following IRS payments page: <https://www.irs.gov/payments/finding-out-how-much-you-owe> (last visited Nov. 27, 2016).

including return amendment, audit reconsideration, refund claims, penalty abatement, innocent spouse, injured spouse, identity theft, return preparer fraud, and doubt as to liability for offer in compromise. As of the date of printing, the IRS is conducting usability testing on different ways to convey these options to the account user.<sup>10</sup> In addition, the National Taxpayer Advocate has encouraged the IRS to increase the 18-month payment history to at least 24 months to provide useful information for refund claims.<sup>11</sup>

### **Restricting Third Party Access of the Online Account to Circular 230 Practitioners Is a Crucial Taxpayer Protection Measure the IRS Must Take From Inception of the Application**

In previous annual reports, the National Taxpayer Advocate raised concerns regarding preparer access to the online account. Specifically, we are concerned that the IRS will expose taxpayers to potential harm due to preparer incompetence or misconduct if it does not restrict access to only those preparers subject to IRS oversight pursuant to Circular 230.<sup>12</sup> Once it strengthens the testing requirements in the AFSP, the IRS should expand access to those preparers who obtain the AFSP record of completion.<sup>13</sup> When the National Taxpayer Advocate raised this recommended restriction on preparer access during the dozen National Taxpayer Advocate Public Forums held around the country, the proposal received overwhelming support.<sup>14</sup>

The IRS Office of Online Services (OLS) is currently planning the parameters and features of the online account for third party access. The Product Management division of OLS has committed to share the prototype with TAS in various stages of development and consider our comments and suggestions for improvement.<sup>15</sup> It also plans to test a prototype of a third party account at the 2017 IRS Nationwide Tax Forums. We urge the IRS to proceed cautiously in testing this prototype at the Tax Forums, because such testing might unnecessarily raise expectations with the unenrolled preparer population. It is ill-advised to request this group to user test the prototype only to subsequently bar access.

### **Taxpayers Without Broadband Access Will Not Be Able to Use the Online Account**

While the online account will benefit many taxpayers, there is still a significant population that cannot access the account. TAS survey research has shown that approximately 33 million U.S. taxpayers have no broadband access at all. Taxpayers with internet service connections slower than broadband will likely

10 MediaBarn, *IRS Online Account – Research Findings, Test Periods: February & March* (Mar. 28, 2017).

11 National Taxpayer Advocate 2016 Annual Report to Congress 121-37 (Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*). Under IRC § 6511(a), a taxpayer must file a claim for credit or refund of an overpayment within: 1) three years from the time the return was filed, or 2) two years from the time the tax was paid, whichever is later. If no return was ever filed by the taxpayer then the claim must be filed within two years of payment of the tax.

12 31 U.S.C. § 10.3.

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

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

15 Meeting with IRS Office of Online Services (Mar. 28, 2017).

experience delays when attempting to access large files or complex web pages. In addition, 14 million U.S. taxpayers have no internet access at all.<sup>16</sup>

### Crucial e-Authentication Requirements Impose a Barrier to Entry for a Significant Population

In the 2016 annual report, we raised concerns about the IRS's reliance on the online account for service delivery even though a substantial portion of those who attempt to create accounts cannot satisfy the necessary strict e-authentication requirements.<sup>17</sup> Immediately after the IRS established its current online account in Fall 2016 with three-factor security authentication, only about 30 percent of the taxpayers who attempted to create an online account were able to do so.<sup>18</sup> Further, as of May 20, 2017, of the approximately 1.6 million account registration attempts since the application launched, only about 21 percent (334,328) were successful.<sup>19</sup> Thus, while it is absolutely essential to protect the integrity of taxpayer data, e-authentication creates a barrier to access. The IRS recognizes that providing this security has implications for how many taxpayers will be able to access their accounts electronically; however, it has failed to acknowledge that these security protections mean that many will need to contact the IRS by telephone or in taxpayer assistance centers (TACs).

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**While the online account application is a good information retrieval tool, it is not a substitute for personalized service where an IRS employee actually takes the time to hear an explanation of the taxpayer's unique facts and circumstances, and either explains the complex rules and procedures to the taxpayer or makes the appropriate adjustments to the taxpayer's account.**

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TAS will be able to assess how e-authentication impacts taxpayers firsthand during 2017. Beginning in April 2017, TAS began conducting a pilot of the Taxpayer Digital Communication (TDC) Secure Messaging system. TDC uses the same e-authentication requirements as the online account, also known as Secure Access. TAS is conducting the pilot in the following four offices: Dallas, Nashville, New Orleans and Cleveland. The pilot will only include unrepresented taxpayers involved in Earned Income Tax Credit (EITC) or levy cases. TDC enables TAS to send and receive electronic webmail, along with certain digital documents, to and from taxpayers through a secure portal. Taxpayers will be able to communicate within the system using computers, smartphones, or tablets. Once inside the secure portal, taxpayers will be able to respond to their assigned case advocate and upload scanned or photographed documents. This pilot is expected to run through September 2017, with the possibility for an extension of up to a year. TAS will gather data about every step of the process, including the e-authentication process and ease and frequency of system use. We expect this data to assist us in better understanding

16 See National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 1-30 (Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*). The TAS survey research also found that such vulnerable groups as low income, seniors and taxpayers with disabilities are less likely to have broadband access at home. See also Aaron Smith, Pew Research Center, *Record Shares of Americans Now Own Smartphones, Have Home Broadband* (Jan. 12, 2017).

17 National Taxpayer Advocate 2016 Annual Report to Congress 121-37 (Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*).

18 IRS response to TAS fact check (Dec. 20, 2016) (providing data through Dec. 18, 2016). The IRS declined to provide us with an updated official Secure Access pass rate and has said it will no longer make the rate available. Email from IRS Identity Assurance Executive to National Taxpayer Advocate (Mar. 4, 2017).

19 IRS, Wage and Investment Division, Joint Operations Center (JOC), *Online Account External Launch Weekly Report* (week ending May 20, 2017). The registration rate increased to 27 percent by May 20, 2017.

the ability of taxpayers to participate in the IRS online applications with Secure Access e-authentication requirements.<sup>20</sup>

## FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Finalize the administration of and report on the final survey results on *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service* to determine the particular usefulness of channels for various types of activities, as reported by the taxpayers;<sup>21</sup>
- Work with OLS as it designs and implements future releases of the online account to ensure that the program addresses taxpayer needs and preferences, especially those expressed at the 2016 National Taxpayer Advocate Public Forums and the TAS focus groups held at the 2016 IRS Nationwide Tax Forums, and identified in our 2016 interim survey report and upcoming 2017 survey results on *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service*;
- Participate in user tests of prototypes for future releases of the online account to ensure that the program is clearly presented and written in plain language, and addresses suggestions provided in previous user tests;
- Advocate for low income and other vulnerable populations who have low broadband rates, taxpayers who cannot pass the strict e-authentication requirements, and other taxpayers who need or prefer personal interaction, by working with the IRS to ensure it maintains meaningful and high-quality service options for these populations;
- Work with the IRS to restrict preparer access to taxpayers' online accounts to those who are regulated by Circular 230, with the ultimate goal of expanding access to record of completion holders of the voluntary AFSP once the testing component is strengthened; and
- Assess the impact of the TAS TDC pilot to determine the impact of the Secure Access e-authentication requirements on taxpayers attempting to participate in the pilot.

20 Small Business/Self-Employed (SB/SE) Exam launched a pilot of TDC in December 2016, allowing select taxpayers to correspond digitally with Exam regarding their audits. The pilot involved between 4,000 and 5,000 taxpayers selected for audits of itemized deductions. IRS SERP Alert 17A0048, *Secure Messaging Pilot for SBSE Correspondence Exam (TDC)* (Feb. 6, 2017); IRS SERP Alert 16A0336, *Secure Messaging Pilot for SBSE Correspondence Exam (TDC)* (Dec. 20, 2016); Luca Gattoni-Celli, *IRS Plans to Launch Secure Messaging Pilots for Exams*, TAS, TAX NOTES TODAY (Feb. 2, 2017).

21 For a report on the interim results of the survey through November 16, 2016, see National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 1-30 (Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*); see also TAS Research Initiatives, *infra*.



**Area of  
Focus #6**      **TAS Continues to Pursue Improvements to the IRS’s  
Administration of the Earned Income Tax Credit (EITC),  
Particularly With Recent Changes to the Law**

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

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

### DISCUSSION

The Earned Income Tax Credit (EITC) was enacted as a work incentive in the Tax Reduction Act of 1975.<sup>2</sup> It has become one of the government’s largest means-tested anti-poverty programs.<sup>3</sup> In tax year (TY) 2015, over 27 million taxpayers received about \$67 billion in EITC benefits.<sup>4</sup> Unlike traditional anti-poverty and welfare programs, the EITC was designed to have an easy “application” process by allowing an individual to claim the benefit on his or her tax return. This approach dramatically lowered administrative costs, since it did not require an infrastructure of case workers and local agencies to make eligibility determinations. However, the easy application process of the EITC is also associated with a high improper payment rate.<sup>5</sup> In addition, the Department of Treasury has noted that “[EITC] rules are complex and lead to high overclaim error rates for these credits.”<sup>6</sup> The National Taxpayer Advocate has long advocated for changes that could reduce the improper payment rate while ensuring taxpayers eligible for the EITC receive it.<sup>7</sup>

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 Pub. L. No. 94-12, § 204, 89 Stat. 26 (1975).
- 3 Congressional Budget Office, *Federal Means-Tested Programs and Tax Credits – Infographic* (Feb. 11, 2013), <https://www.cbo.gov/publication/43935>.
- 4 IRS, *About Earned Income Tax Credit (EITC)*, <https://www.eitc.irs.gov/EITC-Central/abouteitc>.
- 5 An improper payment is defined as “any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements” and “any payment to an ineligible recipient.” Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111–204, § 2(e) (2010) amending Improper Payments Information Act of 2002, Pub. L. No. 107-300 (2002) by striking § 2(f) and adding (f)(2). The IRS estimates that for fiscal year (FY) 2016, between 22.2 percent (\$15.5 billion) and 25.9 percent (\$18.1 billion) of the total EITC program payments of \$69.8 billion were improper. Department of Treasury, *Agency Financial Report Fiscal Year 2016* 49 (Nov. 2016).
- 6 Department of Treasury, *Agency Financial Report Fiscal Year 2016* 161 (Nov. 2016).
- 7 National Taxpayer Advocate 2016 Annual Report to Congress 325-57; National Taxpayer Advocate 2016 Annual Report to Congress 138-50; National Taxpayer Advocate 2015 Annual Report to Congress 248-60; National Taxpayer Advocate 2012 Annual Report to Congress 103-15; National Taxpayer Advocate 2011 Annual Report to Congress 296-312; National Taxpayer Advocate 2008 Annual Report to Congress 227-42; National Taxpayer Advocate 2007 Annual Report to Congress 222-41; National Taxpayer Advocate 2005 Annual Report to Congress 94-122; National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 8-45.

### Congress Mandated a Delay in Earned Income Tax Credit Refunds to Reduce the EITC Improper Payment Rate

To address the EITC improper payment rate, Congress mandated a delay of any refund that includes the EITC or the refundable portion of the Child Tax Credit until February 15 of each filing year.<sup>8</sup> The National Taxpayer Advocate previously made a similar recommendation.<sup>9</sup> This change could be useful in reducing the improper payment rate, particularly since National Research Program (NRP) data found that 51 percent of returns with an EITC overclaim contained income misreporting as the sole error (with the average claim being \$673).<sup>10</sup> Even though it had to hold the refunds until February 15, the IRS informed taxpayers this year not to expect the refunds until the week of February 27 because banking and financial systems needed time to process the deposits.<sup>11</sup> The National Consumer Law Center has warned that such delay may create financial hardships for low income taxpayers.<sup>12</sup> In addition, delayed refunds may have a negative effect on the timing and level of consumer spending.<sup>13</sup>

### EITC Returns Undergo Several Levels of Review

Each return filed has the potential to go through many layers of review. Figure 3.6.1 presents a flowchart for the processing of an electronic EITC return.

1. A return is prepared (either by the taxpayer, a paid preparer, or a service such as a Volunteer Income Tax Assistance site).
2. The return is transmitted to the IRS Modernized e-file system (MeF). At this point, the system checks for any duplicate Taxpayer Identification Numbers (TINs) used and established consistency checks. In this process, the return may be rejected before IRS accepts the return information. If the return is not accepted, it will receive a rejection code, and the taxpayer will receive a written explanation.
3. The return passes initial checks and moves to the Error Resolution System (ERS). This review may include incorrect or unverifiable line entries (such as transposed numbers or wages listed on the wrong line) and incorrect or missing schedules on the return. Some errors can be resolved without contacting the taxpayer and will be fixed manually. If there is an unresolved error, the return is posted and a math error notice is issued at this stage. If the ERS cannot resolve the problem, taxpayer contact is necessary, which will further delay resolution.
4. A return claiming a refund then moves to three filters concurrently: Dependent Database (DDb), Return Review Program (RRP), and Exam Scoring. The return is subject to identity theft scoring in DDb. RRP scores the likelihood of each Form W-2 being invalid or fraudulent and also screens for potential identity theft. Exam Scoring is the method by which the IRS selects returns to be audited. The IRS uses different filters to score for identity theft and examination selection.

8 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title II, §201, 129 Stat. 3076 (2015) (codified at IRC § 6402(m)). This applies to refunds made after December 31, 2016. IRC § 6402(m). For a full discussion of the filing season and the February 15 refund delay, see *Review of the 2017 Filing Season*, *supra*.

9 *The National Taxpayer Advocate's 2014 Annual Report to Congress: Hearing before the H.Subcomm. on Government Operations Committee on Oversight and Government Reform*, 114th Cong. 27 (2015) (written statement of Nina E. Olson, National Taxpayer Advocate).

10 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 16 (Aug. 2014).

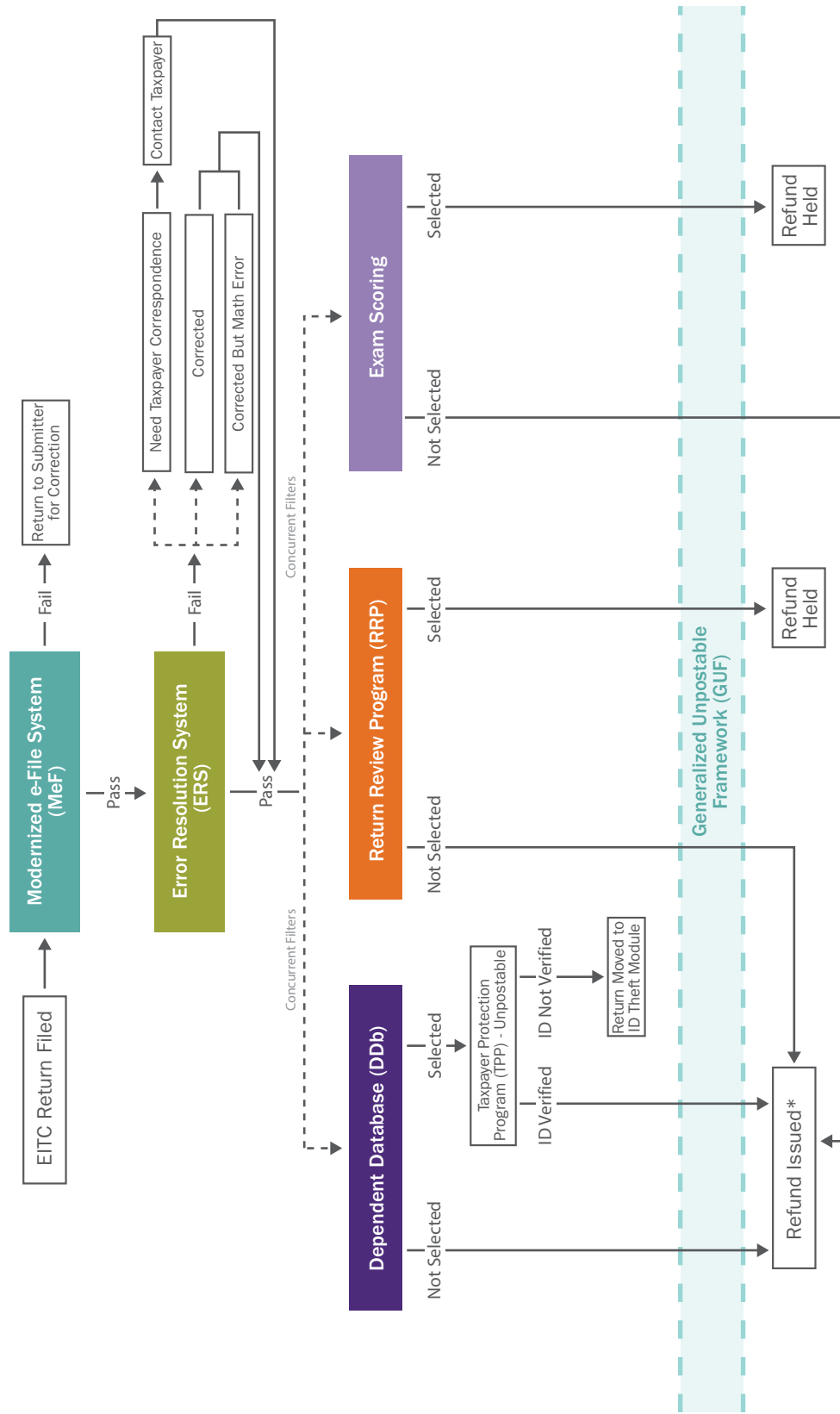
11 IRS, *Refund Timing for Earned Income Tax Credit and Additional Child Tax Credit Filers*, <https://www.irs.gov/individuals/refund-timing>.

