

Area of Focus #1 **TAS Is Developing an Electronic Roadmap Tool to Assist Taxpayers As They Navigate Through the Complex Tax System**

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*

DISCUSSION

The National Taxpayer Advocate’s 2018 Annual Report to Congress included a series of “roadmaps” of various stages of tax return preparation, processing, and disputes with the IRS. In the context of the Annual Report, the roadmaps served as visuals for the Most Serious Problems section of the report that covered issues faced by taxpayers as they embark and continue on their journey through tax administration. The original conception of the roadmaps, however, was for them to serve as the underlying architecture for a digital interactive tool to help taxpayers and representatives as they navigate through the frustratingly complex processes and procedures of the U.S. tax system. The seven final roadmaps published in the 2018 annual report covered the following phases of the taxpayer’s journey:

1. Tax Return Preparation,
2. Tax Return Processing,
3. Notices,
4. Exam,
5. Appeals,
6. Collection, and
7. Litigation.

Despite all the complex processes and procedures illustrated in the existing seven roadmaps, they are still very high-level. While developing the roadmaps, we certainly faced challenges in our attempt to take insanely complicated procedures and depict them in a readable and easy-to-follow path. We were forced to oversimplify certain areas due to the two-dimensional limitations of the paper end product. We were also afraid that showing the actual complexity would cause readers to become completely lost in the cluttered details. Therefore, for every step shown on the roadmaps published in the 2018 Annual Report, there are multiple sub-steps and detours that we did not represent.

We also found it challenging to graphically depict the connections between the different stages of the taxpayer’s journey. After publication of the Annual Report, we continued to work to visually represent the taxpayer’s journey at a high level—in the format of a metro or subway map. We are pleased to publish this map in digital and hard copy in connection with this June report. The large “roadmap”—suitable for framing by anyone so inclined—lays out, at a very high level, the stages of the taxpayer’s journey and the connections and overlaps and repetitions between those stages.

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

This roadmap is not simple, even at the very high level we've chosen for it. The roadmap makes clear the complexity of IRS tax administration and the burden on the taxpayer who has to navigate it.² Few IRS employees actually understand the interrelatedness of actions they take on employees (and taxpayers) in other units. Thus, although the roadmap is from a high-level perspective, it is a powerful teaching tool.

During the remainder of fiscal year (FY) 2019 and into FY 2020, we will develop a digital version of our roadmap. The benefit of a digital roadmap is that we can have a very simple starting point that requires no tax administration knowledge or expertise, and yet we can also go as deeply into the complexity of the tax system as the taxpayer wishes. As the entry point, the taxpayer or representative can input the number of the letter or notice received. For each notice, the digital tool will have a pop-up window providing the following basic information:

- **What does this letter or notice mean?** The tool will provide a description of what the letter or notice means and its legal significance. The taxpayer will be able to click on an embedded link that will pull up a generic version of the notice; the taxpayer can hover over different components of that generic version to see pop-up boxes that explain the specific components of the notice (*e.g.*, specific dates of great importance to timeframes for action).
- **Where am I in the tax system?** The tool will visually show the taxpayer where exactly he or she is located in the tax administration process in order to receive that particular letter or notice. We currently envision a pop-up window showing his or her exact location on the overall roadmap (a consolidation of all of the roadmaps); from there, the taxpayer can click to see his or her location on the roadmap of the specific phase of the journey (such as exam or collection).
- **How did I get there?** The tool should provide a general explanation of the process or procedures that preceded the current location, and the taxpayer can also click on the roadmap to see detailed maps of past stages of the journey.
- **What are my next steps?** This vital information will explain the taxpayer's current options. That is, the tool will explain what the taxpayer needs to do next to address the matter raised in the letter or notice, and the consequences of action and inaction. Embedded links will direct the taxpayer to appropriate sites on IRS.gov or even external sites (*e.g.*, the United States Tax Court's website for a video about the Tax Court and a fillable PDF of a Tax Court petition).
- **What are my rights as a taxpayer?** The taxpayer will learn what rights the taxpayer has and how action or inaction will impact these rights. The taxpayer can follow links to the TAS Taxpayer Bill of Rights web pages.³
- **Where can I get additional help?** This section will provide information on how to seek assistance from a Low Income Taxpayer Clinic (LITC) or TAS. It will also provide links to IRS and TAS guidance related to the matter.

Thus, by addressing six key questions every taxpayer will have in response to an IRS letter or notice, the initial pop-up box will provide an entry way into the complex tax system. The taxpayer will be able to determine where he or she is, why this notice is so important and what rights it provides or affects, what he or she must do next, and where he or she can get additional help. Through embedded links

2 In working on the roadmap, our graphics contractor consistently sought to simplify the roadmap. We had to explain, against all graphic design and communication principles, that we needed to represent the actual complexity of the system, not simplify it!

3 TAS, TBOR, www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

the taxpayer can obtain greater detail about all of these steps, or the taxpayer can just seek help from LITCs or TAS. The digital roadmap tool thus empowers the taxpayer with knowledge and helps build understanding of the tax system and the taxpayer's place in it.

CONCLUSION

During FY 2020, we plan to build on the foundation of the 2018 Annual Report's basic roadmap diagrams. Given the reception we have received regarding the existing roadmaps, we hope to provide taxpayers, their representatives, and even other IRS employees a truly valuable tool. The final digital product will educate taxpayers about their rights and help them navigate through the extremely complex processes and procedures of tax administration.

FOCUS FOR FISCAL YEAR 2020

In fiscal year 2020, TAS will:

- Identify any gaps in the seven roadmaps published in the 2018 Annual Report to Congress;
- Identify the notices associated with each step of the seven roadmaps;
- Develop the content for each notice, step, and sub-step of the roadmap; and
- Design, develop, test, and launch the first iteration of the digital roadmap tool on the TAS website. The first iteration will cover information on the most important IRS notices that provide significant legal rights and protections to taxpayers: the notice of deficiency, math error notices, and notice of levy and right to a collection due process hearing.

Area of Focus #2 **TAS Will Urge the IRS to Reconsider Its Position on the Application of the Religious Freedom Restoration Act to the Social Security Requirement Under IRC § 24(h)(7), Which Has the Effect of Denying Child Tax Credit Benefits to the Amish and Certain Other Religious Groups**

TAXPAYER RIGHTS IMPACTED¹

- *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 Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DISCUSSION

Beginning in about the 1950s, members of certain religious groups, most notably the Amish, found their religious beliefs at odds with certain legal requirements. To ensure that an individual's freedom to exercise his or her religion is not infringed upon, the courts, Congress, and administrative agencies have fashioned certain exceptions to the legal requirements to accommodate the free exercise of religion.² These exceptions were created largely to address concerns raised by the Amish community.

Although there are sects within the community that differ in their interpretation of religious doctrines, the Amish community generally shares a number of fundamental religious beliefs that shape their interactions with the modern world,³ such as a strong belief in community and humility.⁴ The Old Order Amish have a long and deep adherence to their religious tenets, which focus on their "devotion to a life in harmony with nature and the soil, as exemplified by the simple life of the early Christian era that continued in America during much of our early national life."⁵ Further, their religious beliefs prohibit them from accepting government benefits because they believe that God and the community

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 See *Wisconsin v. Yoder*, 406 U.S. 205 (1972); IRC §§ 1402(g) and 3127; Internal Revenue Manual (IRM) 21.6.3.4.1.3, *Child and Dependent Care Credit* (Oct. 1, 2018). For taxpayers indicating a religious (e.g., Amish/Mennonite) or conscience-based objection to obtaining a taxpayer identification number (TIN), refer to IRM 21.6.1.6.1, *Determining the Exemption Deduction* (Oct. 1, 2018).

3 Christopher Petrovich, *More Than Forty Amish Affiliations? Charting the Fault Lines*, JOURNAL OF AMISH AND PLAIN ANABAPTIST STUDIES, Issue 1, 120-142 (2017).

4 *The Amish and Photography*, <https://www.pbs.org/wgbh/americanexperience/features/amish-photography/> ("The Amish believe any physical representation of themselves (whether a photograph, a painting, or film) promotes individualism and vanity, taking away from the values of community and humility by which they govern their lives.").

5 *Wisconsin v. Yoder*, 406 U.S. 210 (1972).

should care for those in need. One consequence of observing these core beliefs is that most individuals in the Amish community refrain from accepting Social Security benefits and in some cases from obtaining a Social Security number (SSN), at least until later in life.⁶

To accommodate this deeply held belief, Congress passed Internal Revenue Code (IRC) §§ 1402(g) and 3127, which relieve qualifying religious individuals from complying with the old-age, survivors, and disability insurance obligation.⁷ As the legal landscape continues to evolve, the Amish continue to encounter tension between their religious tenets—most notably their abstinence from participating in the Social Security system, including applying for SSNs—and their ability to navigate the tax system.⁸

Most recently, the Tax Cuts and Jobs Act of 2017 (TCJA) imposed a requirement that taxpayers must include an SSN for every qualifying child for whom they claim the Child Tax Credit (CTC).⁹ This Area of Focus analyzes the impact of this SSN requirement and the IRS's implementation of the provision of that requirement. As we will clearly show, the IRS has put in place procedures to implement this requirement that impermissibly offer an exception to the SSN requirement to an unprotected class (parents of a child who is born and dies in the same year or in the consecutive year) while denying such an exception to a protected class (Amish parents that do not have an SSN for their children pursuant to their religious beliefs).

Taxpayers Are Now Required to Include a Social Security Number for Every Qualifying Child for Whom They Claim the Child Tax Credit, Thereby Conflicting With the Religious Beliefs of Some Individuals

The TCJA amended IRC § 24 by requiring a taxpayer who is claiming a CTC for a qualifying child to provide the child's SSN on the return.¹⁰ Prior to this amendment, IRC § 24 only required that a taxpayer identification number (TIN) be provided, and the IRS developed a procedure that allowed Amish taxpayers to claim the CTC without placing an identifying number on the dependent line of the return.¹¹ The stated purpose for the TCJA amendment was to prevent taxpayers who are not eligible

6 Peter J. Ferrara, *Social Security and Taxes*, in *THE AMISH AND THE STATE* 125, 129 (Donald B. Kraybill ed., John Hopkins Press 2d ed. 2003).

7 IRC § 3101 requires a 6.2 percent tax on an employee's wages to fund old-age, survivors, and disability insurance.

8 Although the issues raised in this discussion may affect other religious groups, this piece will primarily focus on issues facing and affecting the Amish, as it is this community that has historically found themselves in conflict with the tenets of their religion and obligations imposed on them by law.

9 Tax Cuts and Jobs Act (TCJA), Pub. L. No. 115-97, § 11022(a), 131 Stat. 2054, 2073-2074 (2017).

10 IRC § 24(h)(7). The IRS accepted an Individual Taxpayer Identification Number (ITIN), Social Security Number (SSN), or Adoption Taxpayer Identification Number (ATIN).

11 See IRM 21.6.3.4.1.3, *Child and Dependent Care Credit* (Oct. 1, 2017). For taxpayers indicating a religious (e.g., Amish/Mennonite) or conscience-based objection to obtaining a TIN, refer to IRM 21.6.1.6.1, *Determining the Exemption Deduction* (Oct. 1, 2017). Currently, when an individual believes they should be exempt from paying employment taxes on grounds of their religious beliefs, they will file Form 4029, *Application for Exemption from Social Security and Medicare Taxes and Waiver of Benefits*, with the Social Security Administration (SSA). The form must include evidence of membership in and adherence to the tenets and teachings of the religion and a waiver of all benefits and payments under the Social Security Act. The Commissioner of Social Security must also find the following: the sect's beliefs are required; the members have practiced them for a substantial period; and the sect has been in existence since December 31, 1950. Once the Form is approved by SSA, it will then be sent to the IRS for its approval. Generally, a Form that is approved by SSA will also be approved by IRS. Historically, when claiming the dependency exemption for a dependent who does not have an SSN, an Amish taxpayer will write "Amish Form 4029" in the dependency line.

to obtain a work-eligible SSN from improperly or fraudulently claiming the CTC or the American Opportunity Tax Credit (AOTC).¹²

In 2018, the National Taxpayer Advocate asked IRS senior leadership to address the impact of the CTC SSN requirement on the Amish community, specifically requesting it implement an administrative workaround for taxpayers with religious objections to an SSN, as the IRS has done in the past. At the end of 2018, the National Taxpayer Advocate was advised the IRS had created a process that would allow Amish taxpayers to claim the CTC.¹³

On February 6, 2019, notwithstanding the IRS's December communication, the IRS issued guidance to its employees instructing the *suspension* of amended returns where the taxpayer:

- Claims the CTC, Additional Child Tax Credit, or the Credit for Other Dependent;
- Does not provide an SSN(s) for the dependent(s); and
- Identifies as Amish or Mennonite, has a Form 4029/4029 exemption, or has a religious or conscience-based objection.¹⁴

The IRS Wage & Investment Division (W&I) also informed TAS that the IRS would be suspending both amended and original tax year 2018 returns that meet the above criteria and would not correspond with the taxpayer during the time the return was in suspense status. On March 7, 2019, the National Taxpayer Advocate alerted Congress to this issue when she testified before the House Ways and Means Subcommittee on Oversight.¹⁵

On March 29, 2019, the IRS Office of Chief Counsel (Chief Counsel) issued program manager technical advice (PMTA) to an IRS executive responsible for implementing this new provision concluding "... the [IRS] need not provide administrative relief for these taxpayers."¹⁶ The IRS has

12 H.R. REP. NO. 115-409, at 141-142 (2017). Individuals must list their SSN on a tax return, and individuals who must file a return but do not have an SSN must apply for an ITIN from the IRS. Individuals who are eligible to obtain an SSN are not eligible to receive an ITIN. IRC § 6109. Receiving an ITIN does not authorize an individual to work in the United States or receive Social Security benefits. To obtain the Child Tax Credit (CTC) in 2018, the taxpayer must list on the return as the child's identifying number an SSN that is valid for employment in the United States. See H.R. REP. NO. 115-466, at 230-233 (2017). The requirement to have a work-eligible SSN to claim the CTC is similar to the requirement to have a work-eligible SSN to obtain the Earned Income Tax Credit (EITC), which was added to the IRC under the Personal Responsibility and Work Opportunity Reconciliation Act, Pub. L. No. 115-97, 110 Stat. 2105 (1996). The House Report states that the requirement to provide an SSN to claim the EITC was to ensure that only individuals who were authorized to work in the United States should be able to claim the credit. H.R. REP. NO. 104-651, at 1457 (1996).

13 Email communication from Deputy Chief Counsel to National Taxpayer Advocate (Dec. 18, 2018). The IRS plans to largely continue its practice of allowing taxpayers with a religious exemption who have an approved Form 4029 on file, and did not provide an SSN for their dependents, to claim the CTC. Taxpayers who object to providing the dependent's SSN for religious reasons will receive a slightly modified Letter 3050C to confirm the taxpayer's U.S. citizenship. IRM 21.6.1.6.1(8) (Oct. 1, 2018) requires the IRS to issue letter 3050C requesting specific documentation "in paragraph 1" of that letter. The letter requests that the taxpayer submit the child's birth certificate or green card, hospital medical records documenting the birth of the child or other public record documenting the birth of the child, school records, childcare records, a letter from a government benefits provider, cancelled child support checks, or medical records or statement from a health care provider verifying the child's address.

14 SERP Alert 19A0070 (Feb. 6, 2019).

15 *The Tax Filing Season: Hearing Before the H. Subcomm. on Government Oversight of the H. Comm. on Ways and Means*, 116th Cong. 22-27 (2019) (testimony of Nina E. Olson, National Taxpayer Advocate).

16 Program Manager Technical Advice (PMTA), *Administration of the Child Tax Credit for Objectors to Social Security Numbers*, POSTS-117474-18, PMTA 2019-2 (Mar. 29, 2019) (concluding, among other things that "[i]n implementing [IRC] section 24(h)(7), the [IRS] has compelling governmental interests to ensure uniform and orderly tax administration and to prevent improper CTC claims. For the [IRS], the least restrictive, and the only, means to further those compelling interests is to require a qualifying child's eligible SSN.").

since revised its guidance to reflect this advice¹⁷ and is disallowing the CTC where the qualifying children do not have SSNs. Under the TCJA, the maximum CTC for 2018 was \$2,000 per child. Without an SSN, the taxpayer can only receive a partial \$500 credit allowed for a dependent, a significant reduction of 75 percent.¹⁸

The National Taxpayer Advocate profoundly disagrees with Chief Counsel’s conclusion that the IRS does not need to administratively accommodate taxpayers with religious or conscience-based objections to obtaining SSNs and believes the legal advice’s analysis inaccurately interprets the IRS’s obligation to comply with the Religious Freedom Restoration Act of 1993 (RFRA).¹⁹ The discussion below describes the evolution of free exercise claims, how such claims are analyzed when applying RFRA, *and relevant United States Supreme Court decisions.*

The Evolution of Free Exercise of Religion Claims

Beginning in the 1960s, the U.S. Supreme Court decided several landmark free exercise of religion cases, several of which directly involved the Amish. The first landmark case on this issue was *Sherbert v. Verner*.²⁰ In *Sherbert*, a member of the Seventh-day Adventist Church, which forbids working on Saturday in observance of the sabbath, was fired after refusing to work on Saturdays.²¹ Ms. Sherbert could not find any other work that did not require her to work on Saturday.²² She applied for unemployment compensation, but her claim was denied because the state’s law provided that a claimant is ineligible for unemployment if he or she has failed, without good cause, to accept other available work offered.²³

The Court held that denial of Ms. Sherbert’s unemployment claim represented a substantial burden upon her free exercise of religion.²⁴ Justice Brennan, who wrote the majority opinion, stated, “to condition the availability of benefits upon this appellant’s willingness to violate a cardinal principle of her religious faith effectively penalizes the free exercise of her constitutional liberties.”²⁵ The Court next considered whether the state had a compelling interest to justify the substantial infringement on Ms. Sherbert’s First Amendment right and determined the state did not.²⁶ Further, this opinion established what is known as the *Sherbert* Test, which requires the demonstration of a compelling interest and a narrow tailoring of a law that substantially burdens an individual’s free exercise of religion.

Now is not the first time the Amish community and its deeply held religious beliefs have been at odds with a legal requirement. In the landmark Supreme Court decision *Wisconsin v. Yoder*,²⁷ the Amish challenged a Wisconsin compulsory school attendance law requiring children to attend school up until the age of 16 on the basis that this requirement infringed upon their First Amendment right to the free

17 IRM 3.12.3.26.17.6,(2) *TIN Requirements (EC 287)* (Apr. 15, 2019).

18 IRC § 24(h)(2), (4), and (7).

19 PMTA, *Administration of the Child Tax Credit for Objectors to Social Security Numbers*, POSTS-117474-18, PMTA 2019-2 (Mar. 29, 2019); Religious Freedom Restoration Act of 1993, Pub. L. No. 103-141, 107 Stat. 1488 (1993), codified at 42 U.S.C. §§ 2000bb et seq; *Burwell v. Hobby Lobby Stores, Inc.*, 573 U.S. 682 (2014).

20 *Sherbert v. Verner*, 374 U.S. 398 (1963).

21 *Id.* at 399 (1963).

22 *Id.*

23 *Id.* at 400 (1963).

24 *Id.* at 403 (1963).

25 *Id.* at 406 (1963).

26 *Id.* at 406-409 (1963).

27 *Wisconsin v. Yoder*, 406 U.S. 205 (1972).

exercise of religion. (Amish children do not attend school beyond eighth grade so they can learn the ways of the Amish faith.) The U.S. Supreme Court held that Wisconsin’s compulsory school attendance law was unconstitutional when applied to the Amish, because it imposed a substantial burden on the free exercise of religion and was unnecessary to serve a compelling governmental interest.²⁸

In 1982, the Supreme Court stepped back from its compelling interest analysis in *Yoder* and adopted a narrower test for free exercise of religion cases. In *United States v. Lee*, an Amish farmer who employed other Amish filed a refund suit claiming a refund of employment taxes paid, arguing that payment of Social Security taxes violated his First Amendment free exercise rights because the Amish oppose contributing to and benefiting from a national social security system.²⁹ The U.S. Supreme Court determined that requiring Amish employers to pay Social Security taxes was an infringement on their free exercise of religion, but further held that limiting religious liberty is permissible if the state shows doing so is essential to “accomplish an overriding governmental interest,” (*i.e.*, the payment of tax).³⁰ Having found that it would be difficult for the government to accommodate the comprehensive social security system with myriad exceptions flowing from a variety of religious beliefs and that the tax law was neutral in its general application, the Court held that this burden to the Amish religion was not unconstitutional.³¹

The holding in *Yoder* was further eroded by the U.S. Supreme Court in *Employment Division, Department of Human Resources of Oregon v. Smith*.³² There, the Court held that the “right of free exercise does not relieve [an] individual of [the] obligation to comply with [a] valid or neutral law of general applicability on [the] ground that [the] law proscribes, or requires, conduct that is contrary to his religious practice.”³³ In so doing, it effectively overruled the compelling governmental interest standard of scrutiny applied in *Sherbert* and *Yoder*.³⁴

Congress responded to this ruling by enacting the Religious Freedom Restoration Act in 1993. The stated purpose of the RFRA was as follows:

1. To restore the compelling interest test as set forth in *Sherbert*³⁵ and *Yoder*³⁶ and to guarantee its application in all cases where free exercise of religion is substantially burdened; and
2. To provide a claim or defense to persons whose religious exercise is substantially burdened by government.³⁷

The compelling interest test set forth in the RFRA provides:

- (a) In General. Government shall not substantially burden a person’s exercise of religion even if the burden results from a rule of general applicability, except as provided in subsection (b).

28 *Wisconsin v. Yoder*, 406 U.S. 205 (1972).

29 *U.S. v. Lee*, 455 U.S. 252, 257 (1982).

30 *Id.* at 257-258 (1982).

31 *Id.* at 259-260, 263 (1982).

32 494 U.S. 872 (1990).

33 *Employment Division, Department of Human Resources of Oregon v. Smith*, 494 U.S. 872, 879 (1990).

34 *Sherbert v. Verner*, 374 U.S. 398 (1963). Mary L. Topliff, Annotation, Validity, Construction, and Application of Religious Freedom Restoration Act (42 U.S.C.A. §§ 2000bb et seq.), 135 A.L.R. Fed. 121 (1996).

35 *Sherbert v. Verner*, 374 U.S. 398 (1963).

36 *Wisconsin v. Yoder*, 406 U.S. 205 (1972).

37 42 U.S.C. 2000bb-(b)(1), (2). Pub. L. 103-141, § 2, 107 Stat. 1488 (1993).

(b) Exception. Government may substantially burden a person's exercise of religion only if it demonstrates that application of the burden to the person—

- (1) is in furtherance of a compelling governmental interest; and
- (2) is the least restrictive means of furthering that compelling governmental interest.³⁸

One of the most recent and significant cases where the standards set out in RFRA were applied to a federal law and a regulation was in *Burwell v. Hobby Lobby Stores, Inc.*³⁹ The Court adopted a three-step analysis to determine how RFRA applies:

- Step 1: Whether the complainant was covered under RFRA;
- Step 2: Whether the government action or mandate “substantially burdens” the “exercise of religion” as defined under the Act; and
- Step 3: Whether the government action or mandate is *both* (1) in furtherance of a compelling governmental interest *and* (2) the least restrictive means of furthering that compelling governmental interest.

Hobby Lobby presented an opportunity for the Court to weigh a free exercise claim against the Patient Protection and Affordable Care Act's requirement that businesses' health insurance include coverage for contraception. Three closely held corporations and their owners asserted that such a requirement violated their religious beliefs.⁴⁰ The least-restrictive-means standard is exceptionally demanding, said the Court, and it was not satisfied that the government met that standard in this case.⁴¹ The relevant inquiry is whether an agency is able to show that it lacks other means of achieving its desired goal without imposing a substantial burden on the exercise of religion.⁴² The Court held that the Secretary of Health and Human Services had previously adopted other means by which the regulation could be complied with while not substantially burdening a person's free exercise of religion.⁴³ Additionally, the Court determined that failing to provide this alternative means of compliance would force the companies' owners to either violate their deeply held religious beliefs or honor those beliefs and ultimately pay a financial penalty of millions of dollars, thereby substantially burdening their free exercise of religion.⁴⁴

Applying the Religious Freedom Restoration Act to the Requirement That a Social Security Number Be Included on the Return for Each Dependent Where the Child Tax Credit Is Being Claimed

The holding in *Hobby Lobby* illustrates that the Supreme Court expects agencies to conduct an RFRA analysis when developing administrative policies and procedures. Thus, when implementing IRC § 24(h)(7)—or any statute—the IRS is obliged to consider whether implementation would run afoul of RFRA.

38 42 U.S.C. § 2000bb-1(a) and (b).

39 *Burwell v. Hobby Lobby Stores, Inc.*, 573 U.S. 682 (2014).

40 The three closely held companies are Hobby Lobby Stores, Inc., Mardel, and Conestoga Wood Specialties Corporation (the owners of Conestoga Wood Specialties were members of the Mennonite faith).

41 *Burwell v. Hobby Lobby Stores, Inc.*, 573 U.S. 682, 728 (2014).

42 *Id.*

43 *Id.* at 730-731 (2014).

44 *Id.* at 682 (2014).

When applying RFRA and the holding in *Hobby Lobby*, the IRS must consider whether there is a compelling governmental interest and, if so, how to achieve that compelling governmental interest in a manner that imposes the least restrictive burden on an individual's free exercise of religion. In Chief Counsel's advice, it rightly concludes that the IRS has a compelling governmental interest to ensure uniform and orderly tax administration and to prevent improper CTC claims.

In support of its conclusion that the IRS "need not provide administrative relief for these taxpayers," Chief Counsel quotes *Hernandez v. Commissioner*, which in turn quoted *United States v. Lee*, as follows: "The tax system could not function if denominations were allowed to challenge the tax system on the ground that it operated in a manner that violates their religious belief."⁴⁵

Both the *Hernandez* and *Lee* cases cited by Chief Counsel were decided *before* the enactment of the RFRA, which explicitly reinstated the *Sherbert* compelling governmental interest test when analyzing how a federal law restricts an individual's free exercise of religion. As noted above, in *Sherbert*, the Court held the state's denial of unemployment compensation to a Seventh-day Adventist who was fired for refusing to work on Saturday, her Sabbath, was a violation of the Free Exercise Clause of the Constitution.⁴⁶ While acknowledging that the Free Exercise Clause "is not totally free from legislative restriction,"⁴⁷ the Court reasoned:

Here, not only is it apparent that appellant's declared ineligibility for benefits derives solely from the practice of her religion, but the pressure upon her to forego that practice is unmistakable. The ruling forces her to choose between following the precepts of her religion and forfeiting benefits, on the one hand, and abandoning one of the precepts of her religion in order to accept work, on the other hand. Governmental imposition of such a choice puts the same kind of burden upon the free exercise of religion as would a fine imposed against appellant for her Saturday worship.⁴⁸

The Court next considered "whether some compelling state interest enforced in the eligibility of the South Carolina [unemployment insurance] statute justifies the substantial infringement of appellant's First Amendment right."⁴⁹ The Court concluded there was none and noted:

Significantly, South Carolina expressly saves the Sunday worshipper from having to make the kind of choice which we here hold infringes the Sabbatarian's religious liberty. When, in times of "national emergency," the textile plants are authorized by the State Commissioner of Labor to operate on Sunday, "no employee shall be required to work on Sunday ... who is conscientiously opposed to Sunday work, and if any employee should refuse to work on Sunday on account of conscientious ... objections, he or she shall not jeopardize his or her seniority by such refusal or be discriminated against in any other manner." S.C. Code, § 644. No question of the disqualification of a Sunday worshipper for benefits is likely to arise, since we cannot suppose that an employer will discharge him in violation of this statute. The unconstitutionality of the disqualification of the Sabbatarian is thus compounded by

45 *United States v. Lee*, 455 U.S. 252 at 260 (1982); *Hernandez v. Comm'r*, 490 U.S. 680, 699-700(1989).

46 *Sherbert v. Verner*, 374 U.S. 398 (1963).

47 *Id.* at 403 quoting *Braunfeld v. Brown*, 366 U.S. 599, 603 (1961).

48 *Sherbert v. Verner*, 374 U.S. 398, 404 (1963).

49 *Id.*

the religious discrimination which South Carolina's general statutory scheme necessarily effects.⁵⁰

With respect to the Amish and the SSN requirement when claiming the CTC, Chief Counsel advice states, "... the least restrictive, and the only, means to further those compelling interests is to require a qualifying child's eligible SSN,"⁵¹ relying on the language of IRC § 24(h)(7) as justification for its narrow interpretation of the least restrictive means analysis. And yet here, as in *Sherbert*, the government is applying this statutory requirement disparately between groups of taxpayers. Specifically, despite the statutory requirement that qualifying children have SSNs for taxpayers to claim and receive the CTC and Earned Income Credit (EITC), the IRS has put in place procedures that allow parents of children who were born and died in the same or consecutive tax years to claim these credits *even if they do not have an SSN for the child*. Internal Revenue Manual (IRM) 3.12.3.26.17.6, which was updated April 15, 2019, *after* the issuance of the Chief Counsel memo, states:

Allow the Child Tax Credit when the child's SSN is missing, and the child was **born** and **died** in the same or consecutive tax period if the taxpayers provide documentary support in the form of a copy of the birth certificate, death certificate, or hospital record ...

Moreover, the IRS has provided guidance regarding these procedures to taxpayers in general, in the form of an FAQ on its website:

My child was born and only lived 40 minutes. Can this child be my qualifying child for the earned income credit and the child tax credit?