12 National Consumer Law Center, *Tax Time Kick-Off: Delays and Risks Await Many Taxpayers This Year* (Jan. 23, 2017), <https://www.nclc.org/media-center/delays-risks-await-many-taxpayers.html>.

13 Steven Russolillo, *Equities – Ahead of the Tape: A Taxing Effect on Retailers' Revenue*, THE WALL STREET JOURNAL (Mar. 15, 2017).

FIGURE 3.6.1, Processing of an Electronic Earned Income Tax Credit Refund Return

Processing of an Electronic Earned Income Tax Credit Refund Return



\*Unless selected by one of the other two programs

5. The return at this point is reviewed simultaneously by the Generalized Unpostable Framework (GUF). GUF simply determines if the return can post and works to correct returns that cannot post. If the return can be corrected, it will be posted.

### TAS Has Not Identified Any Specific Problems With the Refund Freeze, Yet the IRS Must Remain Aware of Potential Problems for Taxpayers

Based on an analysis of IRS data from filing season 2017, it appears that all computer-generated freezes related to the Protecting Americans from Tax Hikes Act (PATH Act) of 2015 released as anticipated.<sup>14</sup> Furthermore, TAS compared the number of EITC refunds issued week-by-week in filing season 2016 to the comparable period in filing season 2017. TAS found that by the fourth week of filing season 2016, the IRS had issued 13.6 million refunds. In comparison, by the fourth week of filing season 2017 (the first week in which EITC refunds were issued), the IRS had issued refunds to slightly less than 11.3 million taxpayers. See Figure 3.6.2.

**FIGURE 3.6.2, Comparison of Refund Issuance Dates on Returns Receiving the Earned Income Tax Credit Between Filing Seasons 2016 and 2017<sup>15</sup>**

Week Ending	2016 Cumulative	2017 Cumulative	Percentage Difference
Jan. 26, 2017	855,083		
Feb. 2, 2017	7,424,783		
Feb. 9, 2017	11,104,413		
Feb. 16, 2017	13,627,831	11,260,446	-17.4%
Feb. 23, 2017	15,533,821	13,367,603	-13.9%
Mar. 2, 2017	16,995,981	15,265,718	-10.2%
Mar. 9, 2017	18,166,010	16,691,389	-8.1%
Mar. 16, 2017	19,134,737	17,814,073	-6.9%
Mar. 23, 2017	19,971,655	18,775,735	-6.0%
Mar. 30, 2017	20,713,482	19,635,955	-5.2%
Apr. 6, 2017	21,468,224	20,459,066	-4.7%
Apr. 13, 2017	22,323,775	21,351,318	-4.4%
Apr. 20, 2017	23,494,074	22,534,564	-4.1%

TAS also compared the period of time between when a return posted and when the refund was issued in filing seasons 2016 and 2017. For filing season 2016, about 239,000 taxpayers had to wait two weeks or more for the IRS to issue their refunds after their returns posted. This number climbed to more than seven million taxpayers in filing season 2017 (a 2,858 percent increase).<sup>16</sup> However, the increase in waiting time declined as filing season 2017 progressed. For taxpayers who had delays of four weeks or more, there was a 31 percent increase between filing seasons 2016 and 2017 (over 108,000 taxpayers

14 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title II, §201, 129 Stat. 3076 (2015) (codified at IRC § 6402(m)).

15 The 2017 figures differ slightly from those TAS reported in recent testimony. Hearing Before the H. Comm. on Appropriations, Subcomm. on Financial Services and General Government, 114th Cong. 34-35 (2017) (written testimony of Nina E. Olson, National Taxpayer Advocate). The data presented here were generated June 5, 2017, and while we are unsure why the data differ, the order of magnitude and percentage change is the same.

16 TAS review of Individual Returns Transaction File and the Individual Master File.

in filing season 2016 compared to over 141,000 taxpayers in filing season 2017). The average delay was about a week longer in 2017 than 2016 (through the end of March 2017).

The number of frozen EITC returns between filing seasons 2016 and 2017 increased by nearly 260 percent (from about 41,000 to 148,000), and EITC dollars frozen increased by about 225 percent (from \$147 million to \$479 million).<sup>17</sup> The dollars frozen in filing season 2017 constitute a potential 2.1 percent decrease in improper payments from filing season 2016 to 2017.<sup>18</sup> This is not surprising because although income misreporting is the most frequent source of EITC errors, it does not account for the largest dollar amount of EITC errors.<sup>19</sup> Because EITC noncompliance is attributable to multiple causes, there is no single solution; instead, it will take multiple approaches to bring down the improper payment rate.

### *Some Barriers May Prevent the IRS From Fully Benefiting From the Refund Freeze*

Of those taxpayers whose refund returns posted by February 15, a Form W-2 was available for 85 percent of EITC claimants (approximately 11.6 million EITC returns filed, with 9.9 million matches) and 83 percent of non-EITC claimants (approximately 21.3 million non-EITC returns filed, with approximately 17.7 million matches with a Form W-2).<sup>20</sup> However, the Government Accountability Office (GAO) reports that the IRS was able to verify the wage information for only over 35 percent of the frozen EITC returns before February 15.<sup>21</sup> The IRS reprocessed about one million returns during the freeze period as new data became available; however, the IRS was unable to verify wage information for more than 58 percent of EITC returns before February 15.<sup>22</sup> The GAO reports three reasons for the inability to verify all W-2 information:

- The IRS receives electronic W-2 data from the Social Security Administration (SSA) daily but because of older IRS technology, it could only load the information on a weekly basis;
- Some employers requested extensions beyond the new deadline of January 31 or missed the deadline; and
- W-2 information in paper form was not sent by the SSA until March 2017.<sup>23</sup>

17 TAS review of Individual Returns Transaction File and the Individual Master File. Data includes taxpayers whose tax year (TY) 2015 refunds were processed by March 2016 and whose TY 2016 returns were processed by March 2017 and scheduled to receive EITC after IRS math error processing, but prior to audit.

18 This percentage is calculated as the additional \$332 million of EITC not refunded divided by the FY 2016 lower bound EITC improper payment estimate of \$15.5 billion. We will not know the exact decrease in the improper payment rate until the IRS has made a final determination on each case where the EITC was frozen as a result of the wage verification process.

19 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* (Aug. 2014). See also National Taxpayer Advocate 2016 Annual Report to Congress 325-57 (Legislative Recommendation: *Tax Reform: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*).

20 As of the 13th week of 2017, there were 21,255,911 non-EITC returns filed around February 15, 2017, with 17,676,337 of those returns having a matched Form W-2. There were about 11,634,573 EITC returns filed around February 15, 2017, with about 9,907,286 matched to a Form W-2. These results are for a match on primary Taxpayer Identification Number (TIN) only and a match indicates that at least one Form W-2 was filed for the primary taxpayer. Individual Returns Transaction File and the Information Returns Master file for TY 2016 returns.

21 *2017 Filing Season: Hearing Before the H. Subcomm. on Oversight of the H. Comm. on Ways and Means*, 115th Cong. 7 (2017) (written statement of Jessica Lucas-Judy, Government Accountability Office Acting Director, Strategic Issues).

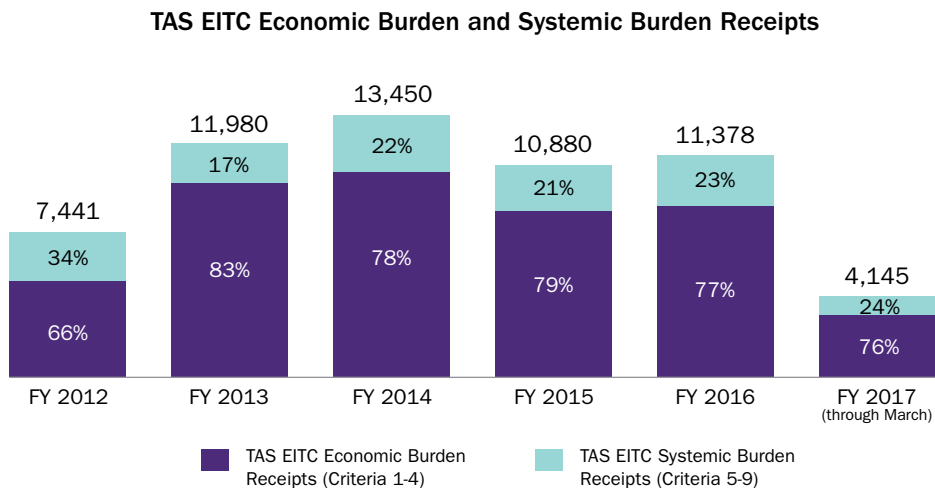
22 *Id.*

23 *Id.* at 8.

Ultimately, IRS officials report that the initial W-2 verification process for all returns with a frozen refund allowed the IRS to identify approximately 162,000 potentially fraudulent returns, representing about \$863 million in refunds.<sup>24</sup>

The IRS and TAS will continue to analyze the 2017 filing season data to determine what impact freezing EITC refunds until February 15 had on the EITC overpayment rate. Additionally, TAS will monitor its caseload to ensure the IRS minimized any unnecessary hardships due to the February 15 freeze. The majority of TAS cases related to the EITC are consistently based on economic hardship, as shown in Figure 3.6.3.<sup>25</sup> In fact, the GAO reported the IRS opted to not hold all refunds until February 15 because of the burden such an action could have on the economy.<sup>26</sup>

FIGURE 3.6.3<sup>27</sup>



**The Joint EITC Audit Improvement Team Continues to Make Improvements for Taxpayers Claiming the EITC**

*The List of Acceptable Documentation to Substantiate an EITC Claim Has Been Expanded*

TAS is an active participant on a collaborative IRS team dedicated to identifying ways to improve the audit process for taxpayers claiming the EITC. One area of improvement includes the identification of acceptable documents for substantiating EITC claims, which are particular to the circumstances of low

24 2017 Filing Season: Hearing Before the H. Subcomm. on Oversight of the H. Comm. on Ways and Means, 115th Cong. 9 (2017) (written statement of Jessica Lucas-Judy, Government Accountability Office Acting Director, Strategic Issues).

25 TAS receives cases that fall into four categories: economic hardship, systemic burden, best interest of the taxpayer, and TAS public policy. Internal Revenue Manual (IRM) 13.1.7.1 (Feb. 4, 2015). Economic burden cases are those involving a financial difficulty to the taxpayer: an IRS action or inaction has caused or will cause negative financial consequences or have a long-term adverse impact on the taxpayer. Systemic burden cases are those in which an IRS process, system, or procedure has failed to operate as intended, and as a result the IRS has failed to timely respond to or resolve a taxpayer issue. IRM 13.1.7.2 (Feb. 4, 2015).

26 2017 Filing Season: Hearing Before the H. Subcomm. on Oversight of the H. Comm. on Ways and Means, 115th Cong. 7 (2017) (written statement of Jessica Lucas-Judy, Government Accountability Office Acting Director, Strategic Issues).

27 In 2017, TAS generally did not accept cases where the taxpayer sought assistance getting an EITC refund frozen under the PATH Act expedited. However, there were six exceptions to this rule, which among other things, involved accepting the case if it required case building while the refund was frozen. TAS, 2017 Filing Season - PATH Act Section 201 2-3 (2017).

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**Because Earned Income Tax Credit noncompliance is attributable to multiple causes, there is no single solution; instead, it will take multiple approaches to bring down the improper payment rate.**

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income taxpayers. This is something for which the National Taxpayer Advocate has consistently advocated.<sup>28</sup> Previous internal guidance provided a list of acceptable documentation to substantiate an EITC claim; however, the list was very narrow and did not reflect the types of documentation and methods of proof that would most likely be available or best-suited for taxpayers claiming the EITC.

Through the work of the EITC Audit Improvement Team, Internal Revenue Manual (IRM) 4.19.14-1 was added in July 2016. This IRM section will foster acceptance of substantiating documentation outside of the traditional EITC documentation, which typically includes letters from schools and doctors' offices. In addition to listing various "new" documents for Exam employees to consider, such as paternity test results, eviction notices, and statements from homeless shelters, the internal guidance informs exam employees that this list is not all-inclusive. The National Taxpayer Advocate will continue to work to have even more alternative documents listed in IRM 4.19.14-1.

### *TAS Continues to Advocate For Affidavits As a Tool For Taxpayers to Substantiate EITC Claims*

The EITC Audit Improvement Team is considering how to incorporate the use of affidavits in EITC audits. Data from the IRS NRP reveals that the IRS should be focusing its efforts on EITC claims that involve qualifying child errors. While only 15 percent of returns with an EITC overclaim contained just a qualifying child error, the average claim was \$2,327, which is one of the largest dollar sources for EITC errors.<sup>29</sup> The NRP data broke the errors down even further and found that by far, the residency test is the highest source of errors. The data show that at least 75 percent of the children known to be claimed in error fail the residency test.<sup>30</sup> Compared to residency, only 20 percent of children known to be claimed in error failed the relationship test.<sup>31</sup>

In 2005, the IRS studied the use of affidavits as part of its EITC Qualifying Child Residency Certification Study.<sup>32</sup> For the study, the IRS mailed documents to taxpayers (the test group) who had claimed the EITC with qualifying children in the previous tax year, but for whom the IRS could not establish qualifying child residency through available data. The documents sent to the taxpayer explained the certification requirements and included Form 8836, *Qualifying Child Residency Statement*, an affidavit form, and educational publications.<sup>33</sup> To certify their claim, the taxpayers in the study could submit any combination of documents described in Form 8836 (medical and school records, a letter on official letterhead, etc.) or the affidavit. The study found that affidavits had the highest rate of acceptance at 82 percent, compared to an overall acceptance rate of 64 percent for all document types.<sup>34</sup> The study concluded that this outcome was reasonable because affidavits had dedicated lines for all of the

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28 National Taxpayer Advocate 2015 Annual Report to Congress 253-54; National Taxpayer Advocate 2011 Annual Report to Congress 305; National Taxpayer Advocate 2007 Annual Report to Congress 225; National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 20.

29 The National Research Program (NRP) conducted EITC audits in order to gather information about the nature of errors taxpayers made when claiming the EITC in tax years 2006 through 2008. IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 16 (Aug. 2014).

30 *Id.* at 22.

31 *Id.* at 23.

32 IRS, *IRS Earned Income Tax Credit (EITC) Initiative Final Report to Congress* 7 (Oct. 2005).

33 *Id.*

34 *Id.* at 33.

information, explaining “as long as the affidavit was filled out completely, it would contain all the required information to be accepted.”<sup>35</sup>

The National Taxpayer Advocate believes that the affidavit should be incorporated into the EITC audit process as a tool for any taxpayer to use for substantiating his or her claim, and will help reduce the improper payment rate. It is an option that TAS is advancing through its participation on the joint EITC Audit Improvement Team. While keeping in mind that the National Taxpayer Advocate would like affidavits available to all EITC taxpayers, the EITC Audit Improvement Team is currently reviewing which particular group of EITC taxpayers could most benefit from receiving an affidavit early in the audit process.

TAS also plans to offer training to its employees during the months of June, July, and September. The training, which is entitled *EITC: Advocating With and For Taxpayers*, is based on a training developed by the EITC Audit Improvement Team for IRS employees. The training will discuss how to use communication skills to create a partnership with EITC taxpayers during the initial telephone contact.

### TAS Will Continue Its Study to Research How Increased Education Can Improve Compliance

In January 2016, the National Taxpayer Advocate sent about 7,100 letters to the taxpayers who were not audited but appeared to have erroneously claimed EITC on their 2014 returns.<sup>36</sup> The letters were specifically designed to inform and educate taxpayers with targeted and specific information about EITC eligibility rules, geared to the error the IRS identified. The letters explained their purely educational purpose and clearly stated that this contact was not an audit. For those taxpayers who received Title IV benefits (Temporary Assistance for Needy Families, etc.), the letter included a sentence reminding them that the eligibility rules for EITC were different from the rules for Title IV benefits, so a taxpayer could receive Title IV benefits for a child and yet not be eligible for the EITC with respect to that same child. TAS then compared the level of compliance shown on taxpayers’ 2016 returns among three groups:

- Taxpayers who were not audited but were sent the TAS letter;
- A representative sample of taxpayers whose 2014 returns were audited; and
- A representative sample of taxpayers whose 2014 returns appeared to erroneously claim the EITC but who were not audited and did not receive the TAS letter.<sup>37</sup>

The TAS letter, intended to educate taxpayers about the requirements for claiming EITC, appeared to help taxpayers avoid repeating their mistakes.<sup>38</sup> Taxpayers who were sent the TAS letter because they appeared to not meet the relationship test on their 2014 returns were less likely to repeat that error on their 2015 returns. Those who did not receive the TAS letter repeated their error 77.3 percent of the time, compared to 74.7 percent for the TAS group, an improvement of 2.6 percent.<sup>39</sup> There were about 1.2 million returns for 2014 that appeared to erroneously claim EITC because the relationship

35 IRS, *IRS Earned Income Tax Credit (EITC) Initiative Final Report to Congress* 33 (Oct. 2005).

36 National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 32-51 (Research Study: *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits Apparently in Error and Were Sent an Educational Letter From the National Taxpayer Advocate*). Over 500 letters were returned to TAS as undeliverable.