Answer

Yes, if you meet the requirements, you may claim:

1. The Earned Income Credit
2. The Dependency Exemption and/or Child Tax Credit

Specifically, in regards to claiming the Child Tax Credit, the FAQ states the following:

The child tax credit requires that you provide a valid SSN for your qualifying child. If you meet all of the other requirements to claim this credit and your child was born and died in 2018 and didn't have an SSN, instead of an SSN, you may enter "DIED" on column 2 of the Form 1040 and attach a copy of the child's birth certificate or a hospital record showing a live birth.⁵²

Thus, despite the IRS's position that it is *required* to deny CTC claims where a child does not have an SSN for religious reasons, it has miraculously found a way—and established a procedure—to permit CTC claims where a child does not have an SSN because the child was born and died in the same or consecutive years. As sympathetic as this second group of taxpayers is, it is not a protected class under the Constitution, and the RFRA does not apply to these taxpayers' circumstances. Thus, the IRS's own established procedures and public announcements demonstrate that its implementation of

50 *Sherbert v. Verner*, 374 U.S. 398, 406 (1963).

51 PMTA, *Administration of the Child Tax Credit for Objectors to Social Security Numbers*, POSTS-117474-18, PMTA 2019-2 (Mar. 29, 2019).

52 IRS, *Frequently Asked Questions, Qualifying Child Rules 1*, <https://www.irs.gov/faqs/earned-income-tax-credit/qualifying-child-rules/qualifying-child-rules-1> (last visited June 4, 2019).

IRC § 24(h)(7) is not consistent with a “valid or neutral law of general applicability.” To the contrary, the IRS has carved out an exception to the law for an *unprotected class*, even as it says it is required to apply the law with no exceptions with respect to a protected class. Thus, Chief Counsel’s decision seemingly stands legal reasoning on its head.

In response to our question about the justification for the discriminatory procedures described above, an official from Chief Counsel noted that the Social Security Administration will not issue an SSN to a deceased person, pointing out that the parent of a child who was born and died in the same year is unable to obtain an SSN for the deceased child, whereas religious objectors make a choice not to obtain an SSN, albeit in observance of their religious obligations.⁵³

The Social Security Administration’s refusal to issue SSNs to deceased individuals in certain circumstances is irrelevant in the face of the plain statutory requirement invoked by Chief Counsel to deny religious objectors the CTC.⁵⁴ *Sherbert*, as incorporated into RFRA, requires the law to be neutral and generally applicable; if an exemption is offered to one, then it must be offered to everyone.

The procedures for claiming children born and deceased in the same year or consecutive years also exposes the fallacy of Chief Counsel’s claim that:

In light of the unambiguous language of section 24(h)(7), the least restrictive, and indeed the only, means to further those compelling interests is to require a qualifying child’s eligible SSN for CTC. The Service has no ‘viable alternative’ to implement this clear congressional mandate to require an eligible SSN for a qualifying child.⁵⁵

This conclusion is manifestly inaccurate, as the IRS has, in fact, found a “viable alternative” where children are born and die in the same or consecutive tax years.

Moreover, since about the mid-1980s there has been, and still is, a procedure whereby the IRS processes returns from religious and conscientious objectors claiming dependent exemptions without SSNs.⁵⁶ This procedure requires the taxpayer to file with his or her return a Form 4029, *Application for Exemption from Social Security and Medicare Taxes and Waiver of Benefits*, that has been approved by the Social Security Administration. Up until the IRS issued its new guidance disallowing CTC claims where Amish or Mennonite taxpayers’ children did not have SSNs, the IRS required the taxpayer to provide detailed information and documentation demonstrating the existence, age, relationship, and residence of the child before the IRS processes the return.⁵⁷ This documentation is far in excess of what is required of parents of children who were born and deceased in the same or consecutive years. Thus, the

53 Email dated May 31, 2019, on file with TAS.

54 See Program Operations Manual System (POMS), RM 10225.080, *Policy on Social Security Number (SSN) Applications on Behalf of Deceased Persons, A. Assigning an SSN after death* (Mar. 10, 2017). The statement says the following for the situation of parents who request an SSN for a deceased child when an SSN was not requested through the normal procedures: “FOs (Field Officers) should not assign an SSN merely to process a claim for benefits to a denial or to obtain an SSN for a deceased child so that the parent(s) may claim the child as an exemption. For information on claiming exemptions, please visit IRS.gov.”

55 PMTA, *Administration of the Child Tax Credit for Objectors to Social Security Numbers*, POSTS-117474-18, PMTA 2019-2 (Mar. 29, 2019).

56 These procedures still apply to late-filed returns for which the dependent exemption under IRC § 151 is still available.

57 This documentation was enumerated in letter 3050C included a birth certificate, hospital medical record documenting the child’s birth, or other public record documenting the child’s birth, and school records on official letterhead, statement from a childcare provider either on company letterhead or notarized, statement from a government agency providing benefits to the child or verifying that the child is disabled, cancelled checks or statements verifying child support paid, or medical records or a written statement from the health care provider.

government cannot argue that its compelling government purpose—to combat improper or fraudulent claims of CTC—is a justification for substantially burdening the religious beliefs of Amish taxpayers when it is clearly applying a less restrictive means to another (non-religious) group of taxpayers.

CONCLUSION

Since the nation's founding, the First Amendment of the U.S. Constitution has guaranteed the free exercise of religion. This enumerated right has continually been protected by the United States Supreme Court, Congress, and governmental agencies. Congress has reinforced this foundation by enacting the RFRA. Recent Chief Counsel advice on the CTC issue impermissibly and substantially burdens the free exercise of religion under RFRA by exempting one group from the application of IRC § 24(h)(7) while refusing to exempt taxpayers who have a religious objection to obtaining SSNs. Moreover, the IRS has created and is implementing a less restrictive means to achieve its compelling governmental purpose for the former group but has declined to implement it with respect to religious objectors. These are clear violations of the RFRA and may even be a violation of the Free Exercise Clause. The IRS must either deny the CTC and EITC to parents whose children were born and deceased in the same or consecutive years—something the National Taxpayer Advocate is *not recommending*—or it must apply the exemption afforded to this group of taxpayers to the Amish and similar taxpayers as well.

FOCUS FOR FISCAL YEAR 2020

In fiscal year 2020, TAS will:

- Advocate for the IRS to reconsider its position on requiring SSNs for qualifying children of Amish and similar taxpayers who have religious objections when claiming the CTC; and
- Develop a legislative recommendation to amend IRC § 24(h)(7) to allow taxpayers to claim the CTC for qualifying children without SSNs when there is an approved Form 4029 on file.

Area of Focus #3 **TAS Will Continue to Advocate for the IRS to Proactively Identify, Educate, and Assist Taxpayers at Risk of Economic Hardship Throughout the Collection Process**

TAXPAYER RIGHTS IMPACTED¹

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

DISCUSSION

Congress has repeatedly directed the IRS to protect taxpayers who are experiencing economic hardship from any additional economic harm due to tax collection.² The National Taxpayer Advocate remains concerned that the IRS does not *proactively* identify taxpayers at risk of economic hardship at the beginning of the collection process, despite having the ability to do so.³ Furthermore, the IRS routinely applies collection treatments that do not require any financial analysis, including placing taxpayers into streamlined Installment Agreements (IAs).⁴ Because the IRS typically does not place a marker on the accounts of taxpayers who seem at particular risk for economic hardship, and because taxpayers are often unaware the IRS must halt collection action if it causes economic hardship, vulnerable taxpayers may face potentially harmful collection action, such as an IRS levy or a lien filing, or enter into a streamlined IA they cannot afford and may later default on.⁵

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).
- 2 See, e.g., IRC § 6343(a)(1)(D) (requiring the IRS to release a levy if the IRS determines that “such levy is creating an economic hardship due to the financial condition of the taxpayer”); IRC §§ 6320(c), 6330(c)(2)(A)(ii) (permitting a taxpayer, in a collection due process hearing, to raise the inability to pay due to hardship as a “challenge to the appropriateness of collection action”); IRC § 7122(d) (requiring the IRS to develop allowable living expense (ALE) guidelines to determine when an offer in compromise (OIC) is adequate and should be accepted to resolve a dispute).
- 3 Taxpayers who meet the definition of economic hardship are those “unable to pay his or her reasonable basic living expenses.” See IRC § 6343; Treas. Reg. § 301.6343-1; Internal Revenue Manual (IRM) 5.8.11.2.1, *Economic Hardship* (Aug. 5, 2015).
- 4 IRC § 6159; IRM 5.14.1.1.1, *Streamlined Installment Agreements (IAs)* (Dec. 23, 2015). In theory, a streamlined IA may help taxpayers by avoiding the burden of providing financial information. However, by avoiding the financial analysis this tool actually harms taxpayers who would otherwise not be able to afford an IA and would be better off with a different collection alternative.
- 5 The IRS has internal data available to provide an initial indicator of whether a taxpayer may be at risk of economic hardship, but uses this information in very limited circumstances. For instance, the Low Income Indicator (LII) is used to determine whether taxpayers entering into an IA are eligible for a reduced or waived user fee. An income-based LII is placed on accounts that are at or below 250 percent of the federal poverty level depending on household size and state of residence. The LII is placed on the IRS’s Individual Master File (IMF) system, and is determined by reviewing the taxpayer’s income and exemptions on the taxpayer’s most recent tax return and comparing them with the poverty level charts created by the Department of Health and Human Services (HHS). IRM 5.14.1.2, *Installment Agreements and Taxpayer Rights* (July 16, 2018); see also IRS response to TAS information request (Sept. 14, 2018) (on file with TAS).

The IRS does not flag cases for potential economic hardship even when Inventory Delivery System (IDS) scoring shows the cases are not likely to produce payments, including the shelved cases that the IRS sets aside.⁶

In fiscal year (FY) 2018, the IRS agreed to nearly 2.9 million installment agreements. Over 72 percent (2,079,743) of these agreements were streamlined IAs, not requiring financial analysis or the use of Allowable Living Expense (ALE) standards.⁷ Over the past six years, nearly 4.3 million IAs have been arranged for cases assigned to the IRS's Automated Collection System (ACS) and about 84 percent of those IAs were streamlined.⁸ Furthermore, as we reported in the 2018 Annual Report to Congress, about 40 percent of taxpayers who entered into a streamlined IA in ACS in FY 2018 had incomes at or below their ALEs.⁹ While the overall default rate for ACS streamlined IAs in FY 2018 was 19 percent,¹⁰ the default rate for streamlined IAs of taxpayers whose income did not exceed their ALEs, was 39 percent.¹¹ These taxpayers agreed to pay their tax debts while, even by the IRS's own standards, they could not pay for their basic living expenses. These taxpayers may default on their IAs or continue to make payments but be unable to meet what the IRS has determined are basic living expenses.¹² Furthermore, 40 percent of taxpayers who entered into IAs while their debts were assigned to private collection agencies (PCAs) had incomes at or below their ALEs.¹³ Thirty-seven percent of taxpayers who entered into IAs while their debts were assigned to PCAs defaulted, a frequency that rises to 44 percent when the defaulted IAs that PCAs do not report to the IRS as required are taken into account.

The IRS does not consider ALE guidelines in deciding which collection cases to work, although research by TAS shows that in a sample comprising a large segment of ACS casework being transferred to the

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- 6 The IRS uses the Inventory Delivery System (IDS) to evaluate a collection case and determine where it should be worked using decision analytics and risk-based collection criteria. IRM 5.1.20, *Collection Inventory* (Nov. 2, 2016).
- 7 IRM 5.14.5.1, *Overview* (May 23, 2014). Streamlined Criteria have two tiers, up to \$25,000, and \$25,001–\$50,000. In-Business Trust Fund Express IAs can be secured without securing financial information on business accounts up to \$25,000. For more information on streamlined IAs in particular, see IRM 5.14.5.2, *Streamlined Installment Agreements* (Dec. 23, 2015). The number of streamlined IAs reported above includes guaranteed IAs available to taxpayers under IRC § 6159(c), which also do not require financial analysis. IRS, *Collection Activity Report (CAR) NO-5000-6* (Oct. 1, 2018).
- 8 There are instances where IAs may be arranged by other Collection units than the Automated Collection System (ACS). In Fiscal Year (FY) 2018, streamlined IAs made up about 72 percent of total IAs. IRS, *CAR NO-5000-6* (Oct. 1, 2018).
- 9 IRC § 7122(d). If the allowable living expense (ALE) standards exceed the taxpayer's income, the taxpayer is unable to pay his or her necessary living expenses. IRS, *Collection Financial Standards*, <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards> (last visited Jun. 18, 2019). See also IRS, *CAR, IA Default Report, FY 2018*.
- 10 IRS, *CAR, IA Default Report, FY 2018*.
- 11 IRS, *CAR, IA Default Report, FY 2018*, for the default rate information for streamlined IAs, and TAS Research analysis of the ACS and IA accounts, FY 2018, for results on percentage of streamlined IAs whose income did not exceed their ALEs who defaulted.
- 12 For more information, see National Taxpayer Advocate 2018 Annual Report to Congress 255-265 (Most Serious Problem: *IRS's Automated Collection System (ACS): ACS Lacks A Taxpayer-Centered Approach, Resulting in A Challenging Taxpayer Experience and Generating Less Than Optimal Collection Outcomes for the IRS*).
- 13 This figure reflects allowance of vehicle ownership and operating expenses in calculating ALEs. If vehicle ownership expenses are not allowed, 33 percent of taxpayers who entered into IAs while their debts were assigned to private collection agencies (PCAs) had incomes at or below their ALEs. For a further discussion of ALEs, see 2018 National Taxpayer Advocate Annual Report to Congress vol. 2 39-52 (Research Study: *A Study of the IRS's Use of the Allowable Living Expense Standards*).

Collection queue, about 93 percent of payments received by the IRS came from taxpayers with income exceeding their calculated ALEs or who have assets that can be detected through systemic means.¹⁴

TAS's research shows that an algorithm using internal data about a taxpayer's income and assets, and comparing that information to ALEs, can be a reliable way to predict taxpayers at risk of economic hardship. TAS evaluated a sample of 278 cases in which a taxpayer's account was closed by ACS or the Field with an IA in FY 2018, all cases in which the IRS obtained financial information from the taxpayer which showed ability to pay, and analyzed whether filtering those cases based on systemic information about a taxpayer's income and ALEs would arrive at the same result.¹⁵ Only 14 cases, or five percent of the sample group, showed no ability to pay by the algorithm—meaning that TAS's algorithm arrived at the same result as the IRS employee in 95 percent of the cases. In five of the 14 cases where TAS's algorithm indicated the taxpayer had no ability to pay, the IRS employee initiated a back-up currently not collectible (CNC) determination in case the IA defaulted.

In addition to inflicting financial harm on the affected taxpayers, the IRS wastes resources by pursuing these cases because it has to reverse collection actions in some cases and it has to deal with defaulted installment agreements in others. Pursuing these taxpayers also contravenes the intent of Congress, which is to avoid creating or exacerbating a financial hardship.¹⁶

The IRS's failure to proactively identify and flag taxpayers at risk of economic hardship throughout the collection process, and in turn, to consider the facts and circumstances that might affect the taxpayers' ability to pay, and respond to them appropriately, violates taxpayers' *right to be informed, right to quality service, right to a fair and just tax system, right to pay no more than the correct amount of tax, and right to finality*.¹⁷

The National Taxpayer Advocate has repeatedly expressed her concerns about the IRS's failure to protect taxpayers who experience economic hardship or who cannot pay their basic living expenses

14 See National Taxpayer Advocate 2018 Annual Report to Congress vol. 2 157-192 (Research Study: *Further Analyses of "Federal Tax Liens and Letters: Effectiveness of the Notice of Federal Tax Liens (NFTL) and Alternative IRS Letters on Individual Tax Debt Resolution"*). The National Taxpayer Advocate persuaded the IRS to conduct a study to determine if the NFTL or one of three alternative collection letters were more effective in reducing the balances owed by taxpayers. The IRS selected a random sample of about 13,000 taxpayers within ACS who generally owed between \$10,000 and \$25,000 whose liabilities were being transferred to the collection queue. TAS Research's analysis of these cases showed that taxpayers with income exceeding their calculated ALEs or who have systemically detected assets account for about 93 percent of the payments made over two years regardless of the treatment type.