37 *Id.*

38 *Id.* at 47.

39 *Id.* at 45.



requirement had not been met. If the TAS letter had been sent to all of those taxpayers, the projected savings would be about \$47 million.<sup>40</sup>

TAS is repeating the letter test in the 2017 filing season. TAS added an additional sample of taxpayers who are offered, in the letter, the availability of a dedicated “Extra Help” line staffed by trained TAS employees who can answer taxpayer questions about the letter and the EITC eligibility rules. TAS is tracking the compliance behavior of that cohort as well and will report on that in the 2017 Annual Report to Congress.

## CONCLUSION

As mentioned above, the EITC suffers from a high improper payment rate. However, since the EITC provides a benefit to so many low income taxpayers, any approach to reduce the improper payment rate must be balanced with minimal disruption to low income taxpayers, who rely on this credit for their day-to-day survival. The IRS has recently adopted new measures that will benefit both the improper payment rate and low income taxpayers.

## FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Propose a Legislative Recommendation based on a thorough review of the extended refund issuance date;
- Coordinate with the IRS to implement the use of affidavits for all taxpayers who need to recertify for the EITC; and
- Complete the second year of the study addressing the impact of education on noncompliance.

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<sup>40</sup> There were 1,197,374 returns processed in 2015 (which generally equates to returns filed for TY 2014) that appeared to contain this error. Data is from a Business Object interface with the Dependent Database (DDb), showing returns claiming EITC scored by the DDb for processing year 2015, which generally corresponds to returns filed for TY 2014. National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 44.

**Area of Focus #7**     **The IRS Makes Needed Changes to the Individual Taxpayer Identification Number (ITIN) Program, But Barriers for ITIN Applicants Remain**

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

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

### DISCUSSION

Individual Taxpayer Identification Numbers (ITINs) play a valuable role in tax administration by allowing taxpayers who are ineligible for Social Security numbers (SSNs) to file returns and pay taxes that are required under the law.<sup>2</sup> ITINs facilitate international business because foreign taxpayers report their ITINs to third parties and withholding agents to document foreign status and claim exemptions from withholding or reduced rates of withholding.<sup>3</sup> In late 2015, Congress passed the Protecting Americans Against Tax Hikes (PATH) Act and for the first time codified elements of the ITIN program, including how an applicant may apply, what documents are required, when an ITIN expires, when an ITIN must be issued to claim certain refundable credits, and when the IRS may use math error authority.<sup>4</sup> Following the passage of the PATH Act, the IRS implemented changes to the ITIN program, including:

- Notifying taxpayers and deactivating ITINs for either age of issuance or non-use;<sup>5</sup>
- Exercising its math error authority<sup>6</sup> to disallow credits and exemptions for returns including a deactivated ITIN;<sup>7</sup>
- Disallowing the Child Tax Credit (CTC) and American Opportunity Tax Credit (AOTC) when the ITIN is not considered issued by the tax return due date;<sup>8</sup>

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified as IRC § 7803(a)(3)).

2 All United States (U.S.) citizens and persons considered U.S. residents under the IRC are required to file and pay U.S. taxes on their worldwide income and need a Taxpayer Identification Number (TIN) to do so. See, e.g., IRC § 61. Individuals considered nonresident aliens under the IRC are required to file and pay tax on income derived from sources within the United States. See IRC §§ 1, 2, 871, 7701(b).

3 Chapter 3 of the IRC generally requires withholding agents to collect the substantive tax liability of nonresident aliens imposed under IRC §§ 871(a), 881(a), and 4948 by withholding on certain payments of U.S. source fixed or determinable annual or periodical income. See IRC §§ 1441-1443. See also IRC §§ 1471-1474 (Chapter 4).

4 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV (2015) (hereinafter PATH Act).

5 Under the law, all Individual Taxpayer Identification Numbers (ITINs) issued after 2012 will remain in effect unless the ITIN holder does not file a tax return with the ITIN, or is not included on another's return as a dependent, for three consecutive taxable years. ITINs issued before 2013 will expire at the earlier of: after a period of three consecutive years of nonuse (as described in prior sentence), or on the "applicable date" scheduled between 2017 and 2020. PATH Act § 203(a) (codified at IRC § 6109(i)(3)).

6 The IRS is currently authorized to correct mathematical or clerical errors — arithmetic mistakes and the like — and assess any tax increase using summary assessment procedures that do not provide the taxpayer an opportunity to challenge the proposed deficiency in the United States Tax Court before the tax is assessed. See IRC §§ 6213(b)(1), (g)(2).

7 PATH Act § 203(e) (codified at IRC § 6213(g)(2)).

8 PATH Act §§ 205, 206 (codified at IRC §§ 24(e), 25A(i)(6)).

- Expanding the Certifying Acceptance Agent (CAA) program for applicants residing in the United States;<sup>9</sup> and
- Providing ITIN services at Taxpayer Assistance Centers (TACs) on limited days and by appointment only.

Although the IRS has made commendable efforts to implement the ITIN provisions of the PATH Act, it falls short in terms of making it possible for all taxpayers to timely comply with their filing and payment obligations. The National Taxpayer Advocate remains concerned that the IRS has not included TAS in ITIN cross-functional teams nor has it sought TAS's advice regarding the development of new ITIN policies, which fail to protect key taxpayer rights, such as the *right to be informed*, the *right to challenge the IRS and be heard*, and the *right to a fair and just tax system*.<sup>10</sup> ITIN applicants will continue to face barriers to filing and paying their taxes until the IRS further revises its ITIN policies and procedures.

### The IRS Deactivated a Significant Number of ITINs for Age of Issuance or Non-Use at the Start of 2017

To implement section 203(a) of the PATH Act, the IRS announced in August 2016 that it would deactivate all ITINs not used on a tax return within the last three years and ITINs with the middle digits 78 and 79, which were issued between 1996 and 2000.<sup>11</sup> The IRS sent a notice informing taxpayers their ITINs would be deactivated to only those who had filed a tax return within the last three years, and started accepting renewal applications in October. During late December 2016 and early January 2017, the IRS deactivated approximately 12.4 million ITINs, including approximately 134,000 in error.<sup>12</sup> Although the IRS identified and corrected the programming error that caused the erroneous deactivations, any program to automatically deactivate ITINs may always carry the risk of future errors.

In 2016, the IRS stated that it expected approximately 750,000 ITIN holders to renew their ITINs in 2017 — all of the approximately 450,000 affected ITIN holders who had filed a tax return in the last three years and approximately 300,000 of the 11 million affected ITIN holders who had not filed returns recently.<sup>13</sup> However, as of the week ending May 13, 2017, the IRS had received only about 196,000 renewal applications, and had renewed approximately 155,000 ITINs.<sup>14</sup> There are multiple reasons taxpayers may have failed to renew their ITINs thus far, including:

- Lack of awareness of the requirement to renew;
- Lack of a tax filing requirement;
- Inability to submit required identification documents; and
- Concerns about the immigration consequences of sharing information with the IRS.

9 The PATH Act prohibits ITIN applicants residing abroad from using Certifying Acceptance Agent (CAAs). PATH Act § 203(a) (codified at IRC § 6109(i)(1)(B)). The PATH Act envisions an expansion of the CAA program, allowing state and local governments, federal agencies, and others authorized by the IRS to be CAAs. PATH Act § 203(c). As part of a required study, the IRS must evaluate ways to expand CAA availability and participation. PATH Act § 203(d).

10 See National Taxpayer Advocate Fiscal Year (FY) 2017 Objectives Report to Congress 148-49.

11 IRS Notice 2016-48, *Implementation of PATH Act ITIN Provisions*, IRB 2016-33 (Aug. 15, 2016); IRS response to TAS information request (Nov. 29, 2016).

12 IRS response to TAS information request (May 4, 2017).

13 IRS response to TAS information request (Nov. 29, 2016).

14 IRS, Submission Processing (SP) Program Management/Process Assurance (PMPA) Branch, *Filing Season Statistics Report*, Report for Week Ending May 13, 2017.

The IRS is planning to announce the next group of ITINs that will be deactivated based on the middle digits during summer 2017.

### The IRS's Use of Math Error Authority for Expired ITINs Reflects a Sizable Number of Returns Filed With an Expired ITIN

The IRS created 14 new math error codes related to expired ITINs, which it has applied approximately 186,000 times from the start of the 2017 filing season through April 28, 2017.<sup>15</sup> This substantial number suggests there are a significant number of taxpayers who were not aware of the requirement to renew their ITINs before or during the 2017 filing season. Of the 186,000 expired ITIN math error codes, approximately 40,000 (about 21 percent) were applied to taxpayers to whom the IRS had mailed Letter 5821, which advised them in advance to renew their ITINs.<sup>16</sup> Letter 5821 may not have been effective due to taxpayers not receiving the letter or because the letter did not list the specific ITINs within the household that would be expiring.<sup>17</sup>

Better informing taxpayers about the ITIN deactivations prior to them taking place may have prevented some of these math errors, and in turn, reduced the burden on taxpayers by allowing them to apply to renew their ITINs prior to the filing season. As the IRS announces a new group of ITINs to be deactivated based on the middle digits during summer 2017, it should use the results of the 2017 filing season to revisit its procedures to notify taxpayers, identifying more effective ways to inform taxpayers of the deactivations and their ability to apply to renew their ITINs before the filing season.

### The IRS Has Implemented Programming to Disallow the Child Tax Credit (CTC) When the ITIN Is Not Considered Issued by the Tax Return Due Date

The PATH Act requires a taxpayer's ITIN to be issued on or before the tax return due date for the taxable year in order to receive the CTC or AOTC.<sup>18</sup> In January 2017, the IRS updated its Error Resolution System to reduce the allowable amount of the CTC or AOTC when a qualified person's ITIN assignment date was after the due date or approved extended due date for the return.<sup>19</sup> On March 26, 2017, the IRS implemented programming changes to systematically generate the ITIN Assignment Date based on the IRS received date for the ITIN application and attached tax return.<sup>20</sup> These changes are beneficial to taxpayers because even if their ITIN applications are not fully processed and their ITINs not assigned until after the due date, they may still be able to receive the CTC or AOTC if their applications and returns were received by the due date. As of April 28, 2017, the IRS had denied the AOTC approximately 700 times and the CTC approximately 14,000 times due to an ITIN not issued by the tax return due date.<sup>21</sup> These numbers are likely to increase now that the due date for tax year 2016 returns has passed.

15 IRS, *Math Error Report* (week ending Apr. 28, 2017). Because multiple math error codes may be applied to a single return, the 186,000 does not necessarily represent 186,000 returns. Internal Revenue Manual (IRM) 3.12.3-2, *Taxpayer Notice Codes* (Feb. 23, 2017) and IRM 3.22.3-9, *Taxpayer Notice Codes (TPNC)* (Jan. 1, 2017) contain descriptions for the math errors.

16 By comparison, taxpayers who received Letter 5821, *You must renew your Individual Taxpayer Identification Number (ITIN) to file your U.S. tax return* (approximately 450,000 taxpayers) comprised only about 4 percent of the 12.4 million taxpayers whose ITINs the IRS deactivated. IRS responses to TAS information requests (May 4, 2017), (Nov. 29, 2016).

17 Letter 5821 (Aug. 2016) states: "According to our records, the ITIN for you or someone listed on your tax return is set to expire on January 1, 2017."

18 PATH Act §§ 205, 206 (codified at IRC §§ 24(e), 25A(i)(6)).

19 IRS response to TAS information request (May 4, 2017).

20 *Id.*

21 IRS, *Math Error Report* (week ending Apr. 28, 2017).

## IRS Policies Result in the Majority of ITIN Applicants Continuing to Mail Original Documents to the IRS

The IRS has made some positive changes to increase flexibility for ITIN applicants. Following the passage of the PATH Act, the IRS permitted CAAs to certify birth certificates and passports for dependent applicants.<sup>22</sup> As of May 18, 2017, the IRS had received almost 14,000 dependent ITIN applications submitted by a CAA.<sup>23</sup> Expanding the ability of CAAs to certify all types of documents for dependents would help an even greater number of taxpayers.

Although the IRS has made commendable efforts to implement the Individual Taxpayer Identification Number provisions of the Protecting Americans Against Tax Hikes Act, it falls short in terms of making it possible for all taxpayers to timely comply with their filing and payment obligations.

The PATH Act removed the ability of CAAs to certify ITIN applications for applicants residing abroad, and the IRS implemented programming on January 3, 2017 to systematically reject ITIN applications received from foreign CAAs.<sup>24</sup> However, the IRS reversed its procedure on April 17, 2017 and again allowed foreign CAAs to certify ITIN documents.<sup>25</sup> Notwithstanding this change, the IRS could provide further options for certification. The PATH Act gives the IRS latitude to provide alternatives to accepting only original documents or copies certified by the issuing agency, but the IRS has failed to exercise this discretion and has not identified additional types of certified copies.<sup>26</sup>

Similar to the CAA program, options for applying in person to an IRS employee have likewise undergone some expansion and some reduction in recent years. In late 2016, the IRS expanded the list of documents a TAC can certify for primary or secondary taxpayers to 11 documents, but continues to restrict TACs to only certifying three types of documents for dependents.<sup>27</sup> During late 2016, the IRS transitioned to an appointment only policy for TACs, and during much of the filing season there were only 186 TACs certifying ITIN documents.<sup>28</sup> These TACs scheduled ITIN appointments only on Tuesday and Thursdays, with a limited number offering ITIN appointments on Tuesdays, Wednesdays, and Thursdays.<sup>29</sup> Undocumented taxpayers may have been unable to use TACs at all, due to legal requirements for providing identification to enter federal buildings.<sup>30</sup>

22 See Instructions for Form W-7 (Sept. 2016). Previously, CAAs were not allowed to certify identification documents for dependents.

23 IRS, Compliance Data Warehouse (CDW), Form W-7 database (May 18, 2017).

24 IRM 3.21.263.5.4.3, *ITIN Foreign CAA Procedures* (Feb. 8, 2017).

25 IRS, Servicewide Electronic Research Program (SERP) Alert 17A0128, *Rescinding Termination of International CAAs* (Apr. 17, 2017).

26 See IRC § 6109(i)(2)(B)).

27 IRS response to TAS information request (Nov. 29, 2016).

28 IRS, *Taxpayer Assistance Center (TAC) Locations Where In-Person Document Review is Provided*, <https://www.irs.gov/uac/tac-locations-where-in-person-document-verification-is-provided> (last updated May 5, 2017). This webpage was updated on April 18, 2017 to show 306 TACs offering ITIN services and again on May 5, 2017 to show 309. However, the prior webpage, accessed on March 20, 2017, listed only 186 TACs offering ITIN services. IRS, *Taxpayer Assistance Center (TAC) Locations Where In-Person Document Review is Provided*, <https://www.irs.gov/uac/tac-locations-where-in-person-document-verification-is-provided> (last updated Feb. 1, 2017).

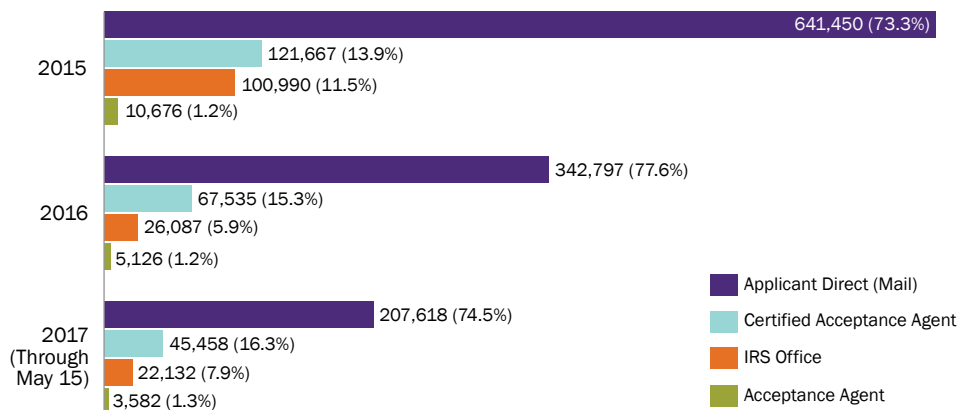
29 IRS, *Field Assistance Appointment Desk Guide 5* (Mar. 15, 2017). TAS has received reports in the past year that taxpayers who reside in Canada and Mexico near the U.S. border experienced further complications when attempting to schedule an appointment due to the toll-free line for making TAC appointments accepting only domestic calls. Systemic Advocacy Management System (SAMS) Issues 34713, 35184.

30 See REAL ID Act of 2005, Pub.L. 109–13, Division B, Title II, §§ 201-202, 119 Stat. 311–15, which sets standards for state-issued identification documents (IDs) that can be used to enter Federal facilities and establishes rules that states must follow in issuing the IDs.

As shown in the chart below, in recent years, only a small percentage of ITIN applicants were able to take advantage of TACs or CAAs to apply for ITINs, despite recent expansions to these programs.

**FIGURE 3.7.1**<sup>31</sup>

**ITIN Applications by Submission Source During Calendar Years 2015-2017**



Due to limited options for applying, the majority of taxpayers continue to mail in original documents and face a number of problems as a result. From January 1, 2017 through March 6, 2017, TAS opened nearly 170 cases from taxpayers suffering a hardship in connection with ITIN issues.<sup>32</sup> The majority of these cases involved taxpayers who urgently needed their original documents back from the IRS. Examples of TAS cases include taxpayers who needed passports or other identification documents back in order to:

- Visit a dying family member;
- Travel for business;
- Travel because a family member passed away and the body could not be buried without the taxpayer;
- Verify identity for banking purposes, for example, to cash a child support payment;
- Apply for school;
- Travel for medical reasons, either for the taxpayer or to authorize surgery for a sick family member; and
- Obtain or use government services, including: appearing in court, obtaining a U.S. driver's license, getting married, applying for citizenship, requesting residency, and other immigration services.

<sup>31</sup> IRS, CDW, Form W-7 Database (May 18, 2017).

<sup>32</sup> Taxpayer Advocate Management Information System (TAMIS), Inventory Report (Mar. 7, 2017).

In the past we recommended the IRS return all original identification documents by expedited mail because depriving any taxpayer of these documents constitutes a hardship.<sup>33</sup> However, to date the IRS has not made this policy change.

## FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Update its Tax Toolkit to provide further information about ITIN deactivations, renewals, and required dates of issuance;
- Monitor deactivations and renewals to ensure the IRS does not deactivate ITINs in error and assist taxpayers in correcting their accounts should erroneous deactivations occur;
- Review and provide recommendations for IRM sections and other internal guidance related to ITINs to promote taxpayer rights;
- Compile data regarding the volume of ITIN applications broken down by submission source and continue to advocate for the IRS to expand alternatives to mailing original documents for ITIN applicants, including options to use TACs, CAAs, and certain notary publics in foreign jurisdictions; and
- Assist taxpayers in locating and returning their original documents by expedited mail when they have an urgent need.

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<sup>33</sup> See National Taxpayer Advocate 2015 Annual Report to Congress 204.

## Area of Focus #8 **The Allowable Living Expense (ALE) Standard Does Not Reflect the Realistic Costs of Maintaining a Basic Standard of Living**

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

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

### DISCUSSION

Internal Revenue Code (IRC) § 7122(d)(2)(A) mandates that the IRS “develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.”<sup>2</sup> Most importantly, Congress instructed the IRS to analyze the facts of each case involving these allowances and stipulated that if application of the allowances results in a taxpayer not being able to provide for basic living expenses, then the allowances should not be used.<sup>3</sup> The resulting Allowable Living Expense (ALE) standards have come to play a major role in analyzing several types of IRS collection cases.<sup>4</sup>

The IRS allows an expense if it is “necessary to provide for a taxpayer’s and his or her family’s health and welfare and/or production of income.”<sup>5</sup> In its efforts to base the allowed expenses on reliable and consistent data, the IRS relies heavily on the Bureau of Labor Statistics. In particular, the IRS uses the Consumer Expenditure Survey, which gathers expenditure information for consumers.<sup>6</sup> Since this survey measures what people *spend* to live, it does not take into account what the goods or services *actually cost* to live. Taxpayers who are of limited means pay for what they can afford, and thus may forego expenses otherwise determined by the IRS definition to be necessary. Additionally, some essential expenses are not included in the category of “necessary” expense, preventing any taxpayer from claiming them.

By focusing on what expenses are *allowable* instead of *adequate*, the IRS has exercised its discretion in a way that does not meet congressional intent, since “allowable” is not synonymous with “adequate” or “basic.”<sup>7</sup> Instead, the IRS should adopt standards that allow for a sufficient or adequate standard of living.<sup>8</sup>

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 See also Treas. Reg. § 301.7122-1(c)(2)(i).

3 IRC § 7122(d)(2)(B).

4 Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, is used to determine monthly expenses and primarily relies on the Allowable Living Expense (ALE) standards. This form is necessary for many types of case resolutions, including certain installment agreements and offers in compromise (OIC). Internal Revenue Manual (IRM) 5.15.1.1(3), *Overview and Expectations* (Nov. 17, 2014).

5 IRM 5.15.1.7(1), *Allowable Expense Overview* (Oct. 2, 2012).

6 Bureau of Labor Statistics (BLS), *Consumer Expenditure Survey (CES) Frequently Asked Questions*, <http://www.bls.gov/ces/csxfaqs.htm>.

7 Congressional intent for maintaining an adequate and basic standard of living can be seen in how Congress has addressed “economic hardship” for IRS Collection purposes, which is defined as an inability to pay “reasonable basic living expenses.” Treas. Reg. § 301.6343-1(b)(4).

8 “Sufficient” is defined as “adequate; of such quality, number, force, or value as is necessary for a given purpose.” Whereas, “allowable” is defined as “acceptable according to the rules; permissible.” BLACK’S LAW DICTIONARY (10th ed. 2014).



## The IRS Continues to Decrease ALEs Despite Data That Show Expenses Are on the Rise

Before the IRS can establish a standard for living expenses, it must understand what amount of money is sufficient for a basic standard of living. The IRS has not established how much it costs to maintain a basic standard of living. As a baseline, the United States often uses the poverty threshold to determine if a person has enough money to survive day-to-day. A person is considered to be living in poverty if his or her family's income falls below an income threshold set up by family size and composition.<sup>9</sup> The current method for determining the poverty level was developed between 1963 and 1964 by Mollie Orshansky, an economist at the Social Security Administration (SSA).<sup>10</sup> The official measure multiplies by three the cost of a minimum food diet from 1963 prices in today's prices.<sup>11</sup> The poverty threshold is not a measure of a sufficient standard of living.

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By focusing on what expenses are *allowable* instead of *adequate*, the IRS has exercised its discretion in a way that does not meet congressional intent, since “allowable” is not synonymous with “adequate” or “basic.” Instead, the IRS should adopt standards that allow for a sufficient or adequate standard of living.

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Based on concerns identified by the National Taxpayer Advocate, the IRS and TAS reached a joint agreement in 2007 whereby “the allowance amount for any ALE category cannot be decreased unless something economic changes significantly, such as a major sustained recession or depression.”<sup>12</sup> In violation of this agreement, on March 28, 2016, the IRS announced that new ALE standards took effect and that “some ALE amounts reflect a decrease from last year’s standard amounts based on current data showing a decline in expenditures.”<sup>13</sup> Between 2015 and 2016, the expenses allowed for out-of-pocket healthcare and transportation decreased, as did the national standards for food, clothing, housekeeping supplies, and miscellaneous.<sup>14</sup>

It is difficult to find evidence to support the proposition that expenditures have actually declined. Instead, data appears to show the opposite. One source has reported on the impact of the Great Recession. It found that from 2004 to 2008, median household income grew by 1.5 percent while median expenditures grew by 11 percent.<sup>15</sup> However, the 2014 median income has decreased by 13 percent from 2004 levels while expenditures increased by nearly 14 percent.<sup>16</sup> One example of this can be seen with health insurance costs. The cost of employer-sponsored health plans has consistently increased at a rate greater than wage

9 U.S. Census Bureau, *How the Census Bureau Measures Poverty*, [https://www.census.gov/library/visualizations/2014/demo/poverty\\_measure-how.html](https://www.census.gov/library/visualizations/2014/demo/poverty_measure-how.html).

10 Gordon M. Fisher, *The Development and History of the Poverty Thresholds*, 55 Soc. Sec. Bull. 3 (Winter 1992).

11 U.S. Census Bureau, *Measuring America: How Census Measures Poverty*, [https://www.census.gov/library/visualizations/2014/demo/poverty\\_measure-how.html](https://www.census.gov/library/visualizations/2014/demo/poverty_measure-how.html). Food was chosen as the original standard of adequacy because it was the only generally accepted standard available at the time. Mollie Orshansky, *Counting the Poor: Another Look at the Poverty Profile*, 28 Soc. Sec. Bull. 5 (1965). The multiplier of three for costs of food was used since research at the time showed that families spent one-third of their budget on food. *Id.* at 9. For a discussion on how Ms. Orshansky came to this decision, see Gordon M. Fisher, *The Development and History of the Poverty Thresholds*, 55 Soc. Sec. Bull. 5 (Winter 1992).

12 IRS, Small Business/Self-Employed (SB/SE) Finance, Research & Strategy, *2015 Allowable Living Expenses Project* iii (Sept. 2015).

13 IRS, *Collection Financial Standards*, <https://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Collection-Financial-Standards> (Mar. 17, 2017).

14 TAS Research analysis of IRS 2015 ALE Standards and IRS 2016 ALE Standards. Housing costs also decreased in 2,314 counties out of 3,221 counties.

15 The Pew Charitable Trusts, *Household Expenditures and Income*, 3 (Mar. 2016).

16 *Id.*

growth. Between 2006 and 2015, the average deductible has tripled (from \$303 to \$1,077), which is seven times faster than wage growth during the same period.<sup>17</sup>

TAS is unaware of how IRS assumptions can be tested using the current system of ALE standards, since the standards are based on averages spent by consumers, rather than an analysis of what individuals and families actually need to provide for a basic living. Despite TAS's concerns with the IRS decision last year, the IRS recently announced ALE standards for 2017 that include decreased amounts for a second year.<sup>18</sup> To be exact, 415 categories of expenses will be decreasing, including out-of-pocket healthcare costs.<sup>19</sup> Some of the categories of expenses increased. TAS is concerned that the IRS continues to make decisions regarding ALEs without fully understanding how the decisions impact taxpayers.

The IRS needs to work with TAS in a joint study to measure a basic standard of living for taxpayers. The joint study could consider how the SSA implements the cost of living adjustment (COLA) for its benefits program. For both the Social Security program and for Supplemental Security Income (SSI), the SSA uses the Consumer Price Index for Urban Wage Earners and Clerical Workers. However, unlike the IRS and its ALE standards, the COLA has never decreased.<sup>20</sup> The worst situation that a recipient will experience is no increase.

### The ALE Standards Should Be Updated to Include Expenses Necessary to Maintain the Health and Welfare of Households Today

TAS continues to study how the ALE standards can be updated to conform with a basic lifestyle today. TAS previously recommended that the IRS expand the ALEs to include child care, an allocation for a basic home computer, and minimal retirement savings as an acknowledgement that these expenses are necessary for maintaining the health and welfare of today's families.<sup>21</sup> TAS is studying the possibility of considering other expenses. For instance, in the United Kingdom (U.K.), the minimum income standard (MIS) is defined as the "income that people need in order to reach a minimum socially acceptable standard of living in the U.K. today, based on what members of the public think."<sup>22</sup> The MIS definition allows for "social and cultural" participation expenses, which includes things such as gifts and recreation.<sup>23</sup> TAS will research the ability to include a small allotment for entertainment and recreation. Additionally, TAS will research an allowable expense for higher education or trade school. TAS will share its results with the IRS.

### The IRS Should Study How Its Recent Deviation Involving ALEs Impacts Taxpayers

The IRS implemented a deviation from normal procedures for certain Automated Collection System and Compliance Services Collection Operations cases between December 17, 2015 and September 30, 2016 that involve financial analysis for particular types of installment agreements and currently not collectible

17 Noam N. Levey, LA TIMES, *Healthcare Costs Rise Again, and the Burden Continues to Shift to Workers* (Sept. 22, 2015).

18 IRS, *Collection Financial Standards*, <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>.

19 TAS Research analysis of IRS 2016 ALE Standards and IRS 2017 ALE Standards.

20 Social Security Administration, *Cost-of-Living Adjustments* <https://www.ssa.gov/oact/cola/colaseries.html>.

21 National Taxpayer Advocate 2016 Annual Report to Congress 200.

22 Joseph Roundtree Foundation, *A Minimum Income Standard for the UK in 2014* 8 (July 2014). The minimum income standard (MIS) is based on input from focus groups comprised of various segments of the population and experts in particular fields of study.

23 *Id.* at 20.

(CNC) cases.<sup>24</sup> For instance, one collection tool is a partial-pay installment agreement (PPIA), which is an installment agreement that does not pay the tax liability in full prior to the collection statute expiration date (CSED). PPIAs require a full collection information statement from the taxpayer, which is where the ALEs are considered.<sup>25</sup> The IRS's deviation will allow certain IRS employees to process PPIA requests without requesting substantiation of ALE expenses unless there is a large discrepancy.<sup>26</sup>

TAS planned to report on the results of this deviation, however, since the deviation was done to address a backlog of work and not to study ALE standards; the IRS did not track details of cases, such as how each case was resolved or which expenses were allowed a deviation. Instead, the IRS tracked cases in the deviation to ensure that procedures of the deviation were followed.<sup>27</sup>

The IRS extended the deviation through fiscal year 2017.<sup>28</sup> During the extended deviation, the IRS will track the total number of non-streamlined installment agreements, PPIAs, and currently not collectible accounts. However, there is no mechanism for the IRS to track which expenses were most likely to be allowed during the deviation or which expenses most often required substantiation.<sup>29</sup> The IRS could have used this type of deviation to closely study the ALEs. For instance, it could find out which expenses were most often allowed a deviation and by how much.

## CONCLUSION

Taxpayers are responsible for paying their tax liabilities. However, Congress intended for the IRS to allow enough expenses to ensure taxpayers have an adequate means to provide for basic living expenses prior to resolving their outstanding tax debts. The current ALE standard is not based on an amount of money that allows for a basic standard of living. It also does not take into account all expenses that are necessary for a basic standard of living today. The IRS should reevaluate how it measures and implements the ALE standard so that taxpayers do not face a hardship while complying with their tax responsibilities, and it should not continue to decrease the amount of ALEs.

## FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Research alternative methods to calculate the cost of providing for the health and welfare of households and share this information with the IRS;
- Issue a Taxpayer Advocacy Directive ordering the IRS to expand the categories available in the ALE standards and to stop decreasing the amount of ALEs; and
- Issue an Internal Guidance Memorandum to provide guidance to TAS employees about how to advocate for deviation from the current ALEs when applicable.

24 Director, Collection Policy and Director, Campus Collection, *Memorandum for SBSE Directors, Collection Policy and Campus Collection, IRM Deviation for ACS/ACSS/CSCO Collection Information Statement (CIS) Case Processing* (Dec. 17, 2015).

25 IRM 5.14.2.1.1 (Sept. 19, 2014).

26 Director, Collection Policy and Director, Campus Collection, *Memorandum for SBSE Directors, Collection Policy and Campus Collection, IRM Deviation for ACS/ACSS/CSCO Collection Information Statement (CIS) Case Processing 2* (Dec. 17, 2015). Furthermore, IRS employees are instructed to accept verbal substantiation unless the taxpayer cannot explain the discrepancy.

27 National Taxpayer Advocate 2016 Annual Report to Congress 198.

28 IRS, *Extension of IRM Deviation for ACS/ACSS/CSCO Collection Information Statement (CIS) Case Processing* (Sept. 26, 2016).

29 IRS response to TAS information request (Mar. 31, 2017).

## Area of Focus #9 The IRS Has Improved Its Internal Guidance for Retirement Levies But More Can Be Done

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

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

### DISCUSSION

Americans are facing a crisis in saving for retirement. Forty-five percent of all working-age households have no retirement account assets.<sup>2</sup> The situation is particularly bleak for low income individuals. In one survey, 94 percent of respondents with a family income over \$100,000 reported having some retirement savings while among respondents making under \$40,000 per year, only 44 percent had any retirement savings.<sup>3</sup> Stagnant wages and burgeoning student loan debt, for both students and their parents, may be responsible for low levels of retirement savings.<sup>4</sup> The National Institute on Retirement Security points out that it is “highly unlikely that most individuals and households will be able to fill such a large retirement income gap by themselves” and suggests that public policy could play a “critical role” in addressing this retirement shortfall.<sup>5</sup>

While any collection action taken by the IRS can affect a taxpayer, levies on assets in retirement accounts may have a particularly negative effect on a taxpayer's future well-being.<sup>6</sup> As a result, the IRS must balance the need for efficient collection of tax with the public policy that encourages saving for

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 National Institute on Retirement Security, *The Continuing Retirement Savings Crisis* 8 (Mar. 2015).

3 Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2015* 59-61 (May 2016). The lack of retirement savings is better understood by considering that only 54 percent of respondents to the same survey reported that they could “fairly easily handle” a hypothetical emergency expense of \$400. Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2015* 22 (May 2016). Women and minorities also face lower levels of saving for retirement. Joint Economic Committee, Ranking Democrat Carolyn B. Maloney, *Social Security and Retirement Savings in the United States* (Aug. 2016).