15 See National Taxpayer Advocate 2018 Annual Report to Congress 228-239 (Most Serious Problem: *Economic Hardship: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*). TAS excluded two cases from the sample because we could not find additional information on the two cases because of an error in the data collection instrument. TAS Research estimated the income for taxpayers in these cases using the Total Positive Income (TPI) reported on the taxpayer's FY 2017 tax return. To evaluate taxpayers that may not have filed a prior-year return, TAS also considered information from third party Information Reporting Program (IRP) documents, including Forms 1099-INT (interest), 1099-DIV (dividends), 1099-R (retirement income), 1099-B (stocks and bonds), 1099-MISC, SSA-1099, and W-2. To incorporate assets, TAS Research looked at Form 1098 (mortgage interest), and real estate tax or mortgage interest paid on Schedule A. TAS calculated the ALEs for each case by using the National Standards (with household size determined based on the number of exemptions claimed on the return), Local Standards (determined by the zip code on the return), Vehicle Ownership Expense, and Out of Pocket Healthcare Expenses (determined by the taxpayer's age). If the taxpayer did not file a return in a previous year, TAS allocated the lower amount.

16 See IRC § 6343(a)(1)(D). Amendments to IRC § 6343 in 1988 set out conditions under which the IRS is *required* to release a levy, including when "the Secretary has determined that such levy is creating an economic hardship due to the financial condition of the taxpayer." See Omnibus Taxpayer Bill of Rights, Pub. L. No. 100-647, § 6236(f), 102 Stat. 3342, 3740 (1988), also known as Taxpayer Bill of Rights 1 (TBOR 1), enacting IRC § 6343(a)(1)(D).

17 There are several provisions of the IRC that protect taxpayers experiencing economic hardship from IRS collection actions. See, e.g., IRC § 6343(a)(1)(D); IRC §§ 6320(c), 6330(c)(2)(A)(ii); IRC § 7122(d).

from harmful collection action.¹⁸ In January 2011, on the recommendation of the National Taxpayer Advocate, the IRS first began applying a low income filter (LIF) to the Federal Payment Levy Program (FPLP) to flag and screen out taxpayers whose incomes were below 250 percent of the federal poverty level (FPL).¹⁹ The purpose of this filter was to protect low income taxpayers from economic hardship arising from levies on their Social Security old age or disability benefits, or Railroad Retirement Board benefits. The filter was implemented after TAS research showed that the FPLP often levied on taxpayers who were experiencing economic hardship.²⁰

The National Taxpayer Advocate continues to be concerned, and in discussions with senior IRS leadership, has issued a two-part recommendation to the IRS. The first recommendation is a first step: to adopt an algorithm to identify taxpayers who may face economic hardship. Then, going beyond that step, the second part of the recommendation is to expand the use of the algorithm. The National Taxpayer Advocate offers suggestions on how the algorithm could potentially be used once adopted.

TAS Will Continue to Urge the IRS to Adopt an Algorithm Similar to the TAS Algorithm

Recently, TAS developed an automated algorithm that can identify taxpayers who are at risk of economic hardship by flagging those with incomes below their ALEs, with a high degree of accuracy.²¹ The TAS algorithm uses information that the IRS already has and could enable the IRS to automatically flag taxpayers at risk of economic harm.²²

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- 18 See, e.g., Nina E. Olson, NTA BLOG, *The IRS Is Not Doing Enough to Protect Taxpayers Facing Economic Hardship* <https://taxpayeradvocate.irs.gov/news/nta-blog-the-irs-is-not-doing-enough-to-protect-taxpayers-facing-economic-hardship?category=TaxNews> (May 24, 2019); *Tax Filing Season: Hearing Before the H. Subcomm. on Oversight of the H. Comm. on Ways and Means*, 115th Cong. (Mar. 7, 2019) (statement of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate 2018 Annual Report to Congress 228-239 (Most Serious Problem: *Economic Hardship: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*); National Taxpayer Advocate 2019 Purple Book 50-51 (*Direct the IRS to Study the Feasibility of Using an Automated Formula to Identify Taxpayers at Risk of Economic Hardship*); National Taxpayer Advocate 2016 Annual Report to Congress 192-202 (Most Serious Problem: *Allowable Living Expense (ALE) Standard: The IRS's Development and Use of ALEs Does Not Adequately Ensure Taxpayers Can Maintain a Basic Standard of Living for the Health and Welfare of Their Households While Complying With Their Tax Obligations*); National Taxpayer Advocate 2013 Annual Report to Congress 84-93 (Most Serious Problem: *Hardship Levies: Four Years After the Tax Court's Holding in Vinatieri V. Commissioner, the IRS Continues to Levy on Taxpayers it Acknowledges are in Economic Hardship and then Fails to Release the Levies*).
- 19 See National Taxpayer Advocate 2013 Annual Report to Congress 84-93 (Most Serious Problem: *Hardship Levies: Four Years After the Tax Court's Holding in Vinatieri V. Commissioner, the IRS Continues to Levy on Taxpayers it Acknowledges are in Economic Hardship and then Fails to Release the Levies*). See also National Taxpayer Advocate 2008 Annual Report to Congress vol. 2 46-72 (Research Study: *Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).
- 20 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2 46-72 (Research Study: *Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).
- 21 See National Taxpayer Advocate 2018 Annual Report to Congress 228-239 (Most Serious Problem: *Economic Hardship: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*).
- 22 For a detailed explanation of the TAS algorithm, see National Taxpayer Advocate 2018 Annual Report to Congress vol. 2 39-52 (Research Study: *A Study of the IRS's Use of the Allowable Living Expense Standards*). The IRS has expressed concern regarding the ALE determination methodology and how to address income when no income tax return is found. However, the results of TAS's research highlight the need for the IRS to study the feasibility of using internal data further and in which situations the algorithm could be beneficial. In some instances where no income tax return is found, the IRS should consider other data about taxpayers such as third-party reporting information.

The National Taxpayer Advocate has recommended the IRS utilize the data it already has access to and adopt a formula similar to the TAS algorithm.²³ The IRS has repeatedly declined to adopt our recommendations.²⁴

Most recently, the IRS responded to our recommendations in the National Taxpayer Advocate's 2018 Annual Report to Congress by saying: "The IRS cannot reliably determine economic hardship based solely on information available in IRS and third-party databases, which is often incomplete."²⁵ It is true the IRS cannot conclusively reach a determination about whether a taxpayer faces economic hardship based on its internal data alone. But that is not what we are recommending. Rather, we are recommending that the IRS systemically place a marker on the accounts of all taxpayers whom its filter identifies as having incomes below their ALEs and no detectable assets. The marker would signal that a taxpayer is *at risk* of economic hardship and therefore that additional information should be requested. Specifically, the marker would alert IRS assistors speaking with taxpayers over the phone that they should verify the taxpayer's ability to pay before placing them in streamlined IAs. The IRS could program their systems so that when an assistor keys in the Social Security number of a taxpayer with an economic hardship risk indicator, a screen is generated with the income information, projected family size, and appropriate ALEs. Then the assistor could engage with the taxpayer and request certain high-level information to verify the accuracy of its internal information. Under this approach, the IRS would be using data to proactively protect financially struggling taxpayers from further financial harm. Similarly, the indicator could be used as a warning to taxpayers who are attempting to enter into streamlined IAs online about other collection alternatives if they are able to substantiate financial hardship.

The IRS further states in its response that "[a]ny attempt to proactively identify taxpayers likely to be in economic hardship based on an incomplete set of facts would lead to flawed results."²⁶ We disagree and believe this further misses the point of the recommendation. We believe an indicator would serve as a starting point to engage taxpayers and verify the financial status of taxpayers who may face economic hardship. The indicator would not constitute a final determination of the taxpayers' financial status or ability to pay.

Many anxious or intimidated taxpayers seeking to resolve their liabilities as quickly as possible are unaware the IRS is required to halt collection actions if they are in economic hardship. As a result, they often agree to make tax payments they cannot afford. When a taxpayer calls the IRS stating that he or she cannot pay the tax due, the IRS collection employee generally can verify some or all of the financial information provided by the taxpayer. However, IRS guidance in Internal Revenue Manual (IRM) 5.14.1.2 instructs Collection employees to first seek to obtain full payment and, only if that is not possible, to offer a streamlined IA under IRM 5.14.5.2.²⁷

23 For these specific recommendations, see TAS Recommendations #15-1 to #15-5 in the National Taxpayer Advocate 2018 Annual Report to Congress 228-239 (Most Serious Problem: *The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*).

24 See, e.g., IRS responses to the National Taxpayer Advocate 2018 Annual Report to Congress 228-239 (Most Serious Problem: *Economic Hardship: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*), incorporated in National Taxpayer Advocate Fiscal Year 2020 Objectives Report vol. 2, www.TaxpayerAdvocate.irs.gov/ObjectivesReport2020, available July 2019.

25 *Id.*

26 *Id.*

27 See IRM 5.14.1.2, *Installment Agreements and Taxpayer Rights* (July 16, 2018); see also 5.14.5.2, *Streamlined Installment Agreements* (Dec. 23, 2015).

In a time of limited resources, focusing on more productive cases rather than IAs likely to default or to produce no payment could help the IRS avoid unnecessary rework, including time and resources to obtain an updated financial statement, to reroute the case, or even to make a Notice of Federal Tax Lien determination on additional periods. At a minimum, the IRS should carefully study how the automated use of internal data can better protect financially vulnerable taxpayers from economic harm and improve the efficiency of collection, and it should conduct a pilot to test the use of an algorithm, similar to what TAS has developed.

TAS Will Urge the IRS to Use the Algorithm to Prioritize Cases and Filter Out Taxpayers Facing Economic Harm

As explained above, our recommendation is a two-part recommendation. After adoption of the algorithm identifying taxpayers who may face economic hardship, the second part of the recommendation focuses on potential uses for the algorithm.

With this algorithm, the IRS could take many proactive actions to prioritize cases, including filtering out taxpayers facing economic hardship from automated collection treatments. There are a lot of potential uses for this indicator. For example, the IRS could use this indicator to identify and educate these taxpayers by sending them notices about collection alternatives and creating account markers that telephone assistors could see when responding to taxpayers' calls, and that taxpayers could see when seeking to enter into online IAs to call their attention to the possibility they may qualify for collection alternatives.

Since the IRS generally has internal data about a taxpayer's income and assets from the prior year tax return and receives third-party information, the IRS can plug the data into an algorithm and apply the results to the accounts of all taxpayers who owe back taxes. By doing so, it can flag the accounts of all taxpayers whom the screen identifies as having incomes below their ALEs and no detectable assets. This indicator could be used to notify taxpayers who are attempting to enter into streamlined IAs online that they may qualify for alternative collection options like currently not collectible-hardship status or an offer in compromise (OIC).

The IRS could use the algorithm to apply a marker during case scoring and route the case to the appropriate group that would properly assist and engage those taxpayers who are at risk of economic hardship. For example, flagging potential economic hardship cases during IDS scoring and before routing the cases to be worked would allow the IRS to better use resources in later stages of the collection process and prevent economic harm to taxpayers who are at risk of economic hardship. In fact, the IRS could program its systems so that when an assistor keys in the Social Security number of a taxpayer with an economic hardship risk indicator, a screen is generated with the income information, projected family size, and appropriate ALEs. This way, the assistor can simply run through some high-level information to verify its accuracy. This indicator would prompt the IRS employee to ask questions to assess the taxpayer's ability to pay and identify more appropriate collection alternatives.

The use of this algorithm could also assist the IRS in screening out these taxpayers from automated collection treatments such as the Federal Payment Levy Program, referral to PCAs, and passport certification, unless the IRS makes a direct personal contact with the taxpayer and determines the taxpayer does not qualify.²⁸ Finally, the algorithm could be used for the IRS's systemic follow-up review

²⁸ See Taxpayer First Act of 2019, H.R. 3151, 115th Cong. (2019) (enacted). The Taxpayer First Act of 2019 screens out from Private Debt Collection taxpayers whose AGI is 200 percent of the FPL, which is close to our recommendation regarding ALEs and 250 percent of the FPL.

of currently not collectible-hardship cases to determine whether the taxpayer's financial situation has changed or remained the same.²⁹

While we are mindful of the IRS's concern for resources, the IRS has never quantified the amount of employee time expended upon undoing the downstream effects of unnecessary and unwarranted collection actions. We believe there would be significant resource savings for the IRS if the IRS used this indicator to prioritize the cases that were most likely to have collection potential and applied its resources to that population. After creating this indicator, if the IRS wanted to attempt some collection against taxpayers with this indicator, then it should first attempt to engage the taxpayers and verify their financial information. Otherwise, the IRS should not place these taxpayers into the Federal Payment Levy Program, the PDC program, or even impose automated levies, because such actions would repeat the very pattern we have empirically shown over and over to occur, as referenced above, that 40 percent of the taxpayers assigned to the PDC program, who make payments under certain installment agreements have income below their ALEs. Therefore, when the IRS makes attempts to engage these taxpayers via telephone or through tailored mailings to verify their financial information, the IRS will save resources later by not having to undo a lot of IAs due to defaults.

TAS Will Pursue Helping the IRS Create Educational Economic Hardship Notices

The IRS could further use the algorithm to educate taxpayers who are at risk of economic hardship by sending them notices that explain their rights, options, and obligations.³⁰ These notices may also direct affected taxpayers to a dedicated phone line.

TAS Will Continue to Research This Issue

In previous responses to our recommendation that the IRS proactively use data to exclude taxpayers experiencing economic hardship, the IRS has said it is too difficult to create an algorithm because the relevant data is stored in different systems. In order to address the IRS's objections, the TAS Research function analyzed the financial circumstances of taxpayers assigned to ACS over the last five years. TAS Research then applied three multiples of federal poverty levels to that same population base to determine whether a percentage of federal poverty level (computed on adjusted gross income (AGI)) would be a reasonable proxy for ALE.³¹ Approximately ten percent of this population could not be analyzed because taxpayers had not filed recent tax returns and therefore we could not determine their AGI.

29 IRM 5.16.1.6, *Mandatory Follow-Up* (Dec. 8, 2014) (describing the two-year review process for currently not collectible (CNC) cases).

30 TAS's research shows that targeted contact with taxpayers can help them understand their obligations and avoid future mistakes. See National Taxpayer Advocate 2018 Annual Report to Congress vol. 2 193-210 (Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*); see also IRS, *Behavioral Insights Toolkit* 13, 27 (2017).

31 We used adjusted gross income (AGI) to be consistent with the language in the Taxpayer First Act. See Taxpayer First Act of 2019, H.R. 3151, 115th Cong. (2019) (enacted).