4 Abha Bhattarai, *Two-Thirds of Americans Aren't Using This Easy Way to Save For Retirement*, WASH. POST., Feb. 22, 2017.

5 National Institute on Retirement Security, *The Continuing Retirement Savings Crisis* 17 (Mar. 2015).

6 In some instances, a taxpayer can experience additional harm on top of losing the contents of his or her retirement account. First, pursuant to IRC § 408(d), generally, the entire amount paid from a retirement account or any distribution, is considered gross income and is subject to taxation. The payor is generally required to withhold twenty percent. IRC § 3405(c)(1). However, IRS offers no withholding guidance with the levy issued to payors. In some instances, payors fail to withhold and taxpayers have no resources to pay the tax liability created by the distribution. The taxpayer may be liable for a state income tax as well. TAS is working on a project that will look to provide better guidance to payors so that under withholding can be avoided.

retirement.<sup>7</sup> The National Taxpayer Advocate previously raised several concerns regarding the inadequacy of IRS internal guidance related to levies on retirement accounts.<sup>8</sup>

Internal Revenue Code (IRC) § 6331 gives the IRS the right to levy on a taxpayer's property and rights to property, including funds held in retirement accounts.<sup>9</sup> As an acknowledgement that retirement account levies can impact a taxpayer's future well-being, the IRS's internal guidance requires three steps to be taken before the IRS can issue a notice of levy on a taxpayer's retirement account:

1. Determine what property (retirement assets and non-retirement assets) is available to collect the liability, and if there is property other than retirement assets that can be used to collect the liability, or if a payment agreement can be reached, these alternatives are considered before issuing a levy on retirement assets;
2. Determine whether the taxpayer's conduct has been flagrant; and
3. Determine whether the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.<sup>10</sup>

### The IRS Has Taken Steps to Improve Internal Guidance, Thereby Ensuring Cases With Retirement Levies Receive Consistent Analysis

One of the National Taxpayer Advocate's main concerns with retirement levy cases is the lack of internal guidance provided to employees. For instance, IRS employees are instructed to make a determination of flagrancy on a case-by-case basis and may consider extenuating circumstances that mitigate otherwise flagrant behavior.<sup>11</sup> However, there is no on-point definition of what constitutes "flagrant" behavior in the IRC, accompanying regulations, or the Internal Revenue Manual (IRM).

#### *The IRS Created Guidance for Considering Extenuating Circumstances*

To its credit, the IRS has worked with TAS to address some concerns with how the determination to levy a retirement account impacts taxpayer rights.<sup>12</sup> For instance, through discussions, the IRS agreed to provide guidance on what constitutes an extenuating circumstance. The IRS now provides guidance to employees that extenuating circumstances are "at times situations beyond the control of taxpayers."<sup>13</sup> Examples of extenuating circumstances include illness, loss of employment, a personal loss (family or loved one), identity theft or return preparer misconduct, and "natural acts of nature."<sup>14</sup>

7 Understanding the importance of Americans having sufficient retirement savings, Congress has formulated policies to not only provide Social Security income to retirees, but to protect the rights of individuals to pensions and to encourage retirement savings accounts. For example, the Employee Retirement Income Security Act of 1974 was enacted to provide protection for participants in pension and health plans in private industry. Pub. L. No. 93-406, 88 Stat. 829 (1974).

8 National Taxpayer Advocate 2015 Annual Report to Congress 100-11; National Taxpayer Advocate 2015 Annual Report to Congress 340-45 (Legislative Recommendation: *Levies On Retirement Accounts: Amend IRC § 6334 to Include a Definition of Flagrancy and Require Consideration of Basic Living Expenses at Retirement Before Levying on Retirement Accounts*); National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 53-58.

9 For information on what constitutes a retirement plan, see IRC § 4974(c). The IRS may also levy on retirement income or distributions once the taxpayer retires. Internal Revenue Manual (IRM) 5.11.6.1, *Retirement Income* (Jan. 22, 2010).

10 IRM 5.11.6.2(4) - (7) (June 14, 2016).

11 IRM 5.11.6.2(5) (Revision June 14, 2016).

12 National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 94-101.

13 IRM 5.11.6.2(5) (June 14, 2016).

14 *Id.*

### *IRS Guidance Now Encourages Communication With the Taxpayer Prior to Levy Action*

The National Taxpayer Advocate has also called for more taxpayer education around the issue of retirement levies. The IRS recently adopted guidance which promotes greater communication with taxpayers prior to a levy on their retirement account. Guidance to IRS employees reads: “Prior to levy, attempt to advise taxpayers that contributions to voluntary retirement plans are not a necessary expense.”<sup>15</sup> Most importantly, taxpayers will be informed that continuing to make voluntary contributions to retirement accounts, while asserting an inability to pay an amount that is owed, may be considered flagrant conduct, and could result in a levy on retirement accounts.<sup>16</sup> However, the IRS is not prohibited from making the determination to levy on a retirement account if this conversation does not take place.<sup>17</sup>

### **The IRS Can Do More to Improve Internal Guidance for Retirement Levies**

#### *A Definition of Flagrancy Is Still Needed*

The IRS cannot levy on a taxpayer’s retirement account unless the IRS determines the taxpayer has exhibited flagrant conduct.<sup>18</sup> Unfortunately, the IRS guidance in this area does not include a definition of what constitutes flagrant conduct. The IRS explains flagrant conduct through a list of examples.<sup>19</sup>

Through negotiation with TAS, the IRS recently agreed to strengthen the examples of flagrant conduct. For example, the IRS considers a taxpayer to be exhibiting flagrant conduct if he or she either voluntarily contributes to a retirement account during the time period he or she knew unpaid taxes were accruing, or the taxpayer continues to make voluntary contributions to retirement accounts while asserting an inability to pay an amount that is owed.<sup>20</sup> The IRS has added a note to its internal guidance to explain that if a taxpayer verifies he or she has been automatically enrolled to have a limited percentage of his or her basic pay deducted and deposited into a retirement account, this should not be considered flagrant conduct.<sup>21</sup> However, the IRS continues to refuse to provide a definition of flagrant conduct.<sup>22</sup>

The National Taxpayer Advocate believes that without a definition of flagrant conduct, taxpayers do not know what they need to do to comply with tax laws, which diminishes the *right to be informed*. The National Taxpayer Advocate believes a definition of flagrant conduct is essential to proper analysis of these cases and will continue to advocate for a definition of flagrancy that includes a willful action (or failure to act) which is voluntarily, consciously, and knowingly committed, and which appears to a reasonable person to be a gross violation of tax laws.<sup>23</sup>

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**The National Taxpayer Advocate believes that without a definition of flagrant conduct, taxpayers do not know what they need to do to comply with tax laws, which diminishes the right to be informed.**

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15 IRS, Director, Collection Policy, *Interim Guidance for Revenue Officers regarding Levies on Retirement Plans* (Jan. 13, 2017); IRM 5.15.1.27(2) (Jan. 23, 2017).

16 *Id.*

17 *Id.*

18 IRM 5.11.6.2(5) (June 14, 2016).

19 IRM 5.11.6.2(6) (June 14, 2016).

20 *Id.*

21 *Id.*

22 National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress vol. 2, 59.

23 National Taxpayer Advocate 2015 Annual Report to Congress 341.

### *The IRS Has Changed Policy to Allow Retirement Levies at the Request of Taxpayers*

Prior to June 2016, the IRS specifically did not levy on retirement accounts at the request of taxpayers.<sup>24</sup> The guidance read, in part:

Because of the exception to the 10 percent additional tax made on account of a levy, occasionally taxpayers may ask the Service to levy the funds in the retirement accounts. Even though the taxpayer may be able to voluntarily withdraw money in a lump sum from a retirement account and apply it to the outstanding tax liability, do not levy on retirement assets at the request of the taxpayer.<sup>25</sup>

However, against the recommendation of TAS, the IRS has implemented a change in policy that allows taxpayers to “request” retirement levies. This change goes directly against the policy mentioned above that treats retirement levies as special cases, requiring the three-step analysis, including the determination of flagrant conduct. If a taxpayer requests a levy on his or her retirement account, the guidance now requires that the IRS employee analyze what other assets are available for levy and determine whether the taxpayer needs the retirement assets for necessary living expenses.<sup>26</sup> Notably, IRS employees are instructed to *not* make a determination of flagrant conduct, which is otherwise necessary prior to levying on a retirement account.<sup>27</sup> To its credit, the IRS accepted a TAS recommendation to make sure the taxpayer’s request is in writing and recorded in the case history.<sup>28</sup>

In practice, it will not be as simple as the taxpayer choosing to pay his or her debt with a retirement account. The IRS employee will consider the retirement account while conducting his or her financial analysis under IRM 5.15.1.1, which provides the “basis for determining a taxpayer’s ability to pay delinquent tax liabilities, which enables Collection employees to make appropriate collection decisions to resolve cases.”<sup>29</sup> Once the retirement account is part of the analysis, a conversation about liquidating the asset can occur without regard to a flagrancy determination.

The IRS justified this change in policy by arguing that all taxpayers should be able to avoid the early withdrawal penalty, not just those taxpayers who receive an IRS levy on their retirement account.<sup>30</sup> While a “voluntary” levy may appear to be an attractive tool for taxpayers who want to avoid the additional ten percent tax on retirement distributions before the age of 59½, TAS is concerned that the special analysis that protects retirement accounts will be lost through this new procedure.

Furthermore, taxpayers may not realize the long-term tradeoff they are making when they request this option. The potential for abuse in this area is enormous. Since IRS employees are instructed to “emphasize to the taxpayer how much the Service expects from them rather than how the Service expects them to spend their money,” it is easy to see how in the normal course of working a collection case, the existence of a retirement account will now become part of a financial analysis stripped of the necessary flagrancy determination.<sup>31</sup> The typical taxpayer will feel pressure to give up his or her retirement account

24 Generally, there is a ten percent additional tax on early distributions from a qualified retirement plan, but this additional tax does not apply to distributions made from an account because of an IRS levy. IRC § 72(t)(2)(A)(vii).

25 IRM 5.11.6.2(3) (Sept. 26, 2014).

26 IRM 5.11.6.2(3) (June 14, 2016).

27 *Id.*

28 *Id.*

29 IRS response to TAS information request (Mar. 24, 2017).

30 *Id.*

31 IRM 5.15.1.1(11) (Nov. 17, 2014).

when it is part of a financial analysis and the IRS employee cannot establish flagrant conduct on the part of the taxpayer. This undermines the entire public policy protection of retirement accounts.

### *The IRS Should Adopt a “Retirement Needs” Calculator Based on a Theoretical Model Developed By TAS*

TAS remains concerned that there is inadequate instruction to employees for analyzing future retirement calculations. Collection employees are instructed to use the standards in IRM 5.15, *Financial Analysis*, to establish necessary living expenses and the life expectancy tables in Publication 590-B, *Distributions From Individual Retirement Arrangements* (IRAs), to estimate how much can be withdrawn annually to deplete the retirement account in the taxpayer’s remaining life.<sup>32</sup> However, these instructions are silent on what type of calculators to use to determine when funds will be depleted. In addition to the variety of methods that could be used by different revenue officers, the IRM is additionally silent on factoring any growth in retirement funds or projecting future increases in necessary living expenses. TAS has created a proposed model of a “retirement needs” calculator. See Figures 1.9.1 and 1.9.2 in Appendix A immediately following for the calculator and accompanying example. TAS is offering its assistance to the IRS in developing a retirement needs calculator based on this theoretical model.

## CONCLUSION

Congress has granted the IRS the ability to levy on retirement accounts. However, given the low levels of retirement savings and the impact this will have on Americans’ retirement, the IRS should exercise this option only when the taxpayer’s behavior is flagrant and where the levy will not place the taxpayer in a situation where he or she cannot function in retirement. Adopting a definition of flagrant conduct and the use of a retirement calculator, such as the one TAS proposes, will allow for sufficient analysis prior to levying on a retirement account.

## FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:


- Issue an Internal Guidance Memorandum to TAS employees regarding effective advocacy in retirement levy cases, including the use of the retirement calculator in TAS cases, the National Taxpayer Advocate’s proposed definition of flagrant conduct, and pushing back against “voluntary” levies;
- Conduct training for TAS employees so they can effectively advocate in cases involving retirement levies, particularly with respect to the taxpayer’s financial security in retirement, whether the taxpayer’s conduct is flagrant, and undue pressure on taxpayers to consent to “voluntary” levies;
- Work with the IRS to improve internal guidance by developing a definition for flagrant conduct;
- Issue a Taxpayer Advocate Directive ordering the use of the retirement calculator; and
- Draft better guidance for payers so that problems with insufficient withholdings can be avoided for taxpayers who receive a levy on their retirement accounts. TAS will encourage the IRS to publish the improved guidance.

32 IRM 5.11.6.2(7) (June 14, 2016). When conducting this financial analysis, employees are reminded to consider special circumstances that may be present on a case-by-case review.



APPENDIX A

FIGURE 1.9.1, Calculating the Need for Retirement Assets



## CALCULATING THE NEED FOR RETIREMENT ASSETS

When IRS considers levy of a taxpayer’s retirement account assets, Internal Revenue Manual 5.11.6.2(7), *Funds in Pension or Retirement Plans*, states the IRS must “determine whether the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.” The guidance in making this determination is limited.

This document provides a consistent method for calculating the need for retirement account assets to advocate for a taxpayer whose retirement account assets have been levied or are under the threat of levy. The method can be used to verify or challenge the IRS determination.<sup>1</sup>

Five Steps for Calculating the Need for Retirement Assets	
1	<p><b>Calculate the taxpayer’s necessary living expenses.</b> See <a href="#">Collection Financial Standards</a><sup>2</sup> and Internal Revenue Manual 5.15, <i>Financial Analysis</i>.<sup>3</sup></p>
2	<p><b>Calculate the taxpayer’s life expectancy.</b> See Life Expectancy Tables in the appendices of Publication 590-B, <i>Distributions From Individual Retirement Arrangements (IRAs)</i> at <a href="http://www.irs.gov">www.irs.gov</a> (updated annually). Use the life expectancy to determine the number of months income from retirement assets will be required.</p>
3	<p><b>Calculate the taxpayer’s future Social Security Administration (SSA) benefits (if the taxpayer is eligible).</b> See the <a href="#">SSA Quick Calculator</a>.<sup>4</sup></p> <p><b>CAUTION:</b> The SSA Quick Calculator is the least accurate method to estimate benefits. Encourage the taxpayer to secure an estimate by creating an online account at <a href="http://www.ssa.gov">www.ssa.gov</a> or by using the Retirement Estimator on that site. These calculators use the taxpayer’s actual income rather than estimates used by the Quick Calculator.</p>
4	<p><b>Calculate the monthly income that is required from the taxpayer’s retirement assets to meet necessary living expenses.</b> Total income from all sources other than the retirement assets considered for levy, then subtract necessary living expenses.</p>
5	<p><b>Calculate the number of monthly distributions from retirement assets until they are depleted.</b><sup>5</sup> See <a href="#">Retirement Income Calculator</a>.<sup>6</sup></p> <p><i>Note: The calculator indicates annual year-end balances. If retirement funds are not fully depleted by end of life expectancy, the remaining balance would be available for levy.</i></p>

<sup>1</sup> The method in this document factors no growth in retirement assets or inflation of necessary living expenses. Attempting to estimate these future financial uncertainties would include too many variables to ensure a consistent application for all taxpayers.

<sup>2</sup> <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>.

<sup>3</sup> Calculate current necessary living expenses without factoring future growth or inflation. Allow for known increases (e.g., health insurance or medical costs certain to increase upon retirement).


<sup>4</sup> Calculate SSA income without factoring future growth or inflation. <https://www.ssa.gov/OACT/quickcalc/index.html>.

<sup>5</sup> Calculate retirement income without factoring future growth or inflation.

<sup>6</sup> The calculator assumes funds are in a Thrift Savings Plan but can be used for any type of retirement account assets. <https://www.tsp.gov/PlanningTools/Calculators/retirementCalculator.html>.

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FIGURE 1.9.2, Calculating the Need for Retirement Assets – Case Example



## CALCULATING THE NEED FOR RETIREMENT ASSETS

### Case Example

*Assumptions About the Taxpayer*

- Age 61, single, no dependents, and his date of birth is December 31, 1954.
- A wage earner, with no defined benefit retirement plan.
- Current annual wage income is \$75,000.
- Plans to retire December 31, 2016, upon turning age 62.
- Owns a 401k account with a current balance of \$250,000 and an Individual Retirement Arrangement with a current balance of \$50,000.
- Owns no real property, rents an apartment, and owns one auto with a loan balance and no equity.
- Health care expenses are \$300 per month. Health insurance will increase \$32 per month upon retirement.
- Estimated tax on retirement account withdrawals is \$68 per month.

### Five Steps for Calculating the Need for Retirement Assets

**1** Calculate the taxpayer's necessary living expenses. See [Collection Financial Standards<sup>1</sup>](#) and Internal Revenue Manual 5.15, *Financial Analysis*.<sup>2</sup>

The example assumes Form 433A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, has been completed and the current monthly allowable necessary living expenses are \$2,968.<sup>3</sup>

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**2** Calculate the taxpayer's life expectancy. See Life Expectancy Tables in the appendices of Publication 590-B, *Distributions From Individual Retirement Arrangements (IRAs)* at [www.irs.gov](http://www.irs.gov) (updated annually). Use the life expectancy to determine the number of months income from retirement assets will be required.

Publication 590-B, Table I shows a life expectancy of 24.4 years (292 months) for the taxpayer's current age of 61. Therefore, upon retirement in seven months, the taxpayer's income must meet his necessary living expenses for 23 years and nine months (285 months).


<sup>1</sup> <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>.

<sup>2</sup> Calculate current necessary living expenses without factoring future growth or inflation. Allow for known increases (e.g., health insurance or medical costs certain to increase upon retirement).

<sup>3</sup> To make an accurate comparison of living expenses and income, this example uses today's dollars for necessary living expenses with no future growth rate.

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FIGURE 1.9.2, Calculating the Need for Retirement Assets – Case Example (continued)



## CALCULATING THE NEED FOR RETIREMENT ASSETS

**3** Calculate the taxpayer’s future Social Security Administration (SSA) benefits (if the taxpayer is eligible). See the [SSA Quick Calculator](#).<sup>4</sup>

**CAUTION:** The SSA Quick Calculator is the least accurate method to estimate benefits. Encourage the taxpayer to secure an estimate by creating an online account at [www.ssa.gov](http://www.ssa.gov) or by using the Retirement Estimator on that site. These calculators use the taxpayer’s actual income rather than estimates used by the Quick Calculator.

The SSA calculator shows the taxpayer’s monthly benefits to be \$1,394, beginning age 62.<sup>5</sup>

**4** Calculate the monthly income that is required from the taxpayer’s retirement assets to meet necessary living expenses. Total income from all sources other than the retirement assets considered for levy, then subtract necessary living expenses.

Monthly necessary living expenses (\$2,968) plus anticipated monthly health insurance increase (\$32) minus monthly SSA benefits (\$1,394) equals monthly income required from retirement assets (\$1,606).

**5** Calculate the number of monthly distributions from retirement assets until they are depleted.<sup>6</sup> See [Retirement Income Calculator](#).<sup>7</sup>

*Note: The calculator indicates annual year-end balances. If retirement funds are not fully depleted by end of life expectancy, the remaining balance would be available for levy.*

The Retirement Income Calculator shows the monthly distributions of \$1,606 would be depleted in 15 years and seven months (187 months), which is 98 months short of the taxpayer’s expected life span.<sup>8</sup> Therefore, the retirement account assets should not be levied upon.

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<sup>4</sup> Calculate SSA income without factoring future growth or inflation. <https://www.ssa.gov/OACT/quickcalc/index.html>.

<sup>5</sup> The Social Security Administration Quick Calculator allows the user to estimate today’s dollars or inflated (future) dollars. To make an accurate comparison of living expenses and income, this example uses today’s dollars.

<sup>6</sup> Calculate retirement income without factoring future growth or inflation.

<sup>7</sup> The calculator assumes funds are in a Thrift Savings Plan but can be used for any type of retirement account assets. <https://www.tsp.gov/PlanningTools/Calculators/retirementCalculator.html>.

<sup>8</sup> The Thrift Savings Plan Retirement Income Calculator allows the user to estimate an annual rate of return to include in the projected earnings. In order to make an accurate comparison of living expenses and income, this example uses zero percent annual rate of return.

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**Area of Focus #10** **With a Recent Decline in Tax-Related Identity Theft Cases, the IRS Can Focus on Making Its Authentication Procedures Less Burdensome for Victims**

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

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

### DISCUSSION

Tax-related identity theft is an invasive crime that has significant impact on its victims and the IRS. Victims of identity theft not only must spend time dealing with the IRS to prove their identity, but generally will not receive their refunds until their cases are resolved.

The National Taxpayer Advocate has highlighted the need for the IRS to establish or improve procedures to assist victims of identity theft for well over a decade.<sup>2</sup> The IRS has adopted many of our recommendations to improve its identity victim assistance procedures over the years. For example, one significant change involved centralizing its identity theft victim assistance units, something that TAS has long advocated.<sup>3</sup>

#### Decline in Identity Theft Case Receipts

For reasons we cannot know for certain, the IRS has seen a decline in identity theft case receipts. During calendar year (CY) 2015, the IRS received nearly 700,000 identity theft cases in which the taxpayer needed victim assistance.<sup>4</sup> In CY 2016, the IRS received about 376,000 identity theft cases — a decline of about 46 percent.<sup>5</sup> As of March 2017, the IRS-wide inventory of identity theft cases was approximately 34,000 — less than half of the inventory two years ago.<sup>6</sup>

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 See National Taxpayer Advocate 2015 Annual Report to Congress 180-87; National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 44-90; National Taxpayer Advocate 2013 Annual Report to Congress 75-83; National Taxpayer Advocate 2012 Annual Report to Congress 42-67; National Taxpayer Advocate 2011 Annual Report to Congress 48-73; National Taxpayer Advocate 2009 Annual Report to Congress 307-17; National Taxpayer Advocate 2008 Annual Report to Congress 79-94; National Taxpayer Advocate 2007 Annual Report to Congress 96-115; National Taxpayer Advocate 2005 Annual Report to Congress 180-91; National Taxpayer Advocate 2004 Annual Report to Congress 133-36.

3 See National Taxpayer Advocate 2007 Annual Report to Congress 115.

4 IRS, *Global Identity (ID) Theft Report* (Jan. 2017). Part of the decline in identity theft cases may be attributable to the IRS's decision to modify the criteria for counting cases included in the "Identity Theft Taxpayer Impacted" inventory.

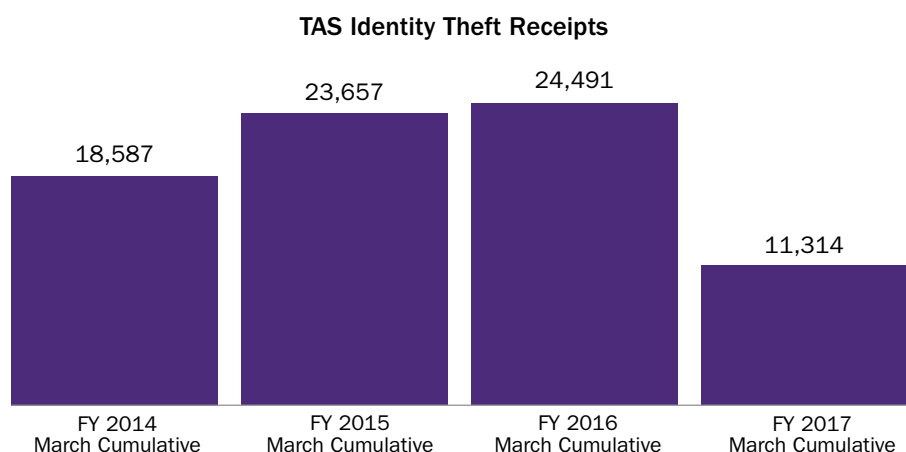
5 IRS, *Global ID Theft Report* (Jan. 2017).

6 IRS, *Global ID Theft Report* (Mar. 2017).

**FIGURE 3.10.1, IRS-Wide Inventory (Identity Theft Taxpayer Impacted)**<sup>7</sup>

	Calendar Year 2015	Calendar Year 2015 (Through March)	Calendar Year 2016	Calendar Year 2016 (Through March)	Calendar Year 2017 (Through March)
Beginning Inventory	71,098	71,098	64,424	64,424	31,328
Receipts	698,794	104,857	376,488	78,801	56,336
Closures	703,418	101,739	409,286	103,577	54,662
Ending Inventory	64,424	74,217	31,328	39,353	33,877

TAS has experienced a similar decline in its identity theft case receipts over the past fiscal year, reversing the trend in previous years. In fiscal year (FY) 2017 (through March), TAS had 11,314 identity theft case receipts — less than half the 24,491 identity theft cases TAS received over the same period in FY 2016.<sup>8</sup>

**FIGURE 3.10.2**<sup>9</sup>

The IRS is continually improving its fraud detection filters and safeguards. For example, the IRS now limits the number of refunds delivered to one bank account, which makes it more difficult for perpetrators to get away with mass refund fraud schemes.<sup>10</sup>

<sup>7</sup> IRS, *Global ID Theft Report* (Mar. 2017).

<sup>8</sup> Data obtained from Taxpayer Advocate Management System (TAMIS) (Apr. 1, 2016; Apr. 1, 2017).

<sup>9</sup> Data obtained from TAMIS (Apr. 1, 2016; Apr. 1, 2017).

<sup>10</sup> IRM 21.4.1.4.7, *Direct Deposits — General Information* (Oct. 1, 2016).

## The IRS Needs to Strengthen Procedures for Assisting Victims of Large-Scale Data Breaches

Now that the IRS is getting better at detecting traditional identity theft, some identity thieves are targeting tax practitioners and employers to obtain the personal identifying information (PII) of taxpayers.<sup>11</sup> TAS continues to receive reports of large-scale data breaches, which leave taxpayers vulnerable to identity theft.<sup>12</sup> With PII obtained from data breaches, these cyber criminals may be able to bypass many of the identity theft filters.

While the IRS has implemented a process for employers to report large-scale breaches, it still needs to develop procedures to assist the impacted taxpayers as a group.<sup>13</sup> TAS has received several complaints from practitioners whose clients are victims of data breaches.<sup>14</sup> When a taxpayer's personal information is breached, the IRS may require him or her to authenticate his or her identity in person at a Taxpayer Assistance Center (TAC). When the nearest TAC is hundreds of miles away, or when the TAC has limited hours and the next available appointment is months away, requiring victims of data breaches to authenticate in person at TACs is overly burdensome.

Could there be an alternative to in-person authentication that minimizes the risk to the IRS but is not too burdensome to the taxpayers? Should taxpayers who live too far from a TAC be given the option to mail in authentication documents? Should taxpayer representatives be allowed to authenticate their clients? These are the types of questions the IRS should be asking as it develops procedures to assist victims of large-scale data breaches.

## Impact of Protecting Americans from Tax Hikes (PATH) Act of 2015 Provisions

While it is difficult to single out one reason for the decrease in tax-related identity theft in the past year, one significant factor is the impact of the accelerated due dates for certain information reporting. As part of the PATH Act of 2015, the due date for filing Forms 1099-MISC (which are used to report non-employee compensation) and Forms W-2 with the IRS and Social Security Administration (SSA) was moved up to January 31.<sup>15</sup> Until this year, the due dates for these information reporting forms were the last day of February (or March, if filed electronically).

Prior to the enactment of the PATH Act, the IRS received much of the W-2 data from the SSA after the filing season, when the majority of refunds had already been issued, and began data matching in the summer. The accelerated deadline allows the IRS to verify the legitimacy of tax returns by comparing the return data against the data on Forms W-2 filed by employers **before** paying out refunds.

By the week ending March 23, 2017, the IRS had received approximately 222 million Forms W-2, a nearly 30 percent increase from the 171 million received by the same point in 2016.<sup>16</sup> There was an even greater increase in the number of Forms 1099-MISC that the IRS received in 2017 compared to 2016.

11 IRS, IR-2016-163, *Protect Your Clients: Security Summit Partners Warn Tax Pros of Cybercriminals, Launch New Awareness Tips* (Dec. 7, 2016).

12 See, e.g., Systemic Advocacy Management System (SAMS) issues 35584, 35757, 35763, 35767, 35822, and 35929.

13 IRS, *Data Theft Information for Tax Professionals*, <https://www.irs.gov/individuals/data-theft-information-for-tax-professionals> (Mar. 29, 2017).

14 See SAMS issues 35757, 35822, and 35929.

15 Protecting Americans from Tax Hikes (PATH) Act of 2015, Pub. L. No. 114-113, Division Q, Title II, § 201(a), 129 Stat. 2242, 3076 (2015) (codified at IRC § 6071(c)).

16 IRS Compliance Data Warehouse (CDW), Information Returns Master File (as of cycle 201712). For processing years 2016 and 2017, cycle 12 is the week ending March 24, 2016, and March 23, 2017, respectively.

By the week ending March 23, 2017, the IRS received 31 million Forms 1099-MISC, more than 2½ times the 12 million received by the same period in the prior year.<sup>17</sup>

## FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Advocate for recommendations made in Annual Reports to Congress related to IRS processing of identity theft cases, including assigning a single employee to coordinate IDT cases involving multiple issues or multiple years;
- Push for the IRS to develop procedures to assist victims of large-scale data breaches; and
- Collaborate with the IRS to thoroughly examine the impact of the accelerated due dates of information reporting.

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<sup>17</sup> IRS CDW, Information Returns Master File (as of cycle 201712). For processing years 2016 and 2017, cycle 12 is the week ending March 24, 2016, and March 23, 2017, respectively.

**Area of Focus #11** **While the IRS Continues to Do a Reasonable Job in Administering the Affordable Care Act (ACA), Taxpayers Still Encounter Difficulties Attempting to Comply With the Complex Provisions**

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

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*

### DISCUSSION

The IRS is charged with implementing certain provisions of the Patient Protection and Affordable Care Act of 2009 (ACA).<sup>2</sup> To ensure that taxpayer rights are protected, TAS has been actively involved with the implementation of the ACA provisions. Some of the issues we reviewed include:

- The IRS halted plans to reject “silent returns” in response to an executive order;
- TAS’s Premium Tax Credit (PTC) case receipts decreased significantly in fiscal year (FY) 2017;
- A commercial tax preparation software program incorrectly calculated PTC or failed to submit Form 8962, *Premium Tax Credit (PTC)*;
- Taxpayers had difficulty receiving advanced PTC (APTC) due to “failure to reconcile” flags; and
- Uncertainty regarding how the IRS will propose and assess the employer shared responsibility payment (ESRP) under Internal Revenue Code (IRC) § 4980H.

#### Background: Filing Season 2017 Overall Results

ACA was enacted by Congress in 2010 to provide affordable health care coverage for all Americans. To accomplish this goal, ACA provides targeted tax credits for low income individuals and for small businesses, while imposing a personal responsibility on individuals to have health coverage.<sup>3</sup> During the 2017 filing season, eligible individual taxpayers claimed the PTC on tax year (TY) 2016 returns. Figure 3.11.1 provides preliminary data through April 27, 2017, regarding the extent to which individual taxpayers claimed the PTC on their TY 2016 returns.

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Patient Protection and Affordable Care Act of 2009 (ACA), Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act (HCERA) of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

3 ACA, Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by HCERA, Pub. L. No. 111-152, 124 Stat. 1029 (2010); Senate Finance Committee, *Description of Policy Options: Expanding Health Care Coverage: Proposals to Provide Affordable Coverage to All Americans* (May 14, 2009).



**FIGURE 3.11.1, Reporting of the Premium Tax Credit on Forms 8962 for TY 2016 Returns Through April 27, 2017<sup>4</sup>**

Returns Filed with Forms 8962, <i>Premium Tax Credit (PTC)</i>	5.1 million
Total PTC Amount Claimed	\$17.6 billion
Average PTC Amount Claimed Per Return	\$3,455
Returns Reporting Advanced PTC	4.9 million (96% of returns with Forms 8962)
Total Advanced PTC Reported	\$19.4 billion
Prepared Returns Filed with Forms 8962 (Paid or Volunteer)	3.2 million (63% of returns with Forms 8962)

Individual taxpayers who did not have minimum essential coverage (MEC) or qualify for an exemption were required to make an individual shared responsibility payment (ISRP) on their TY 2016 returns.<sup>5</sup> Figure 3.11.2 provides preliminary data through April 27, 2017, on the reporting of ISRPs on TY 2016 returns.

**FIGURE 3.11.2, Reporting of the Individual Shared Responsibility Payments on TY 2016 Returns Through April 27, 2017<sup>6</sup>**

Returns with ISRP	4.0 million
Average ISRP	\$708
Prepared Returns Reporting ISRP (Paid or Volunteer)	2.6 million (65%)
Returns Filed with Forms 8965, Health Coverage Exemptions	10.7 million
Returns Filed with Forms 8965 Claiming Household Coverage Exemption (Form 8965 Part II)	3.9 million
Returns Filed with Forms 8965 Claiming Coverage Exemption (Form 8965 Part III)	8.0 million
Prepared Returns Filed with Forms 8965	5.8 million (54%)

### The IRS Halted Plans to Reject Silent Returns in Response to Executive Order

On January 20, 2017, the President signed an executive order requiring all agencies in the executive branch with responsibilities under ACA to take actions to minimize the economic and regulatory burdens imposed by the Act. Specifically, the order stated that the agencies should exercise all authority and discretion to waive, defer, grant exemptions from, or delay the implementation of any requirement of the Act that would impose burden.<sup>7</sup>

4 IRS, Compliance Data Warehouse (CDW), Individual Returns Transaction File (IRTF) TY 2016 (May 2017). This preliminary data is based on returns that had posted as of April 27, 2017, and is subject to change as the IRS reviews the data, processes additional TY 2016 returns, and conducts compliance activities.