FIGURE 4.3.1, Comparison of Ability to Pay by Indicated Percent of Federal Poverty Level (Computed on Adjusted Gross Income) to Ability to Pay as Determined by an Analysis of Total Positive Income to ALE (FYs 2013–2018)³²

100% of Federal Poverty												
	2013		2014		2015		2016		2017		2018	
	Cannot Pay	Can Pay	Cannot Pay	Can Pay	Cannot Pay	Can Pay	Cannot Pay	Can Pay	Cannot Pay	Can Pay	Cannot Pay	Can Pay
ALE Classification, Cannot Pay	30.46%	69.54%	27.46%	72.54%	28.23%	71.77%	28.67%	71.33%	26.35%	73.65%	27.53%	72.47%
ALE Classification, Can Pay	0.06%	99.94%	0.07%	99.93%	0.07%	99.93%	0.07%	99.93%	0.06%	99.94%	0.06%	99.94%

200% of Federal Poverty												
	2013		2014		2015		2016		2017		2018	
	Cannot Pay	Can Pay	Cannot Pay	Can Pay	Cannot Pay	Can Pay	Cannot Pay	Can Pay	Cannot Pay	Can Pay	Cannot Pay	Can Pay
ALE Classification, Cannot Pay	72.58%	27.42%	69.18%	30.82%	69.93%	30.07%	71.70%	28.30%	68.09%	31.91%	68.69%	31.31%
ALE Classification, Can Pay	2.21%	97.79%	95.04%	4.96%	1.92%	98.08%	1.75%	98.24%	0.16%	99.84%	1.31%	98.69%

250% of Federal Poverty												
	2013		2014		2015		2016		2017		2018	
	Cannot Pay	Can Pay	Cannot Pay	Can Pay	Cannot Pay	Can Pay	Cannot Pay	Can Pay	Cannot Pay	Can Pay	Cannot Pay	Can Pay
ALE Classification, Cannot Pay	86.26%	13.74%	84.19%	15.81%	85.25%	14.75%	87.20%	12.80%	84.83%	15.17%	85.02%	14.98%
ALE Classification, Can Pay	4.92%	95.08%	4.70%	95.30%	5.14%	94.86%	3.91%	96.09%	3.47%	96.53%	3.06%	96.94%

³² Figure 4.3.1 is sourced from the Individual Accounts Receivable Dollar Inventory, the Individual Returns Transaction File and the IMF as of Cycle 13, 2019. The data was extracted in May 2019. Single = 1 vehicle allowance; married filing jointly = 2 vehicle allowances.

Figure 4.3.1 shows during FY 2018, 85 percent of taxpayers who fell under the 250 percent federal poverty level threshold, which is one indicator used to identify taxpayers who are at risk of economic hardship, and under the ALE classification could not likely pay their tax liability. During FY 2018, 69 percent of taxpayers who fell under the 200 percent federal poverty level threshold and under the ALE classification could not pay their tax liability. During FY 2018, 28 percent of taxpayers who fell under the 100 percent federal poverty level threshold and under the ALE classification could not pay their tax liability. These figures show that many taxpayers likely need other collection alternatives and could benefit from the IRS adoption of an economic hardship filter to proactively flag cases in collection.

Figure 4.3.1 shows that over five years, the 250 percent of the FPL threshold consistently excluded about 85 percent of taxpayers that the ALE analysis predicted could not pay IRS debts without incurring economic hardship. Furthermore, 250 percent FPL had the lowest percentage of taxpayers where ALE analysis said they could not pay but the FPL analysis predicted they could. Not surprisingly, 250 percent FPL also has the highest percentage of taxpayers who the ALE analysis shows could pay but the FPL analysis says could not pay. Because the harm of collecting tax from someone experiencing economic hardship is so great (*i.e.*, the taxpayer cannot pay his or her basic living expenses), we recommend that the IRS err on the side of caution and adopt 250 percent FPL as the proxy for ALEs. For the three percent of taxpayers who are screened out by the 250 percent FPL, where the ALE analysis indicates an ability to pay, the IRS can attempt to engage the taxpayers, verify their financial information, and educate them about payment options.

We believe that ALEs are the best threshold for the IRS to use because they represent what amount of money the IRS determined is necessary for a taxpayer and his or her family to meet all necessary living expenses. Anything above this amount will be considered in calculating the taxpayer's ability to pay the tax liability. ALEs now play a large role in many types of collection cases. However, if the IRS needs to use a proxy for ALEs, 250 percent of the federal poverty level represents an appropriate measure because that is the level Congress chose for access to Low Income Taxpayer Clinics (*i.e.*, clinics that assist vulnerable taxpayers otherwise unable to afford representation to navigate the collection process).³³ Congress has also expressed interest in a 200 percent of the FPL threshold in the context of protecting taxpayers from PCAs.³⁴

CONCLUSION

The IRS's unwillingness to try to identify taxpayers with incomes below the ALEs not only burdens financially struggling taxpayers but wastes IRS resources and creates rework for IRS and Taxpayer Advocate Service employees. It is past time for the IRS to become proactive in this area and use its data to protect vulnerable taxpayers, rather than solely to harm them.

The National Taxpayer Advocate will continue to urge the IRS to adopt our two-step approach. First, to use existing data to create an automated algorithm to identify vulnerable taxpayers, and second, to use this algorithm to shield vulnerable taxpayers from potentially harmful collection actions that are taken without financial analysis. Adopting such an approach would allow the IRS to create special markers proactively identifying cases to allow for further engagement with the taxpayers to verify financial

³³ See IRC § 7526(b)(1)(B).

³⁴ See Taxpayer First Act of 2019, H.R. 3151, 115th Cong. (2019) (enacted). See also Bloomberg Law: Daily Tax Report, *Truce on IRS Debt Collection Program Wrapped Into Bipartisan Bill (2)* <https://news.bloombergtax.com/daily-tax-report/truce-on-irs-debt-collection-program-wrapped-into-bipartisan-bill-2> (Mar. 28, 2019).

information. It would also allow the IRS to further engage with and educate those taxpayers who are at risk of economic hardship about available options and collection alternatives.

Because the IRS does not have the resources to speak with all taxpayers, this indicator could help avoid situations where the IRS would just issue a levy and hope the taxpayer would then, after the fact, reach out to the IRS to explain their situation. These proactive steps by the IRS to identify, engage, and educate taxpayers who may potentially face economic hardship would improve tax administration and strengthen public confidence in the fairness of the tax system.

FOCUS FOR FISCAL YEAR 2020

In fiscal year 2020, TAS will:

- Continue advocating for the IRS to develop and utilize an algorithm to proactively identify taxpayers at risk of economic hardship throughout the collection process;
- Offer assistance to the IRS on how to best utilize the algorithm once it is adopted, including the creation of a filter to automatically screen out taxpayers at risk of economic hardship from potentially collectible inventory;
- Provide suggestions to the IRS on how to educate those taxpayers at risk of economic hardship, including the issuance of educational notices, on collection alternatives and additional assistance available;
- Continue to advocate that the IRS create a new phone line dedicated to responding to taxpayers at risk of economic hardship and help these taxpayers determine the most appropriate collection alternative, including OICs, and educate taxpayers on additional assistance available, including TAS and Low Income Taxpayer Clinics; and
- Continue to research this issue to find feasible solutions to improve voluntary compliance and provide more effective tax administration.

Area of Focus #4 TAS Will Continue to Advocate for Counsel to Disclose Emailed Advice

TAXPAYER RIGHTS IMPACTED¹

- *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 Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

DISCUSSION

Disclosure of Counsel's Legal Analysis Helps Taxpayers

The transparency of the IRS Office of Chief Counsel (Counsel) is important to taxpayers. The *right to be informed* is the first right listed in the Taxpayer Bill of Rights for good reason. If taxpayers do not know the rules and why the IRS has adopted them, they cannot determine if they should exercise their other rights (e.g., the *right to challenge the IRS's position and be heard* or the *right to appeal an IRS decision in an independent forum*). Information about how Counsel interprets the law helps taxpayers avoid taking positions that would incur penalties or ensnare them in audits or litigation.²

Transparency was particularly important in 2018 because Congress had just enacted the Tax Cuts and Jobs Act (TCJA) at the end of 2017. The TCJA raised legal questions that Counsel was answering for IRS program managers. The program managers acted on Counsel's advice, sometimes relaying Counsel's conclusions to the public as FAQs, fact sheets, publications, instructions, etc., without the underlying legal analysis.

Counsel Is Required to Disclose Program Manager Technical Advice

Fortunately for taxpayers, the Freedom of Information Act (FOIA) and a settlement with Tax Analysts require the IRS to disclose Counsel advice to IRS program managers (called Program Manager Technical Advice or PMTA) on the basis of standards applied in two cases.³ The cases permit Counsel to withhold deliberative and pre-decisional communications, but not its final legal positions. The U.S. Court of Appeals for the District of Columbia Circuit explained “[i]t is not necessary that the TAS

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 The IRS response to our recommendations in the 2018 Annual Report to Congress says a “[T]axpayers’ right to be informed is satisfied when the IRS provides guidance ... to those who are charged with tax administration.” See National Taxpayer Advocate Fiscal Year 2020 Objectives Report vol. 2, www.TaxpayerAdvocate.irs.gov/ObjectivesReport2020, available July 2019. However, a taxpayer needs to receive information to be informed. When the IRS provides guidance to itself, it is wrong to suggest that it has satisfied the taxpayer’s right to be informed. [Emphasis added.]

3 The IRS settled with Tax Analysts in July 2007, agreeing to disclose Program Manager Technical Advice (PMTA) dated or prepared after 1994 “on the basis of the standards announced by” the U.S. Court of Appeals for the District of Columbia Circuit in its June 14, 2002, opinion in *Tax Analysts v. IRS*, “as applied by the district court” in its February 7, 2007, opinion. *Tax Analysts v. IRS*, Stipulation of Decision, CA No. 1:96-2285-CKK (July 23, 2007) (citing *Tax Analysts v. IRS*, 294 F.3d 71 (D.C. Cir. 2002), remanded, 483 F. Supp. 2d 8 (D.D.C. 2007)).

[advice] reflect the final programmatic decisions of the program officers who request them. It is enough that they represent OCC's [the Office of Chief Counsel's] final legal position...."⁴ Once Counsel sends its legal analysis to a program manager, it is presumably sending its final legal position, which must be disclosed.⁵

TAS assumed the IRS would issue and disclose more PMTAs following the TCJA. That assumption was wrong. Counsel posted fewer PMTAs in 2018 than it did in 2017 before the TCJA was enacted.⁶

Delayed Disclosure Can Lead to Controversy

Although TAS does not know what advice went undisclosed, one example of delayed disclosure involves taxpayers subject to the new transition tax under Internal Revenue Code (IRC) § 965, which could be paid in interest-free installments over eight years.⁷ On March 13, 2018, the IRS posted an FAQ instructing taxpayers to designate a specific payment for this new tax. Some who had fully paid made an extra payment, which they assumed they could recover. On April 13, 2018, the IRS posted an FAQ, which said they could not. Without the underlying legal analysis, practitioners thought the FAQ was wrong or could be changed. They asked TAS for help in recovering the extra payment. Program managers informed TAS they were relying on a Counsel opinion (probably an email) when they posted the FAQ on April 13, but the opinion was not formally issued as a memo and disclosed until August 2, 2018.⁸

Had the PMTA been disclosed before or at the same time as the program manager posted the FAQ, some of the controversy and confusion could have been avoided.⁹ More taxpayers would have been aware of the IRS's legal reasoning before making extra payments and fewer would have assumed the FAQ was an error. Those who still felt it was an error could have addressed the underlying legal reasoning, helping to ensure the IRS's conclusions were correct.

⁴ *Tax Analysts v. IRS*, 294 F.3d at 81.

⁵ The IRS has not taken the position that IRS program managers work with Counsel on legal advice. If the IRS were to take that position, then there would be a risk that unlicensed program managers would be engaged in the unauthorized practice of law. For program managers who were licensed as attorneys, there would be a risk that they were in violation of Treasury Order 107-04 (Jan. 16, 2009) and Treasury General Counsel Directive No. 2 (July 8, 2015). Those authorities generally require attorneys whose duties include providing legal advice to report to the IRS Chief Counsel.

⁶ Counsel issued and posted only 13 PMTAs in 2018, down from 15 in 2017. TAS analysis of PMTAs posted on IRS.gov (May 29, 2019). In contrast, it issued and posted 68 PMTAs following tax legislation enacted in 1998—more than double the 32 it issued and posted in 1997. *Id.*

⁷ For a more detailed discussion of this issue, see Nina E. Olson, NTA BLOG, *IRS Administration of the Section 965 Transition Tax Contravenes Congressional Intent and Imposes Unintended Burden on Taxpayers* (Aug. 16, 2018), <https://taxpayeradvocate.irs.gov/news/nta-blog-irs-administration-of-the-section-965-transition-tax-contravenes-congressional-intent-and-imposes-unintended-burden-on-taxpayers?category=TaxNews>.

⁸ PMTA 2018-16 (Aug. 2, 2018), https://www.irs.gov/pub/lanoa/pmta_2018_16.pdf. In its response to our 2018 Annual Report recommendations, the IRS asserts that “a final decision about how to address the issue was made in conjunction with the decision to issue ...[the PMTA.]. After that decision was made, the PMTA was issued and immediately released.” See National Taxpayer Advocate Fiscal Year 2020 Objectives Report vol. 2, www.TaxpayerAdvocate.irs.gov/ObjectivesReport2020, available July 2019. However, Counsel's advice must have been issued before the program manager relied on it to issue the FAQ on April 13, 2018. Once a client receives advice and acts on it, it is final. The advice is not retroactively converted into deliberative material that can be withheld simply because it is later reconsidered.

⁹ Moreover, neither this memo nor any other legal analysis posted by the IRS addressed whether the IRS could grant applications on Form 4466, *Corporation Application for Quick Refund of Overpayment of Estimated Tax*, for refunds of excess estimated tax payments pursuant to IRC § 6425, before any tax had been assessed for 2017. That issue was not addressed by PMTA 2018-16. Therefore, taxpayers asked TAS for assistance in obtaining such “quickie” refunds. The IRS does not believe it can pay such refunds. Although it received advice from Counsel, it has not released a PMTA addressing the issue.

A lack of timely guidance led 115 taxpayers to make \$2.8 billion in payments on their transition tax liability that they did not intend to make and that they could not recover from the IRS.¹⁰ Some suffered severe cash flow problems. The IRS could minimize such problems by disclosing PMTA more quickly after they are provided to program managers.

Disclosure Helps IRS Employees Do Their Jobs

Without prompt and complete direct access to Counsel's advice to program managers, other IRS employees, including the National Taxpayer Advocate, the Chief Counsel, the IRS Commissioner, and other attorneys in Counsel might not know that it exists or that they could request a copy. IRS attorneys generally check publicly available sources—including PMTAs that have been released—when analyzing a legal issue. If they cannot find PMTAs that they or their colleagues have issued (*e.g.*, when they work in different areas, memories fail, or attorneys retire or change jobs), they are more likely to provide inconsistent or incorrect legal advice when faced with similar issues in the future.