5 IRC § 5000A.

6 IRS, CDW, IRTF TY 2016 (May 2017). This preliminary data is based on returns that had posted as of April 27, 2017, and is subject to change as the IRS reviews the data, processes additional TY 2016 returns, and conducts compliance activities. Some returns indicated both coverage exemptions for household (Part II on Form 8965) and coverage exemptions for individuals (Part III on Form 8965). As a result, the combined volumes may exceed the total number of returns with Form 8965.

7 White House, Executive Order, *Minimizing the Economic Burden of the Patient Protection and Affordable Care Act Pending Repeal* (Jan. 20, 2017); ACA, Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

In response to the executive order, the IRS announced on February 15, 2017, that it halted its plan to reject electronically filed “silent returns.”<sup>8</sup> Silent returns are ones for which the taxpayer did not 1) check the box on the return to indicate the tax family had full-year health care coverage, 2) complete and attach Form 8965, *Health Coverage Exemptions*, to show tax family members had exemptions from health coverage requirements, or 3) self-assess an ISRP on the return.<sup>9</sup>

While other factors may have influenced filing behavior, Figure 3.11.3 compares the reporting of the ISRP during this filing season to the same period last filing season.

**FIGURE 3.11.3, Comparison of Reporting of the Individual Shared Responsibility Payments on TY 2016 Through April 27, 2017 to TY 2015 Through April 28, 2016<sup>10</sup>**

	TY 2016 (Through April 27, 2017)	TY 2015 (Through April 28, 2016)
Returns With ISRP	4.0 mil	5.6 mil
Prepared Returns Reporting ISRP (Paid or Volunteer)	2.6 mil (65%)	3.6 mil (64%)
Returns Filed With Forms 8965, <i>Health Coverage Exemptions</i>	10.7 mil	11.0 mil
Returns Filed With Forms 8965 Claiming Household Coverage Exemption (Form 8965 Part II)	3.9 mil	3.2 mil
Returns Filed With Forms 8965 Claiming Coverage Exemption (Form 8965 Part III)	8.0 mil	7.8 mil
Prepared Returns Filed With Forms 8965	5.8 mil (54% of returns with Form 8965)	6.0 mil (54% of returns with Form 8965)

The most notable change is the 27 percent drop in returns filed reporting the ISRP. The remaining amounts appear fairly consistent with the previous filing season amounts. In addition, there were just over eight million TY 2016 silent returns filed through April 27, 2017, a slight increase over the number of TY 2015 silent returns filed through April 28, 2016.<sup>11</sup>

As of the date of printing, the IRS is in the process of assessing various options to address silent returns filed in past as well as future filings, including the reinstatement of the plans to reject electronically filed silent returns, the issuance of educational or soft notices, and the issuance of penalty assessment notices. The National Taxpayer Advocate supports any efforts to reinstate plans to reject electronically filed silent returns as well as issue educational and soft notices. These options would help the taxpayer avoid future

8 IRS Statement on Silent Returns (Feb. 15, 2017); IRS, *Individual Shared Responsibility Payment Provision* (Feb. 15, 2017), <https://www.irs.gov/affordable-care-act/individuals-and-families/individual-shared-responsibility-provision>.

9 IRM 3.12.3.14.1, *Error Code 157 (CE) Shared Health Care Responsibility Payment and Checkbox Validation (SRP)* (Jan. 1, 2017).

10 IRS, CDW, IRTF TY 2016, through April 27, 2017 (May 2017); WISS, ACA Fact Sheet 05-31-2016; National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 136–43. Note that some returns indicated both coverage exemptions for household (Part II on Form 8965) and coverage exemptions for individuals (Part III on Form 8965). As a result, the combined volumes may exceed the total number of returns with Form 8965.

11 IRS, CDW, IRTF TYs 2015 and 2016 (June 2017). This data is preliminary based on cycle 17 for tax years 2015 (returns processed through Apr. 28, 2016) and 2016 (returns processed through Apr. 27, 2017). TAS Research used the definition of silent returns from IRM 3.12.3.14.1, *Error Code 157 (CE) Shared Health Care Responsibility Payment and Checkbox Validation (SRP)* (Jan. 1, 2017). In some cases, taxpayers who filed apparent “silent returns” may have actually had their coverage substantiated by an information document, even though the return did not indicate minimum essential coverage; therefore, IRS compliance actions would not be necessary.

compliance problems. In addition, we have recommended that the IRS require commercial software vendors to program checks into their products to prevent the preparation of silent returns.<sup>12</sup>

### **TAS Premium Tax Credit (PTC) Case Receipts Decreased Significantly in FY 2017**

After experiencing a sharp increase in PTC case receipts during FY 2016, TAS is seeing a significant decrease in these cases in FY 2017 through April 30, 2017. During FY 2016, PTC cases quickly became the fourth highest category of TAS cases. In FY 2017 through April 30, 2017, TAS received 3,104 cases with PTC issues, a 56 percent decrease from same period in FY 2016. This considerable decrease caused PTC cases to drop from being the fourth highest category of cases in FY 2016 to the sixth highest category in FY 2017 through April 7, 2017.<sup>13</sup> In about 67 percent of the PTC cases, the tax return was in the Submission Processing Error Resolution (ERS)/Reject unit.<sup>14</sup>

### **A Commercial Tax Preparation Software Program Incorrectly Calculated PTC or Failed to Submit Form 8962, Premium Tax Credit (PTC)**

In March 2017, the TAS ACA Rapid Response Team received an issue elevated through the Systemic Advocacy Management System (SAMS) regarding tax preparation software errors in preparing PTC returns.<sup>15</sup> Specifically, one TAS local office elevated an issue that impacted approximately 25 cases in that particular office, but which may potentially have wider nationwide impact.<sup>16</sup> The commercial tax preparation software used by a Volunteer Income Tax Assistance (VITA) partner incorrectly calculated PTC or failed to submit Form 8962, *Premium Tax Credit (PTC)*. Both the Stakeholder Partnerships, Education and Communication organization in the IRS Wage and Investment Division and the software provider were aware of the issue. The software provider has claimed to have corrected the problem that it estimates could have impacted up to 2,279 returns. To reduce the burden on impacted taxpayers, TAS issued internal guidance to TAS case advocates.<sup>17</sup>

### **Taxpayers Had Difficulty Receiving Advanced PTC (APTC) Due to “Failure to Reconcile” Flags**

Taxpayers who receive advanced PTC (APTC) are required to reconcile the amount of the APTC received with the amount of PTC to which they are entitled on Form 8962, *Premium Tax Credit (PTC)*. Failure to reconcile renders a taxpayer ineligible to receive additional APTC in subsequent years.<sup>18</sup> The IRS provides “flags” to the marketplace informing them of taxpayers who have failed to reconcile. These flags are eliminated once the taxpayer files either an original or amended return with Form 8962. However, there may be a delay between the posting of the Form 8962 and when it is available for the

12 Email from Wage & Investment Division (W&I) to TAS (June 2, 2017); Meeting between W&I and TAS (June 7, 2017).

13 In FY 2016, TAS received 10,910 cases with PTC issues. In comparison, TAS received 3,318 PTC cases in FY 2015 – an approximately 229 percent increase over a one-year period. National Taxpayer Advocate 2016 Annual Report to Congress 522 (TAS Case Advocacy, *Figure 4.1.4, Top 10 Issues for Cases Received in TAS, FYs 2015-2016*); Business Performance Management System (BPMS), Receipts - Core Issues by Business Operating Division (BOD) & Criteria – Cumulative, FY 2016: 1- October through 12- September (Oct. 1, 2016); Business Performance Management System (BPMS), Receipts - Core Issues by BOD & Criteria – Cumulative, FY 2015: 1- October through 12- September (Oct. 1, 2015); National Taxpayer Advocate 2016 Annual Report to Congress 266-76 (Most Serious Problem: Affordable Care Act (ACA): The IRS Has Made Progress in Implementing the Individual and Employer Provisions of the ACA But Challenges Remain).

14 Business Performance Management System (BPMS), Receipts - Core Issues by Business Operating Division (BOD) & Criteria – Cumulative, FY 2017: 1–October through 7–April (May 1, 2017).

15 Systemic Advocacy Management System (SAMS) issue 35850.

16 Taxpayer Advocacy Management Information System (TAMIS) case numbers for the approximate 25 cases are on file with TAS.

17 SAMS 35850; TAS ACA Rapid Response Team, *ACA Related Issues and Concerns, Week Ending March 24, 2017*.

18 IRM 21.6.3.4.2.13, *Premium Tax Credit* (Feb. 15, 2017).

system issuing the flags to the marketplace. Because of these timing differences, some marketplaces are allowing taxpayers to attest to filing a reconciling tax return and then subsequently verifying the attestation. The Centers for Medicare and Medicaid Services and one state marketplace contacted the IRS about this issue and, as a result, Accounts Management issued guidance to customer service representatives (CSRs) on how to assist impacted taxpayers. For those taxpayers who reconciled but are caught in a timing window, CSRs are told to inform the taxpayer of when the data posted and provide an estimate of when the information will be sent to the marketplace. Taxpayers are advised to order a return transcript as proof, but this will only help those taxpayers who reconciled on an original return, because amended return data is not populated on transcripts.<sup>19</sup>

### There Is Uncertainty Regarding the Assessment of the Employer Shared Responsibility Payment Under Code Section 4980H

In addition to the existing provisions impacting individuals, some provisions of the ACA impacting employers became effective in TY 2015. For example, certain employers, referred to as Applicable Large Employers (ALEs), are subject to the ESRP provisions in IRC § 4980H.

ESRP under IRC § 4980H(a) will be assessed if an ALE did not offer MEC to at least 95 percent of its full-time employees (and their dependents) and at least one of its full-time employees was allowed a PTC. The amount of the ESRP under IRC § 4980H(c) is \$2,000 per full-time employee per year (determined on a monthly basis).<sup>20</sup>

Even if an ALE did offer MEC to at least 95 percent of its full-time employees (and their dependents), ESRP under IRC § 4980H(b) will be assessed if one or more of its full-time employees was allowed PTC. The amount of the ESRP under IRC § 4980H(b) is \$3,000 per employee who was allowed a PTC (determined on a monthly basis).<sup>21</sup> For any month, the amount of the ESRP under IRC § 4980H(b) may not exceed an amount equal to what the ALE would have been liable for under IRC § 4980H(a), if the ALE had been liable for such a payment for the month.

The IRS relies on information reports to verify data relevant to the ESRP liability. For example, ALEs must furnish Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage Insurance*, by February 28 (March 31 if filing electronically). If the IRS receives incomplete or inaccurate data, it may erroneously assess ESRPs on ALEs, which can be costly and time-consuming for both employers and the IRS to rectify. It appears the IRS has addressed some of the glitches from the first year processing such information returns — the average rejection rate for ACA information reporting forms significantly declined from 5.6 percent in TY 2015 to 1.1 percent in TY 2016.<sup>22</sup>

Even though these provisions became effective in TY 2015, the IRS has yet to set forth procedures it will use to propose and assess the ESRP under IRC § 4980H. Employers need to know how they will be notified of any proposed ESRP, how long they will have to respond, and whether they may

19 Email from Wage & Investment Division to TAS (Dec. 23, 2016); SERP Alert IPU 16U1764 (Dec. 19, 2016); IRM 21.6.3.4.2.13.8, *Failure to Reconcile Advanced Payment of the Premium Tax Credit* (Dec. 19, 2016).

20 IRC § 4980H(c)(1). The ESRP provisions provide an inflation adjustment mechanism beginning in years after 2014. IRC § 4980H(c)(5).

21 IRC § 4980H(b)(1).

22 IRS response to TAS information request (June 8, 2017).

request a pre-assessment appeal. However, with the President's Executive Order<sup>23</sup> that directs agencies to minimize the burdens imposed by the ACA, it is unclear whether the IRS will set forth procedures related to the ESRP.

## CONCLUSION

As the IRS continues to make significant progress on the implementation of both the individual and business provisions of the ACA, the National Taxpayer Advocate will ensure that taxpayer rights are protected. TAS will address ACA-related issues as they arise and identify systemic issues. We commit to immediately assign any systemic issues that arise to the TAS ACA Rapid Response Team. We encourage both internal and external stakeholders to report any suspected ACA systemic issues on SAMS.

## FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Advocate for taxpayer rights for any actions or inactions the IRS plans to take in response to the ACA executive order issued on January 20, 2017;
- Elevate and address ACA issues to the TAS ACA Rapid Response Team;
- Evaluate PTC cases to determine why it continues to be a top ten issue for TAS case receipts; and
- Review any procedures the IRS sets forth for assessing the ESRP.

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23 Executive Order 13765, *Minimizing the Economic Burden of the Patient Protection and Affordable Care Act Pending Repeal* (Jan. 20, 2017), <https://www.whitehouse.gov/the-press-office/2017/01/20/executive-order-minimizing-economic-burden-patient-protection-and>.

## Area of Focus #12 **IRS Third Party Contact (TPC) Notices Should Be More Specific, Actionable, and Effective**

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

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

### DISCUSSION

#### Third Party Contact (TPC) Notices Should Encourage Taxpayers to Volunteer Information to Avoid TPCs

The IRS is generally required by Internal Revenue Code (IRC) § 7602(c) to give taxpayers reasonable advanced notice before making third party contacts (TPC). This advance notice is supposed to encourage the taxpayer to volunteer information that would, in many cases, make the TPCs unnecessary, and avoid damage to the taxpayer's business and reputation.<sup>2</sup>

#### The IRS Has Discontinued Actionable TPC Notices in Favor of Vague Notices

The IRS used to issue a general TPC notice followed by a more detailed one.<sup>3</sup> Today, it only provides a general notice, which is included in Publication 1, *Your Rights as a Taxpayer*. Publication 1 is so vague that at least one court held it does not even satisfy the statutory requirement.<sup>4</sup> Publication 1 does not request information from the taxpayer. Nor does it indicate whether the IRS plans to make TPCs in his or her particular case. It merely warns “we sometimes talk with other persons if we need information that you have been unable to provide.” Moreover, Publication 1 is typically delivered before the IRS has requested any information from the taxpayer.<sup>5</sup>

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 See, e.g., S. REP. No. 105-174, at 77 (1998) (“taxpayers should have the opportunity to resolve issues and volunteer information before the IRS contacts third parties.”); T.D. 9028, 67 Fed. Reg. 77,419, 77,420 (Dec. 18, 2002) (TPC procedures “enable a taxpayer to come forward with information required by the IRS before third parties are contacted.”). See also Chief Counsel Advice (CCA) 09047 (2001) (“[T]he congressional intent behind these requirements is to provide taxpayers with the opportunity to come forward with information before third parties are contacted and the means to address any reputational concerns arising from such contacts...”); Internal Revenue Manual (IRM) 4.11.57.2(3) (Jan. 17, 2014) (“[T]he intent behind this statute is to prevent the Service from disclosing to third parties that the taxpayer is the subject of a Service action without first providing reasonable notice to the taxpayer and allowing the taxpayer an opportunity to provide the information and resolve the matter.”). In addition, IRC § 7602(c)(3) requires the IRS to provide “periodic” reports of third party contacts. Doing so would help taxpayers mitigate damage to their reputations, but the IRS does not provide periodic reports to taxpayers. See National Taxpayer Advocate 2015 Annual Report to Congress 123 (Most Serious Problem: *IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers’ Businesses and Reputations*).

3 See, e.g., IRM 4.10.1.6.12.2.1(5) (May 14, 1999); *Status of IRS Reform: Hearing Before the S. Finance Comm.*, 106th Cong. 46 (2000) (statement of Charles Rossotti, Commissioner, Internal Revenue).

4 See *Baxter v. United States*, 117 A.F.T.R.2d (RIA) 694 (N.D. Cal. Feb. 8, 2016), *appeal docketed*, No. 16-16021 (9th Cir. June 7, 2016).

5 See, e.g., IRM 4.10.2.7.4.2 (Apr. 2, 2010) (requiring Pub. 1 to be included with the initial contact letter).

By contrast, IRS Letter 3164-G, (*Exam-3 Third Party Contact*), states “we previously requested the following information from you. [information] [date requested]... Since you have been unable to provide the requested information, we are writing to tell you that we may contact other persons to obtain this and any related information.” Letter 3164-G would be even more informative if it provided a reasonable period within which the taxpayer could provide the information and avoid the TPC. However, the IRS has discontinued its use of Letter 3164-G and similar letters that provide specific and actionable information to taxpayers.<sup>6</sup>

### Specific Notices Would Be More Effective

If the IRS wants the TPC notices to be effective, then it should design them so that they motivate taxpayers to provide the information that it would otherwise have to obtain from third parties. A tailored notice that identifies specific information that the IRS is about to contact third parties to obtain if not provided by the taxpayer first, is likely to be more effective than the boilerplate notice provided by Publication 1 that the IRS might someday contact third parties. Thus, if the IRS wants the taxpayer to provide the information, it should revert to its prior practice of using more specific and timely TPC notices like Letter 3164-G.