The IRS Commissioner and the Chief Counsel may also need direct access to the advice so that they can supervise their employees. Similarly, the National Taxpayer Advocate, who is required by IRC § 7803(c)(2) to assist taxpayers and to address systemic problems, needs to know the basis for IRS decisions that require her attention. A program manager or Operating Division Commissioner can revisit a policy decision, whereas only Counsel, the IRS Commissioner, the Treasury Secretary, or Congress can revisit a legal decision. When the IRS does not know the basis for its decisions, the National Taxpayer Advocate sometimes encounters finger pointing, with Counsel saying it is a policy decision and a program manager saying it is a legal decision. Indeed, program managers told TAS the IRC § 965 issue (discussed above) was a legal decision, but Counsel waited until August 2, 2018, to provide TAS with the legal analysis underlying the FAQ that was published on April 13. Thus, the National Taxpayer Advocate needs prompt and complete direct access to Counsel advice so that she can timely fulfill her statutory mandate to assist taxpayers.

The IRS Will Address Some But Not All of the Disclosure Problems

As described in the National Taxpayer Advocate 2018 Annual Report to Congress, Counsel had no written guidance about what it would disclose as PMTA, no firm targets for when it would disclose PMTA, and was telling (but not encouraging) its attorneys they could withhold advice that would otherwise have to be disclosed if they issued it as an email, rather than as a memo.¹¹ Most attorneys would probably prefer to avoid disclosing their advice to the public because doing so can reveal errors or disagreements. Yet, the IRS's response says, "Counsel attorneys do not provide formal advice to program managers by email to avoid the release of legal advice to the public."¹² This is impossible to verify. It seems more likely that attorneys do issue advice by email to avoid disclosure. For this very reason, Counsel attorneys probably issue memos (rather than emails) only upon request. When the National Taxpayer Advocate asks Counsel for legal advice she receives an email unless she specifically asks for a

10 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2019-34-033, *Implementation of the Tax Cuts and Jobs Act Deemed Repatriation Tax Presented Significant Challenges* 12 (May 22, 2019).

11 National Taxpayer Advocate 2018 Annual Report to Congress 34-51 (Most Serious Problem: *Transparency of the Office of Chief Counsel: Counsel Is Keeping More of Its Analysis Secret, Just When Taxpayers Need Guidance More than Ever*). See also Nina E. Olson, NTA Blog, *The IRS Office of Chief Counsel Is Using Email to Avoid Disclosure of Program Manager Technical Advice* (Mar. 6, 2019), https://taxpayeradvocate.irs.gov/IRS_Office_of_Chief_Counsel_Transparency; *The National Taxpayer Advocate on the IRS Filing Season: Hearing Before the H. Subcomm. on Oversight of the H. Comm. on Ways and Means*, 116th Cong. (2019) (statement of Nina E. Olson, National Taxpayer Advocate).

12 See National Taxpayer Advocate Fiscal Year 2020 Objectives Report vol. 2, www.TaxpayerAdvocate.irs.gov/ObjectivesReport2020, available July 2019.

memo. Thus, the National Taxpayer Advocate's report said that Counsel's focus on form over substance was making a mockery of the FOIA and the settlement with Tax Analysts.

The IRS has agreed to update the Chief Counsel Directives Manual (CCDM) to more clearly explain what must be disclosed as PMTA and to post PMTAs more quickly after they are issued. However, it has not agreed to systemically identify PMTAs (*e.g.*, by expanding the email system that it currently uses to identify Chief Counsel Advice). It has not agreed to treat PMTAs as issued when first transmitted to or acted on by a program manager. Nor has it agreed to require disclosure of any advice that is, in substance, PMTA, even if it is issued by email.

The IRS Has Not Explained Why It Does Not Disclose Emailed Advice as Program Manager Technical Advice

The form of Counsel's advice as an email or a memo has no bearing on how much thought went into the analysis, whether it is Counsel's final position, or how it will be used. The cases that the IRS agreed to follow make no distinction based on the form of the advice. Any such distinction would be wrong. *It would be like concluding that memos written in blue ink must be disclosed, but those written in black ink do not.* Moreover, the IRS apparently did not believe the distinction made sense in 2007 when it posted at least three PMTA that were issued as emails.¹³ Indeed, the distinction between emails and memos makes even less sense than the IRS's former two-hour rule—the rule that the IRS would withhold Counsel advice prepared in less than two hours—which the U.S. Court of Appeals for the D.C. Circuit found lacked any legal basis.¹⁴

CONCLUSION

Within a specific period after an IRS program manager receives a PMTA or relies on the advice to make a decision (*e.g.*, drafting an FAQ, fact sheet, instruction, publication, news release, IRM, etc.), the PMTA should be disclosed regardless of its form.

FOCUS FOR FISCAL YEAR 2020

In fiscal year 2020, TAS will:

- Continue to advocate for the IRS to require disclosure of any advice that is, in substance, PMTA, even if it is transmitted by email;
- Continue to advocate for the IRS to disclose a PMTA within a specific period after it is transmitted to a program manager or a program manager relies on it to make a decision;
- Continue to advocate for the IRS to establish a systemic process to ensure PMTA are being identified. For example, it could require attorneys to copy a disclosure mailbox or expand the automated email system that Counsel currently uses to identify Chief Counsel Advice to field employees that must be disclosed; and
- Work with Counsel on CCDM revisions that will clarify how attorneys should identify PMTA and reduce delays between the issuance and disclosure of PMTA.

¹³ See, *e.g.*, PMTA 2008-01567 (Sept. 28, 2007); PMTA 2007-01190 (Aug. 14, 2007); PMTA 2007-01186 (June 11, 2007).

¹⁴ See *Tax Analysts v. IRS*, 495 F.3d 676, 681 (D.C. Cir. 2007) ([the IRC § 6110 disclosure provision] “requires no particular form or formality. Nor does it distinguish between advice a lawyer renders in less than two hours and advice that takes longer than two hours to prepare. Thus, given the broad definition of “Chief Counsel advice” in section 6110(i)(1)(A), we believe that the temporal distinction the IRS draws in its two-hour disclosure rule is contrary to the unequivocal statutory directive...”).

Area of Focus #5 **TAS Will Continue to Advocate for Vulnerable Taxpayers Whose Cases Are Assigned to Private Debt Collection Agencies (PCAs) and for a Reduction of Inactive PCA Inventory**

TAXPAYER RIGHTS IMPACTED¹

- *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 Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to Confidentiality*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

DISCUSSION

The National Taxpayer Advocate in past reports has raised several concerns about how the IRS is administering the current Private Debt Collection (PDC) program.² These include:

- The impact on taxpayers who are likely experiencing economic hardship; and
- The growth in inactive inventory in the hands of private collection agencies (PCAs), with the risk of PCA inventory becoming a mere substitute for the IRS collection queue.³

The IRS can identify taxpayers who are likely experiencing economic hardship by comparing their incomes to other amounts, such as the federal poverty level or IRS allowable living expense (ALE)

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 See, e.g., National Taxpayer Advocate 2018 Annual Report to Congress 286 (Most Serious Problem: *Private Debt Collection: The IRS's Expanding Private Debt Collection Program Continues to Burden Taxpayers Who Are Likely Experiencing Economic Hardship While Inactive Private Collection Agency Inventory Accumulates*); National Taxpayer Advocate 2017 Annual Report to Congress 277 (Most Serious Problem: *Private Debt Collection: The IRS's Private Debt Collection Program Is Not Generating Net Revenues, Appears to Have Been Implemented Inconsistently with the Law, and Burdens Taxpayers Experiencing Economic Hardship*); National Taxpayer Advocate 2016 Annual Report to Congress 172 (Most Serious Problem: *Private Debt Collection (PDC): The IRS Is Implementing a PDC Program in a Manner That Is Arguably Inconsistent With the Law and That Unnecessarily Burdens Taxpayers, Especially Those Experiencing Economic Hardship*).

3 The IRS collection queue is a holding area where unresolved cases go prior to being assigned to a revenue officer for in-person collection when resources become available. Internal Revenue Manual (IRM) 1.4.50.8.3, *Queue* (Sept. 12, 2014). Because revenue officer resources are limited, cases may sit in the collection queue for an extended period of time before assignment to a revenue officer.

standards.⁴ Several different measures all lead to the same conclusion: more than half of taxpayers whose debts are assigned to PCAs are likely experiencing economic hardship:

- 62 percent have gross incomes at or below 250 percent of the federal poverty level;⁵
- 55 percent have adjusted gross incomes at or below 200 percent of the federal poverty level;⁶ and
- 60 percent have gross incomes at or below their ALEs.⁷

Moreover, as the pace of IRS assignments of *new* inventory to PCAs has grown, the volume of *inactive* PCA inventory has increased even more rapidly:

- At the end of fiscal year (FY) 2018, the IRS had assigned 778,859 cases to PCAs. As of March 28, 2019, the IRS had assigned 1,620,771 cases, an increase of 108 percent;⁸ and
- At the end of FY 2018, there were 405,609 unresolved or unproductive cases in PCA inventory.⁹ As of March 28, 2019, there were 973,598 such cases in PCA inventory, an increase of 140 percent.¹⁰

Thus, unresolved case inventory has increased from 52 percent at the end of FY 2018 to 60 percent as of March 28, 2019, and PCAs are quickly becoming the equivalent of the IRS collection queue rather than a means of resolving the queue, which defeats the purpose of the PDC initiative. Unproductive and unresolved cases are moved from one holding area to another, except that the IRS will pay commissions to PCAs on payments taxpayers happen to make while the debt remains in PCA inventory.

The National Taxpayer Advocate is also concerned that:

- The IRS unnecessarily discloses to PCAs that, according to its records, a taxpayer did not file a required return;
- PCAs solicit unfiled returns from taxpayers without the statutory authority to do so; and
- The IRS plans to assign the debts of business taxpayers to PCAs, including payroll tax liabilities. These liabilities, when left uncollected, quickly escalate due to the accrual of penalties and interest.

4 The allowable living expense (ALE) standards determine how much money taxpayers need for basic living expenses such as housing and utilities, food, transportation, and health care, based on family size and where they live. If the ALE standards exceed the taxpayer's gross income, the taxpayer is unable to pay his or her necessary living expenses. See IRS, *Collection Financial Standards*, <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>. See also IRM 5.14.1.4, *Installment Agreement Acceptance and Rejection Determinations* (Sept. 19, 2014).

5 Accounts Receivable Dollar Inventory (ARDI), Individual Returns Transaction File (IRTF), Information Returns Master File (IRMF), Compliance Data Warehouse (CDW) (Mar. 28, 2019). Examples of how this measure is used in tax administration include IRC § 7526(b)(1)(B)(i) (relating to eligibility for assistance from Low Income Taxpayer Clinics) and IRM 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (Oct. 20, 2016) (the IRS's "low income filter" for excluding taxpayers from the automated federal payment levy program).

6 ARDI, IRTF, IRMF, CDW (Mar. 28, 2019). The Taxpayer First Act of 2019, H.R. 1957, 116th Cong. § 1205 (2019), discussed below, uses this measure to identify taxpayers whose debts should be excluded from assignment to private collection agencies (PCAs).

7 ARDI, IRTF, IRMF, CDW (Mar. 28, 2019).

8 *Id.*

9 *Id.* As discussed below, we term as inactive, unproductive, or unresolved those cases in which: the taxpayer entered into an installment agreement (IA) but made no payment for more than 120 days thereafter; and cases in which the taxpayer has neither entered into an IA nor made any payment, and more than three months have elapsed since the case was assigned.

10 *Id.*

The IRS Assigns the Debts of Vulnerable Taxpayers to Private Collection Agencies

As the IRS prepared to launch the current PDC initiative, the National Taxpayer Advocate voiced her concern that the program as implemented would create or exacerbate taxpayers' economic hardship.¹¹ As a proxy for economic hardship, the IRS sometimes uses the measure of gross income that is up to 250 percent of the federal poverty level.¹² When the IRS evaluates proposed installment agreements (IAs), it compares taxpayers' gross income with their ALEs. The National Taxpayer Advocate has recommended excluding taxpayers from the PDC program when their gross incomes are less than 250 percent of the federal poverty level *or* less than their ALEs.¹³ As Figure 4.5.1 demonstrates, both measures reveal that the PDC program burdens a significant portion of taxpayers who are likely in economic hardship.¹⁴

FIGURE 4.5.1, Relationship of Gross Income to the Federal Poverty Level and to Allowable Living Expenses of 1,620,771 Taxpayers Whose Debts Were Assigned to Private Collection Agencies

Gross Income Compared to Poverty Level	Number of Taxpayers	Percent of Taxpayers	Number of Taxpayers with Gross Income At or Below ALE	Percent of Taxpayers with Gross Income At or Below ALE
Gross Income At or Below Federal Poverty Level	605,451	37 percent	605,451	100 percent
Gross Income Above Federal Poverty Level up to 250 Percent of Federal Poverty Level	401,340	25 percent	336,181	84 percent
Subtotal	1,006,791	62 percent	941,632	94 percent
Gross Income Above 250 Percent of Federal Poverty Level	613,980	38 percent	35,958	6 percent
Total	1,620,771	100 percent	977,590	60 percent

Moreover, the measures produce similar results:

- 62 percent of taxpayers would be excluded from the program, measured by gross income up to 250 percent of the federal poverty level; and
- 60 percent would be excluded, measured by gross income at or below ALEs.

On April 9, 2019, the U.S. House of Representatives passed the Taxpayer First Act of 2019, which excludes from assignment to PCAs the debts of taxpayers with adjusted gross incomes (rather than gross income) of up to 200 percent of the federal poverty level (rather than 250 percent of the federal poverty

11 See National Taxpayer Advocate 2016 Annual Report to Congress 172 (Most Serious Problem: *Private Debt Collection (PDC): The IRS Is Implementing a PDC Program in a Manner That Is Arguably Inconsistent With the Law and That Unnecessarily Burdens Taxpayers, Especially Those Experiencing Economic Hardship*).

12 See IRC § 7526 (to identify taxpayers who qualify for assistance from low income taxpayer clinics); IRM 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (Oct. 20, 2016) (to identify certain retirement income recipients who are likely to be in economic hardship in order to exclude them from the IRS's automatic levy program, the Federal Payment Levy Program).

13 See, e.g., National Taxpayer Advocate 2019 Purple Book (Legislative Recommendation: *Amend IRC § 6306(d) To Exclude the Debts of Taxpayers Whose Incomes Are Less Than Their Allowable Living Expenses from Assignment to Private Collection Agencies or, If That is Not Feasible, Exclude the Debts of Taxpayers Whose Incomes Are Less than 250 Percent of the Federal Poverty Level*) (Dec. 31, 2018).

14 All income amounts shown in figures are based on the most recently filed tax return from 2017 or later. For cases with no recently filed tax return, the income was based on third party reports of income.

level).¹⁵ As Figure 4.5.2 demonstrates, this measure would exclude 55 percent of taxpayers from the PDC program (*i.e.*, seven percent fewer taxpayers than if the measure used to exclude taxpayers were gross income compared to 250 percent of the federal poverty level).¹⁶

FIGURE 4.5.2, Relationship of Adjusted Gross Income to the Federal Poverty Level and Relationship of Gross Income to Allowable Living Expenses of 1,620,771 Taxpayers Whose Debts Were Assigned to Private Collection Agencies

Income Compared to Poverty Level	Number of Taxpayers	Percent of Taxpayers	Number of Taxpayers With Gross Income At or Below ALE	Percent of Taxpayers With Gross Income At or Below ALE
Adjusted Gross Income At or Below Federal Poverty Level	614,821	38 percent	612,927	100 percent
Adjusted Gross Income Above Federal Poverty Level Up To 200 Percent of Federal Poverty Level	278,548	17 percent	275,789	99 percent
Adjusted Gross Income Above 200 Percent of Federal Poverty Level	727,402	45 percent	88,874	13 percent
Total	1,620,771	100 percent	977,590	60 percent

The Taxpayer First Act of 2019 also excludes from assignment to PCAs the debts of taxpayers “substantially all of whose income consists of disability insurance benefits” (SSDI).¹⁷ There were 91,034 SSDI recipients whose debts were assigned to PCAs. For 65,056 taxpayers, SSDI payments comprise more than 90 percent of their incomes.¹⁸

Some taxpayers entered into IAs while their debts were assigned to PCAs. Figure 4.5.3 shows these taxpayers’ ability to pay depending on whether the measure is:

- Adjusted gross income as a multiple of the federal poverty level; or
- Gross income in relation to ALEs.

15 Taxpayer First Act of 2019, H.R. 1957, 116th Cong. § 1205 (2019). According to the H. Comm. on Ways and Means, “an exception from the private debt collection program is needed for certain low-income individual taxpayers to protect such taxpayers from entering into payment plans they cannot afford, which ultimately does not result in an increase in actual payments recovered.” H.R. REP. NO. 116-39, at 43 (2019).

16 As Figure 4.5.2 also shows, if the relationship of adjusted gross income to ALEs is the measure used to exclude taxpayers from the PDC program, the same proportion of taxpayers would be excluded from the program as if the relationship of gross income to ALEs were used (60 percent).

17 See Taxpayer First Act of 2019, H.R. 1957, 116th Cong. § 1205 (2019), excluding from assignment to PCAs the debts of taxpayers “substantially all of whose income consists of disability insurance benefits under section 223 of the Social Security Act or supplemental security income benefits under title XVI of the Social Security Act (including supplemental security income benefits of the type described in section 1616 of such Act or section 212 of Public Law 93–66).” The National Taxpayer Advocate has also recommended excluding these taxpayers’ debts from assignment to PCAs. See National Taxpayer Advocate 2018 Annual Report to Congress 286 (Most Serious Problem: *Private Debt Collection: The IRS’s Expanding Private Debt Collection Program Continues to Burden Taxpayers Who Are Likely Experiencing Economic Hardship While Inactive Private Collection Agency Inventory Accumulates*).

18 ARDI, IRTF, IRMF, CDW (Mar. 28, 2019).

FIGURE 4.5.3, Comparison of Ability to Pay As Measured By the Relationship Between Adjusted Gross Income (AGI) and the Federal Poverty Level With Ability to Pay As Measured by the Relationship Between Gross Income and ALEs for 70,348 Taxpayers Who Entered Into Installment Agreements While Their Debts Were Assigned to PCAs

	AGI Up To 100 Percent Federal Poverty Level		AGI Up To 200 Percent Federal Poverty Level		AGI Up To 250 Percent Federal Poverty Level	
	Cannot Pay	Can Pay	Cannot Pay	Can Pay	Cannot Pay	Can Pay
ALE Classification, Cannot Pay	51.6%	48.4%	89.4%	10.6%	97.6%	2.4%
ALE Classification, Can Pay	0.4%	99.6%	1.5%	98.5%	10.4%	89.6%

As Figure 4.5.3 shows, 98 percent of taxpayers whose adjusted gross incomes were at or below 250 percent of the federal poverty level *also* had ALEs in excess of their incomes. Thus, excluding from the PDC program taxpayers whose adjusted gross incomes are at or below 250 percent of the federal poverty level would almost always achieve the same result as excluding taxpayers whose ALEs exceed their gross incomes.¹⁹

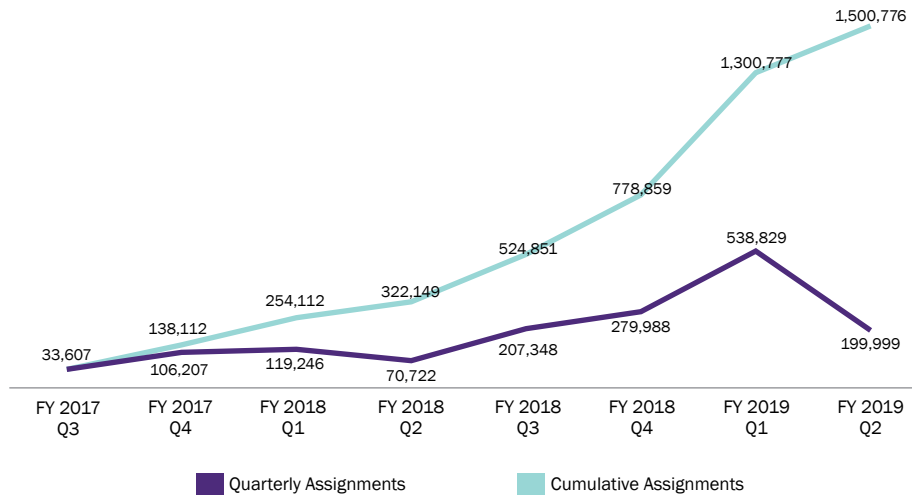
The Pace of Assignments to PCAs is Increasing

As Figure 4.5.4 demonstrates, the number of cases the IRS assigned to PCAs increased in six out of the eight full quarters the program has been operating.

¹⁹ For taxpayers whose debts were not assigned to PCAs, but to the IRS's Automated Collection System, the results are similar: over a six-year period (2013-2018), about 85 percent of taxpayers whose adjusted gross incomes were at or below 250 percent of the federal poverty level also had ALEs in excess of their incomes. See Nina E. Olson, NTA BLOG, *The IRS Is Not Doing Enough to Protect Taxpayers Facing Economic Hardship* (May 24, 2019), [https://taxpayeradvocate.irs.gov/news/nta-blog-the-irs-is-not-doing-enough-to-protect-taxpayers-facing-economic-hardship?category=Tax News](https://taxpayeradvocate.irs.gov/news/nta-blog-the-irs-is-not-doing-enough-to-protect-taxpayers-facing-economic-hardship?category=Tax%20News).

FIGURE 4.5.4²⁰

Cases Assigned to Private Collection Agencies



Assignments for the second quarter of FY 2019 were lower than the previous quarter due to the 35-day lapse in IRS appropriations that began on December 22, 2018.²¹

Due to the rapid increase in the rate at which the IRS assigns inventory to PCAs, the number of assigned cases at the end of FY 2018 (778,859) jumped to 1,620,771 cases by the end of the second quarter of FY 2019, an increase of 108 percent.²²

Inactive PCA Inventory Continues to Grow

In her 2018 Annual Report to Congress, the National Taxpayer Advocate raised concern about the length of time cases had remained in PCA inventory as of September 20, 2018 without being resolved.²³ Categories of inactive or unproductive PCA inventory include:

- Cases in which the taxpayer entered into an IA, but for 120 days thereafter did not make a payment; and
- Cases in which the taxpayer neither entered into an IA nor made payments within 90 days after the case was assigned to the PCA.

20 ARDI, IRTF, IRMF, CDW, reflecting activity on tax modules with an unreversed Transaction Code 971 with an Action Code 054 (Mar. 28, 2019). In addition to the data shown in Figure 4.5.4, we identified 119,995 cases that were selected for assignment in March for delivery to PCAs in the third quarter of FY 2019.

21 Some pre-programmed inventory was delivered to PCAs on Dec. 31, 2018, but the IRS did not assign any other inventory during the lapse in appropriations and PCAs did not engage in collection activity during that time. Email from PDC Program Manager (Jan. 30, 2019), on file with TAS.

22 There were 1,500,776 cases assigned by the end of the second quarter of FY 2019, as shown in Figure 4.5.4 and an additional 119,995 cases that were selected for assignment in March for delivery to PCAs in the third quarter of FY 2019. ARDI, IRTF, IRMF, CDW (Mar. 28, 2019).

23 National Taxpayer Advocate 2018 Annual Report to Congress 286 (Most Serious Problem: *Private Debt Collection: The IRS's Expanding Private Debt Collection Program Continues to Burden Taxpayers Who Are Likely Experiencing Economic Hardship While Inactive Private Collection Agency Inventory Accumulates*).

None of these cases are being resolved, thus defeating the purpose of outsourcing tax collection. Moreover, as discussed below, PCAs may receive commissions on amounts taxpayers do pay, independently of whether the payment was the result of recent PCA activity, as long as the case remains in PCA inventory.

Figure 4.5.5 shows the number of taxpayers whose unresolved debts remained in PCA inventory as of March 28, 2019, compared to the data at the end of FY 2018.²⁴

FIGURE 4.5.5, Number of Taxpayers Whose Debts Are In PCA Inventory and Are Not Being Resolved as of March 28, 2019, Compared to September 30, 2018

	Number of Taxpayers	Average Number of Days Elapsed After Assignment	Median Number of Days Elapsed After Assignment
IA and No Payment For More Than 120 Days (Excluding Defaults, Recalled Cases, and Returned Cases)			
As of Mar. 28, 2019	4,094	256	199
As of Sept. 30, 2018	3,222	272	279
Increase (Decrease)	872	(16)	(80)
No IA or Payment For More Than Three Months After Assignment (Excluding Recalled Cases and Returned Cases)			
As of Mar. 28, 2019	969,504	258	213
As of Sept. 30, 2018	402,387	244	195
Increase	567,117	14	18
Overall			
As of Mar. 28, 2019	973,598	258	213
As of Sept. 30, 2018	405,609	244	195
Increase	567,989	18	18
Percent Increase	140 percent	7 percent	9 percent

As noted in Figure 4.5.5, from October 1, 2018 to March 28, 2019, the number of cases assigned to PCAs increased by 108 percent (from 778,859 cases to 1,620,771 cases). In the same period, as Figure 4.5.5 demonstrates, the number of cases in inactive or unproductive PCA inventory increased 140 percent. Thus, as the IRS assigns new inventory to PCAs, inactive PCA inventory also increases—at a faster rate. Moreover, the percent of assigned cases that were in inactive inventory increased during that same period, from 52 percent (405,609 out of 778,859 cases) to 60 percent (973,598 out of 1,620,771 cases).

When taxpayers make payments while their debts are assigned to PCAs, the IRS retains up to 25 percent of the payment, as authorized by Internal Revenue Code (IRC) § 6306(e)(1), to pay for the costs of services performed by PCAs, including commissions. The IRS retains an additional amount of up to 25 percent of those payments for itself, as authorized by IRC § 6306(e)(2), to pay for additional IRS compliance personnel. Thus, when taxpayers make payments while their debts are in PCA inventory, up

²⁴ ARDI, IRTF, IRMF, CDW (Mar. 28, 2019). Because a taxpayer may have had more than one module assigned, the average and median number of days are computed based on the oldest (highest age or earliest assigned) module in open inventory.

to 50 percent of payments they make are diverted from the public fisc, whether or not the payment was preceded by any recent collection activity by the PCA.

In contrast, when taxpayers whose debts are not assigned to PCAs make payments, the public fisc—U.S. taxpayers—receive the full benefit of those payments. Moreover, research studies show that the IRS could elicit payments from taxpayers whose accounts are in the IRS’s collection queue by simply sending them monthly collection letters.²⁵

The IRS May Unnecessarily Disclose That Taxpayers Have Unfiled Returns

In FY 2018, the IRS began assigning to PCAs cases in which the taxpayer did not file a return which, according to IRS records, was required to be filed (referred to as a delinquent return).²⁶ The electronic records the IRS uses to assign inventory to the PCAs indicate when there appears to be a delinquent return.²⁷

IRC § 6103(n) and the regulations thereunder authorize the IRS to disclose return information to persons “to the extent necessary” in connection with “the providing of other services, for purposes of tax administration.”²⁸ Taxpayers are required to file delinquent returns as a condition to entering into an IA, but not, for example, as a condition to fully paying their account.²⁹ Thus, it is not clear that disclosing delinquent return information to PCAs—before it has been determined that the taxpayer intends to enter into an IA—is necessary for purposes of tax administration within the meaning of IRC § 6103(n). Likewise, the PCA may establish that the taxpayer does *not* intend to enter into an IA (for example, because he or she cannot afford to make payments), which would appear to make the prior disclosure of delinquent return information unnecessary.

Moreover, even if there are circumstances in which IRC § 6103 permits the IRS to disclose delinquent return information to PCAs, it is not clear that PCAs have the authority, under IRC § 6306, to solicit unfiled returns from taxpayers.³⁰

25 National Taxpayer Advocate 2018 Annual Report to Congress vol. 2 159 (Research Study: *Further Analyses of “Federal Tax Liens and Letters: Effectiveness of the Notice of Federal Tax Liens and Alternative IRS Letters on Individual Tax Debt Resolution”*).

26 As the National Taxpayer Advocate has noted, IRS records indicating a return was required are not always accurate. See National Taxpayer Advocate 2014 Annual Report to Congress 197, 202 (Most Serious Problem: *Federal Payment Levy Program: Despite Some Planned Improvements, Taxpayers Experiencing Economic Hardship Continue to Be Harmed by the Federal Payment Levy Program*), reporting that 21 percent of the accounts the IRS identified as delinquent were not actually those of nonfilers (*i.e.*, a return had actually been filed) or there was little or no tax due.

27 Section 4.3.2, *Weekly Files*, PCA Policy and Procedures Guide (PPG) (Feb. 2019), noting “[t]he weekly files will be available every Monday and must be reviewed prior to making any contact with the taxpayer. For example, while monitoring a payment arrangement, the PCA can identify payment transactions and delinquent returns in the weekly files.”

28 IRC § 6103(n); Treas. Reg. § 301.6103-1(b)(1), providing that “[d]isclosure of returns or return information in connection with a written contract or agreement for the acquisition of property or services described in paragraph (a) of this section will be treated as necessary only if the performance of the contract or agreement cannot otherwise be reasonably, properly, or economically carried out without the disclosure.”

29 See, e.g., IRM 5.14.1.4.2 *Compliance and Installment Agreements* (July 16, 2018).

30 Under IRC § 6306(b)(1)(B), PCAs may request the taxpayer to fully pay the liability within 120 days, or, alternatively, may propose an IA. The only other PCA activities authorized by IRC § 6306(b)(1) are to locate and contact the taxpayer (IRC § 6306(b)(1)(A)), and “to obtain financial information specified by the Secretary with respect to such taxpayer” (IRC § 6306(b)(1)(C)).

The IRS Will Assign Business Taxpayers' Debts to Private Collection Agencies in 2019

Because the IRS is more likely to assign larger business tax liabilities to a revenue officer for personal contact and immediate collection, the business debts available for assignment to PCAs are likely to have lower balances.³¹ However, even low balances can quickly escalate, especially if the liability consists of payroll taxes, due to the accrual of interest and the imposition of penalties.³² As discussed above, inactive PCA inventory (which currently consists only of individual taxpayers' liabilities) is increasing and remains unresolved for an average of 258 days. To the extent business tax cases are similarly unproductive or inactive, the purpose of the PDC program is defeated.³³

CONCLUSION

As the pace of assignments to PCAs continues to increase, more vulnerable taxpayers are at risk of having their debts assigned to PCAs. As more cases are assigned, inactive PCA inventory is likely to increase. In the meantime, the IRS will disclose to PCAs information about taxpayers' unfiled returns, and PCAs will solicit unfiled returns from taxpayers, but the legal authority for either of these practices is unclear.