### Direction in the Internal Revenue Manual (IRM) Is a Poor Substitute for Actionable Notices

The IRM provides generic statements such as “[G]enerally, contacts with third parties are made when the examiner is unable to obtain the information from the taxpayer or when it is necessary for the examiner to verify the information provided by the taxpayer.”<sup>7</sup> However, the IRM does not actually require IRS employees to first request the information from the taxpayer or to identify what information, if any, the IRS plans to seek from third parties. A TAS review found that in cases where the IRS made TPCs, IRS employees did not first ask taxpayers for the specific information at issue in 22.8 percent of field examination cases and 11.1 percent of field collection cases.<sup>8</sup> Even if the IRS has made a broad request that technically covers the information it plans to seek from third parties, such a request is unlikely to be as effective as a notice that identifies the specific subset of information that, if provided by the taxpayer, would alleviate the need for the IRS to contact third parties.

6 IRM 4.11.57.4.1.1 (Dec. 20, 2011) provides that Letter 3164-G and other similar letters are “no longer applicable because notice is given via Pub 1.” However, apparently-obsolete IRM 4.31.5.14.4 (May 31, 2005) still provides for its use and the IRS updated the letter in 2016. Although legislative history suggests the TPC notice could “be provided as part of an existing IRS notice,” it does not require the notice to be vague. H. REP. NO. 105-599, at 277 (1998) (Conf. Rep.). Rather, the specific information provided by Letter 3164-G could be included in the existing IRS information document request (e.g., Letter 4564, *Information Document Request (Exam)* and Form 9297, *Summary of Taxpayer Contact (Collection)*) or the existing notices that confirm the IRS’s receipt or non-receipt of the taxpayer’s response to requests for information.

7 IRM 4.11.57.4(1) (Dec. 20, 2011) (emphasis added). See also IRM 4.32.2.7.3.2(3) (June 8, 2012) (“Examiners should attempt to obtain the information in writing from the promoter before contacting any third parties.”); IRM 25.27.1.3 (Jan. 16, 2014) (“It is the Service’s practice to obtain information relating to a liability or collectability determination directly from the taxpayer whenever possible.”); IRM 4.10.3.2.1.4(2) (Mar. 1, 2003) (“Information will be collected, to the greatest extent practicable, directly from the taxpayer to whom it relates... Information about taxpayers collected from third parties will be verified to the extent practicable with the taxpayer before action is taken.”).

8 National Taxpayer Advocate 2015 Annual Report to Congress 123 (Most Serious Problem: *IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers’ Businesses and Reputations*).

## The IRS Was Unresponsive When the National Taxpayer Advocate Raised Concerns About TPC Notices

The National Taxpayer Advocate has already recommended that the IRS:

Include with a TPC notice a specific request for information that would make the TPC unnecessary, except where the IRS employee documents that a TPC notice exception applies or that requesting the information from the taxpayer would be pointless (*e.g.*, because the IRS needs to verify information already provided).<sup>9</sup>

The IRS's formal response stated:<sup>10</sup>

Recommendation Not Adopted. Our current procedures require the examiner/officer to initially request information pertaining to an audit/collection process from the taxpayers to eliminate or reduce the need to conduct a TPC. These procedures are outlined in Internal Revenue Manual (IRM) Sections 4.10.2.8.1.1.2, 4.10.2.8.2.1.2, and 5.1.10.3.2. Taxpayers receive a Form 4564, *Information Document Request* (Examination), or a Form 9297, *Summary of Taxpayer Contact* (Collection), specifying what records are needed as well as the due date for the information. During the audit/collection process, if additional information is needed, subsequent requests will be provided in writing and due dates determined on a case-by-case basis. Taxpayers can also ask clarifying questions regarding the information requested.

The IRS response does not even discuss TPC notices. It seems indifferent to the effectiveness of TPC notices in prompting taxpayers to provide the information the IRS needs. It also does not discuss how the IRS's decision to shift to vague notices is consistent with the recently-adopted Taxpayer Bill of Rights.

## CONCLUSION

Actionable and specific TPC notices would be consistent with IRC § 7803(a)(3), which requires the IRS Commissioner to “ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights...” According to Publication 1, the taxpayer's *right to be informed*, includes the right to “be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.” Under current procedures, however, the IRS's vague TPC notices do not “inform” taxpayers of, or provide a “clear explanation” of, the information the IRS will seek from third parties.

In addition, the *right to privacy* includes the right to “expect that any IRS inquiry... will comply with the law and be no more intrusive than necessary.” However, TPCs will be more intrusive than necessary if the IRS continues to use vague TPC notices that do not enable the taxpayer to provide the specific information necessary to avoid TPCs. Similarly, more specific TPC notices would further the taxpayer's *right to challenge the IRS's position and be heard*, as this right includes the “... right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions.”

Moreover, if the IRS continues to use vague TPC notices, then some taxpayers will figure out what information they need to provide to avoid the TPC, but other similarly-situated taxpayers will not. As a result, vague TPC notices are inconsistent with the *right to a fair and just tax system*.

9 National Taxpayer Advocate 2015 Annual Report to Congress 123, 136. The National Taxpayer Advocate suggested the IRS could return to its prior practice of using Letter 3164-G (DO), (*Exam-3*) *Third Party Contact Letter*, and Letter 3164-F (DO), (*Exam-2*) *Third Party Contact Letter*, for this purpose. *Id.*

10 National Taxpayer Advocate 2017 Objectives Report to Congress vol. 2, 72-79.



Finally, giving taxpayers every opportunity to avoid a disclosure to a third party is consistent with a taxpayer's *right to confidentiality*. Thus, the IRS's decision to use vague notices is inconsistent with five of the ten taxpayer rights adopted by the IRS.

### FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Advocate for the IRS to revisit its decision to rely on vague TPC notices; and
- Review recent complaints from taxpayers about the IRS's TPC procedures and address the problems arising in TAS cases.

**Area of  
Focus #13**

## While the IRS Has Made Encouraging Progress on Its Enterprise Case Management (ECM) Project, Much Work Remains to Be Done for the Project to Succeed

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

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

### DISCUSSION

The National Taxpayer Advocate has previously raised several issues relating to the IRS's development of an enterprise case management (ECM) project.<sup>2</sup> The IRS has many information technology (IT) challenges, including the two oldest IT systems, each nearly six decades old, in the entire federal government.<sup>3</sup> It also has somewhere between 60 and approximately 200 different case management systems.<sup>4</sup> The age, number, and lack of integration across these systems, as well as the lack of digital communication and record keeping, cause waste, delay, and difficulty for IRS employees, including those in TAS, to perform their jobs efficiently and provide quality service to taxpayers.

As a part of its "Future State" vision, the IRS is currently pursuing an ECM project to unify these disparate case management systems and address the issues of automation, records management, and integration. The IRS has identified 63 case management systems to include in this project.<sup>5</sup> The ECM project offers a future vision for consolidated case management that will address the need to modernize, upgrade, and consolidate multiple aging IRS systems. Few of these systems communicate with one another, and none provides an electronic substitute for the paper case file (*i.e.*, there are reams of paper supplementing whatever records are included in the electronic system).

The IRS's current case management system structure requires employees to retrieve data from many systems manually, which requires maintaining both paper and electronic records. Employees must transcribe or otherwise import information from paper and other systems into their own case

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR that was adopted by the IRS are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 National Taxpayer Advocate 2016 Annual Report to Congress 31-3, 109-20.
- 3 See Government Accountability Office (GAO), GAO-16-468, Information Technology: Federal Agencies Need to Address Aging Legacy Systems (May 2016) (discussing aging IT systems throughout the government and listing the IRS's Individual Master File (IMF) and Business Master File (BMF) as the two oldest investments or systems at 56 years old each).
- 4 See *IRS Legacy Information Technology Systems: Hearing Before the H. Subcomm. On Government Operations of the H. Comm. on Oversight and Government Reform*, 114th Cong. 4 (2016) (written testimony of Terence Milholland, IRS Chief Technology Officer) (noting that there are more than 60 aging IRS case management systems), <https://oversight.house.gov/wp-content/uploads/2016/05/2016-05-25-Milholland-Testimony-IRS.pdf>; Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program* 22 (Sept. 2016) (noting that the IRS maintains approximately 90 case management systems); Email from Director, Enterprise Case Management (ECM) to all designated ECM Business Unit Point of Contacts, which included the TAS Executive Director, Business Modernization (Mar. 11, 2016) (listing 198 case management systems). IRS response to TAS fact check (Dec. 16, 2016). See also TIGTA, Ref. No. 2014-20-071, *Information Technology: Improvements Are Needed to Successfully Plan and Deliver the New Taxpayer Advocate Service Integrated System* (Sept. 2014); TIGTA, Ref. No. 2014-20-088, *The Information Reporting and Document Matching Case Management System Could Not Be Deployed* (Sept. 2014) (both TIGTA reports note "there are more than 200 case management applications in operation across the IRS enterprise").
- 5 IRS, *Enterprise Case Management Day, Journey to the Future State* 12 (Aug. 3, 2016).

management systems, and ship, mail, or fax an estimated hundreds of thousands, if not millions, of case management files and supporting documents within or between business functions annually for activities such as case work, management approval, quality review, and responses to Appeals, Counsel, and TAS.<sup>6</sup>

To ameliorate these problems, ECM requires a significant investment of time and money to promote productivity and efficiency gains and to improve taxpayer service. Indeed, success of the ECM project is critical to establish online accounts to effectively serve taxpayers and their representatives.<sup>7</sup> However, although the IRS requires substantial funding for IT in general and ECM specifically, it must provide a clear strategy that will assure both Congress and taxpayers that the IRS will spend this money appropriately.

While the National Taxpayer Advocate continues to support the IRS's ECM efforts and need for adequate funding, she remains concerned that:

- The IRS is not laying the foundation it needs for the ECM project to succeed by designing the project from the ground up and comprehensively engaging its employees; and
- After deciding not to complete the Taxpayer Advocate Service Integrated System (TASIS), the IRS may fail to leverage the extensive investment of time, money, and effort expended on TASIS and neglect its design work and lessons learned in the current ECM project.

### **The IRS Is Not Laying the Foundation It Needs for the ECM Project to Succeed by Designing the Project From the Ground Up and Comprehensively Engaging Its Employees**

The IRS's ECM project involves the daunting task of consolidating 63 unique case management systems.<sup>8</sup> The end goal is to develop an IRS solution for performing case management functions using a common infrastructure platform for multiple projects to share across all business units. The IRS has recently brought on new leadership to the ECM project and is in the process of soliciting information to identify products that will meet its ECM needs.<sup>9</sup> The National Taxpayer Advocate commends the IRS for taking these steps. However, to accomplish this tremendous undertaking, it is critical that the IRS engage in the necessary foundational work and build the ECM project from the ground up.

The National Taxpayer Advocate firmly believes that the IRS should actively and comprehensively engage its employees at the outset of the ECM project, as TAS did when it developed TASIS, which was designed as a comprehensive replacement for its largely obsolete current case management system called the Taxpayer Advocate Management Information System (TAMIS). IRS employees are the front-line users of IRS systems, and understanding their interaction with those systems and ways to make current processes and procedures more efficient are crucial to having a more functional and polished ECM product that will maximize employee productivity. Without this critical foundational step, the ECM system, as designed, may work well for IT and make business processes faster and virtual but will not focus on what IRS employees need to better interact with and assist taxpayers, which will adversely impact taxpayers and practitioners. The National Taxpayer Advocate is unaware of any effort within the current ECM project to comprehensively engage IRS employees about their case management

<sup>6</sup> See National Taxpayer Advocate 2016 Annual Report to Congress 112; National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 196.

<sup>7</sup> See National Taxpayer Advocate 2016 Annual Report to Congress 31.

<sup>8</sup> IRS, *Enterprise Case Management Day, Journey to the Future State 12* (Aug. 3, 2016).

<sup>9</sup> For a description of the IRS Request for Information, see <https://www.fbo.gov/index?s=opportunity&mode=form&id=f2ef8e74927e11203cc978340993624e&tab=core&tabmode=list> (last visited June 8, 2017).

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The end goal [of the IRS's Enterprise Case Management project] is to develop an IRS solution for performing case management functions using a common infrastructure platform for multiple projects to share across all business units.

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system experiences, needs, and suggestions for improvement. In contrast, when TAS went through the TESIS design process, we learned about employee technology needs by holding dedicated town hall or workgroup meetings. TAS asked *all* of its employees what they needed to perform their jobs efficiently, recorded their proposals and “wish lists” for capabilities, and then considered and tracked them in the development of the business requirements to see what, if anything, we could do to address them.

The National Taxpayer Advocate had previously suggested that the IRS consult with other federal agencies with large-scale ECM needs to gauge their experiences.<sup>10</sup> In a recent development, the National Taxpayer Advocate has learned that the IRS plans on reaching out to other federal agencies as well as state governments to solicit opinions about their ECM experiences.<sup>11</sup> The National Taxpayer Advocate is encouraged by this step and hopes that the IRS will continue reaching out to other federal agencies, as well as tax administrators abroad, as it seeks an ECM solution.

### After Understandably Deciding Not to Complete TESIS, the IRS May Fail to Leverage the Extensive Investment of Time, Money, and Effort Expended on TESIS and Neglect Its Design Work and Lessons Learned in the Current ECM Project

The National Taxpayer Advocate has recently learned the IRS does not plan to complete TESIS, which was halted in March 2014 after \$20 million was spent on it.<sup>12</sup> TESIS was a versatile case management system that would have replaced TAMIS, TAS's current antiquated system from the 1980s. Since 2013, Congress had identified TESIS as a major IT system and required quarterly IRS reporting on it.<sup>13</sup> While we understand and appreciate the IRS's reason for not moving forward with TESIS as it seeks an ECM solution and platform that will work across the IRS, the time, effort, and \$20 million spent in developing TESIS should not go to waste. As discussed in the 2016 Annual Report to Congress, TAS worked over several years to develop more than 4,500 business requirements for TESIS.<sup>14</sup> It is critical that the IRS leverage the extensive business requirements, development, and process design work that went into TESIS as it endeavors to find an ECM solution. The IRS can also use the lessons learned from the development of TESIS in its current ECM effort to reimagine its business processes and make them more efficient and user-friendly, thereby enabling it to thrive technologically in the 21st century.

TAS is committed to working with the IRS to develop an ECM solution and is offering its assistance with testing products as the IRS designs and programs the new ECM system. For example, we recommend the IRS test a solution to electronically submit and track Operations Assistance Requests

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10 See National Taxpayer Advocate 2016 Annual Report to Congress 114.

11 See IRS, *Enterprise Case Management Governance Board February Meeting* 15 (Feb. 23, 2017).

12 See National Taxpayer Advocate 2016 Annual Report to Congress 110.

13 The Senate Appropriations Subcommittee on Financial Services and General Government has repeatedly included TESIS on a list of six “major information technology project activities” about which it has directed the IRS to submit quarterly reports. See S. REP. No. 114-280, at 40 (2016); S. REP. No. 114-97, at 39 (2015); S. REP. No. 113-80, at 34 (2013). In 2014, a similar provision was included in the Senate Appropriations Committee's draft report, but the draft report was not adopted for that year.

14 See National Taxpayer Advocate 2016 Annual Report to Congress 117 (Most Serious Problem: *Enterprise Case Management (ECM): The IRS's ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Integrated System (TASIS) As a Quick Deliverable and Building Block for the Larger ECM Project*).

(OARs),<sup>15</sup> which would benefit taxpayers, TAS, and the IRS by reducing delays in case resolution in the most urgent of cases. It would also produce resource savings by eliminating many of the current costs, including shipping, time spent by employees manually inputting and tracking OARs, and time spent physically printing and scanning OARs into other IRS tracking systems.

It is also vitally important that the IRS take steps to address its aging legacy systems while it develops an ECM system, which could take several years. In the meantime, the IRS requires funding, which the National Taxpayer Advocate recommends that Congress provide, to maintain its current aging case management systems, many of which desperately need upgrading to provide effective tax administration and quality service to taxpayers. For example, TAS's antiquated TAMIS case management system requires upgrades to allow TAS's case advocates to do their jobs effectively and assist taxpayers.

Although the IRS requires substantially more funding for IT in general and ECM specifically, it must articulate a clear strategy that will assure both Congress and taxpayers that this money will be spent appropriately. TAS encourages Congress to require the IRS to submit an IT strategic plan to not only show its direction but also identify the talent gaps it has. Congress could then hold oversight hearings but should not simply hand the IRS a blank check.

## CONCLUSION

To ensure the best chance of success for both the individual ECM project and its broader "Future State" vision, the IRS's ECM effort requires comprehensive employee engagement from the ground up and leveraging the extensive investment of time and money expended on TESIS. It also requires congressional funding and oversight.

## FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Collaborate with the IRS in the ECM development process, particularly by lending its case management building expertise and sharing TESIS's relevant business requirements, design work, and lessons learned from this process; and
- Work with the IRS to assist with the testing of new products, such as an electronic OAR process, as the IRS designs and programs the new ECM system.

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<sup>15</sup> An Operations Assistance Request (OAR) is the form that TAS uses to request the IRS to take action on a case when TAS lacks the statutory or delegated authority to perform the action.