FOCUS FOR FISCAL YEAR 2020

In fiscal year 2020, TAS will:

- Request an opinion from IRS Chief Counsel about whether the IRS's practice of disclosing return information to PCAs, including its records showing the taxpayer has unfiled returns, is permissible, and the circumstances in which PCAs are authorized to solicit unfiled returns from taxpayers;
- Continue to advocate for excluding the debts of taxpayers who are likely in economic hardship from assignment to PCAs; and
- Advocate for recalling inactive individual and business tax liabilities from PCA inventory.

31 National Taxpayer Advocate 2016 Annual Report to Congress vol. 2 81 (Research Study: *Collecting Business Debts: Issues for the IRS and Taxpayers*).

32 Business taxpayers often file quarterly employment tax returns and are therefore more likely to be delinquent on more than one business return. Typically, at least half of the balance due by the third year after the IRS assigns an unresolved business account to Taxpayer Delinquent Account status (which occurs at the conclusion of a four-month notice period) is attributable to penalties and interest. National Taxpayer Advocate 2016 Annual Report to Congress vol. 2 91 (Research Study: *Collecting Business Debts: Issues for the IRS and Taxpayers*).

33 Recalling inactive business accounts from PCAs would be consistent with the National Taxpayer Advocate's recommendations with respect to recalling inactive individual taxpayer accounts in PCA inventory. National Taxpayer Advocate 2018 Annual Report to Congress 286, 294 (Most Serious Problem: *Private Debt Collection: The IRS's Expanding Private Debt Collection Program Continues to Burden Taxpayers Who Are Likely Experiencing Economic Hardship While Inactive Private Collection Agency Inventory Accumulates*).

Area of Focus #6 TAS Plans to Design Sample Notices to Better Protect Taxpayer Rights and Reduce Taxpayer Burden

TAXPAYER RIGHTS IMPACTED¹

- *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 Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to Confidentiality*
- *The Right to a Fair and Just Tax System*

DISCUSSION

In the 2018 Annual Report to Congress, the National Taxpayer Advocate expressed concerns about IRS notices that fail to adequately inform taxpayers about their rights, responsibilities, and procedural requirements. She identified three types of notices as Most Serious Problems: Collection Due Process (CDP) Notices, Math Error Notices, and Statutory Notices of Deficiency (SNODs).² Notices are key to informing taxpayers of important events, such as the IRS's intent to increase the taxpayer's tax liability, the IRS's filing of a Notice of Federal Tax Lien (NFTL) against the taxpayer's property, or of the IRS's intent to levy the taxpayer's wages or bank account. Collection notices also inform taxpayers of the right to a hearing to challenge the IRS's collection actions—the CDP hearing.³ Failure to respond to notices can often lead to the loss of core taxpayer rights, such as the *right to pay no more than the correct amount of tax, to appeal an IRS decision in an independent forum, and to a fair and just tax system.*

Many IRS notices fail to adequately inform taxpayers of their rights and effectively guide taxpayers through what they must do in response to receiving a notice. The IRS designs its notices with collection and compliance at the forefront, while often burying or omitting vital information about taxpayers'

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 See National Taxpayer Advocate 2018 Annual Report to Congress 170-173 (Most Serious Problem: *Introduction to Notices: Notices Are Necessary to Inform Taxpayers of Their Rights and Obligations, Yet Many IRS Notices Fail to Adequately Inform Taxpayers, Leading to the Loss of Taxpayer Rights*); National Taxpayer Advocate 2018 Annual Report to Congress 174-197 (Most Serious Problem: *Math Error Notices: Although the IRS Has Made Some Improvements, Math Error Notices Continue to Be Unclear and Confusing, Thereby Undermining Taxpayer Rights and Increasing Taxpayer Burden*); National Taxpayer Advocate 2018 Annual Report to Congress 198-211 (Most Serious Problem: *Statutory Notices of Deficiency: The IRS Fails to Clearly Convey Critical Information in Statutory Notices of Deficiency, Making it Difficult for Taxpayers to Understand and Exercise Their Rights, Thereby Diminishing Customer Service Quality, Eroding Voluntary Compliance, and Impeding Case Resolution*); National Taxpayer Advocate 2018 Annual Report to Congress 212-222 (Most Serious Problem: *Collection Due Process Notices: Despite Recent Changes to Collection Due Process Notices, Taxpayers Are Still at Risk for Not Understanding Important Procedures and Deadlines, Thereby Missing Their Right to an Independent Hearing and Tax Court Review*); National Taxpayer Advocate 2018 Annual Report to Congress vol. 2 194-210 (Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*).

3 See IRC §§ 6320 & 6330.

rights to challenge an IRS decision or the services available to help them resolve their issues with the IRS. Further, as discussed in a literature review in the 2018 Annual Report to Congress, the IRS does not adequately utilize insights from available psychological, cognitive, and behavioral science research to design its notices.⁴ The language and design of notices can help taxpayers understand what they may owe and how to resolve their tax balance, or it can confuse taxpayers.

In this upcoming fiscal year, TAS plans to develop new sample notices based on the recommendations made in the 2018 Annual Report to Congress. The National Taxpayer Advocate has reviewed many IRS notices and will design sample notices to address both specific and general improvements to three important notice types described below.

Math Error Notices

Math error authority allows the IRS to make summary changes to a taxpayer's return when there are mathematical or clerical errors that are obvious by looking at the face of the return.⁵ However, the range of issues that fall under these definitions has steadily expanded and the IRS is using math error authority to summarily resolve more complex issues.⁶ This has led the IRS to erroneously deny tax benefits to some taxpayers.⁷

Math error notices inform taxpayers of the additional tax the IRS has assessed because of a purported mathematical or clerical error on their return. If the taxpayer disagrees with the assessed tax or believes the IRS made a mistake in its assessment, taxpayers must respond to these notices within 60 days and request abatement. If they do not respond within 60 days, they will lose their right to appeal the IRS's assessment in the Tax Court before paying it. These notices, if not properly drafted and presented, could result in either an inaccurate tax assessment or the taxpayer giving up important procedural rights.

The National Taxpayer Advocate's specific concerns about math error notices are that the deadline to request abatement of the tax and retain the right to petition the Tax Court is not mentioned in some math error notices. This lack of information limits the ability of some taxpayers to know about and exercise that right.⁸ Further, many math error notices lack clarity as to the specific error the taxpayer made and the change the IRS made to their return. They only give taxpayers short, generic explanations of the purported errors, and do not direct taxpayers to the exact issue with their return.⁹ The IRS also does not attempt to correct possible errors by referring to its historical data, which leads the IRS to send many math error notices to taxpayers who are actually entitled to the tax benefits the IRS has summarily denied.

4 National Taxpayer Advocate 2018 Annual Report to Congress vol. 2 194-210 (Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*).

5 IRC §§ 6213(b), (g).

6 Compare the Revenue Act of 1926, Pub. L. 69-20 § 274(f) (1926) with Tax Reform Act of 1976, Pub. L. 94-455 and IRC § 6213(g) (which lists all current definitions of mathematical or clerical errors).

7 See, e.g., National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 114, 120 (Research Study: *Math Errors Committed on Individual Tax Returns: A Review of Math Errors Issued for Claimed Dependents*).

8 See CP11, *Math Error Balance Due of \$5 or More*.

9 See Taxpayer Notice Codes (TPNCs).

To address these concerns, TAS plans to design a sample math error notice that:

- Improves the clarity of the math error explanation by better describing the specific error on the notices, along with including the line on the taxpayer's return where the error was made;
- Includes and emphasizes taxpayers' right to petition the Tax Court if they disagree with the IRS's change to their returns; and
- Includes, on the first page of the notice, the deadline date by which taxpayers must request abatement to retain their right to make a prepayment petition in Tax Court.

Statutory Notices of Deficiency

SNODs notify taxpayers if there is a proposed additional tax due and give taxpayers the right to challenge the proposed deficiency in the Tax Court without prepayment, but only if they petition within 90 days. The SNOD is the "ticket" to Tax Court. If the taxpayer does not petition the Tax Court within 90 days, the IRS will assess the tax, send the taxpayer the tax bill, and start collection. The SNOD is critical to many low income and middle income taxpayers because generally without it they would be required to pay the tax first and go to refund fora, such as federal district courts or the United States Court of Federal Claims, in order to challenge the tax adjustment.¹⁰ TAS found that many taxpayers may not be availing themselves of their rights, in part because of faulty design and poor presentation of information in the notices.¹¹

The National Taxpayer Advocate's specific concerns about SNODs are that they do not effectively communicate the information needed for taxpayers to understand their rights and the consequences of not exercising them, the relevant tax issues, or how to respond.¹² SNODs do not sufficiently apply plain writing principles or incorporate behavioral research insights, as directed by the Plain Writing Act¹³ and Executive Order 13707.¹⁴ Finally, the IRS continues to omit Local Taxpayer Advocate (LTA) information required by law on certain SNODs, thereby violating taxpayer rights.¹⁵

10 Nearly 59 percent of those receiving a non-automated substitute for returns (ASFR) statutory notice of deficiency (SNOD) make less than \$50,000 per year. Yet low income taxpayers, who may be eligible for representation through Low Income Taxpayer Clinics (LITCs), are less likely to petition the Tax Court. In fiscal year (FY) 2018, the median total positive income for individuals who did not petition the Tax Court in response to a SNOD issued after an audit was about \$24,000. See National Taxpayer Advocate 2018 Annual Report to Congress 199 (Most Serious Problem: *Statutory Notices of Deficiency: The IRS Fails to Clearly Convey Critical Information in Statutory Notices of Deficiency, Making it Difficult for Taxpayers to Understand and Exercise Their Rights, Thereby Diminishing Customer Service Quality, Eroding Voluntary Compliance, and Impeding Case Resolution*).

11 See National Taxpayer Advocate 2018 Annual Report to Congress 198-211 (Most Serious Problem: *Statutory Notices of Deficiency: The IRS Fails to Clearly Convey Critical Information in Statutory Notices of Deficiency, Making it Difficult for Taxpayers to Understand and Exercise Their Rights, Thereby Diminishing Customer Service Quality, Eroding Voluntary Compliance, and Impeding Case Resolution*).

12 See, e.g., CP3219A, *Automated Underreporter (AUR) Statutory Notice of Deficiency*. For example, one notice directs taxpayers to an IRS website, which tells taxpayers to submit to the IRS the same form whether they agree or disagree with the tax changes the IRS made. See also IRS website at <https://www.irs.gov/individuals/understanding-your-cp3219a-notice> (last visited Dec. 13, 2018).

13 5 U.S.C. § 301.

14 80 Fed. Reg. 56,365 (Sept. 15, 2015).

15 See National Taxpayer Advocate Proposed Taxpayer Advocate Directive (TAD) 2019-2, *Include Local LTA Addresses on All Notices of Deficiency Sent By the IRS* (Apr. 18, 2019); National Taxpayer Advocate 2014 Annual Report to Congress 237–244 (Most Serious Problem: *Statutory Notices of Deficiency: Statutory Notices of Deficiency Do Not Include Local Taxpayer Advocate Office Contact Information on the Face of the Notice*).

To remedy these flaws, TAS plans to design a sample SNOD that:

- Uses plain language to clearly inform taxpayers of their rights, the results of inaction, and how to respond to the SNOD;
- Clearly conveys taxpayers' proposed tax increase, their right to challenge the IRS's determination before the Tax Court, and their ability to obtain TAS or Low Income Taxpayer Clinic (LITC) assistance; and
- Includes the relevant LTA information as is required by law.

Collection Due Process Notices

CDP rights provide taxpayers with an independent review by the IRS Office of Appeals of the decision to file an NFTL or the IRS's proposal to undertake a levy action,¹⁶ which can be appealed to Tax Court.¹⁷ The IRS communicates these important rights during two critical times. The IRS communicates the right to request a CDP hearing via the intent to levy notice or the NFTL.¹⁸ Following the CDP hearing, the IRS communicates its determination to the taxpayer via a notice of determination.¹⁹ Perhaps because the notices provide confusing instructions regarding the due date to file a response, the response rate for CDP notices ranges from under one percent to around ten percent.²⁰ Moreover, CDP notices emphasize collection actions and under-emphasize the statutory due process protections afforded by the hearings, leading unrepresented taxpayers to forego the exercise of important taxpayer rights.

The National Taxpayer Advocate's specific concerns about CDP notices are that the design and wording in these notices underemphasizes the importance of a taxpayer's CDP rights. The notices do not sufficiently explain what a hearing is or why a taxpayer may want to request one.²¹ Additionally, the notices do not clearly mention important information, such as the deadline to file a hearing request. The notice of determination lacks a specific date by which a taxpayer must file a petition in the Tax Court and does not explain why the notice is salient to taxpayers.

16 IRC § 6330(b).

17 IRC § 6330(d)(1).

18 IRC § 6330(a).

19 See, e.g., IRS Letter L3193, *Notice of Determination: Concerning Collection Action(s) Under Section 6320 and/or 6330 of The Internal Revenue Code* (July 2018).

20 See National Taxpayer Advocate 2018 Annual Report to Congress 212-222 (Most Serious Problem: *Collection Due Process Notices: Despite Recent Changes to Collection Due Process Notices, Taxpayers Are Still at Risk for Not Understanding Important Procedures and Deadlines, Thereby Missing Their Right to an Independent Hearing and Tax Court Review*).

21 For instance, during the collection due process (CDP) hearing, the Appeals Officer (AO) must obtain verification that "requirements of any applicable law or administrative procedure have been met." The AO also must consider "whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary." Taxpayers are given the opportunity to raise a collection alternative, such as an installment agreement or offer in compromise, and in some instances, they can contest the underlying liability. IRC § 6330(c).

To address these shortcomings, TAS plans to design a sample CDP notice that:

- Includes information about why a taxpayer may want to request a CDP hearing and why the notice is relevant to the taxpayer;
- Explains the importance of these CDP hearings in terms relating to taxpayer rights and protections;
- Provides more accurate notification of the due date for CDP hearing requests with respect to NFTL filings;
- Includes the exact date on the notices of determination by which the taxpayer must file a petition in Tax Court;
- Highlights the specific deadline date to file a petition in the Tax Court in bold font; and
- Additionally, test these notices, both as part of a Small Business/Self-Employed Division (SB/SE)-led study²² and a TAS study.²³

General Improvements to Notices

In addition to the more specific concerns discussed above, there are many improvements that can and should be made to all IRS notices. The following are general improvements to notices that TAS will incorporate into its new sample notices:

- Framing notices with a taxpayer rights focus (including and emphasizing taxpayer rights and the necessary steps taxpayers must take);
- Improving notice clarity using plain language principles;
- Designing notices using psychological, cognitive, and behavioral science insights to improve taxpayer understanding and reduce taxpayer burden;
- Prominently including important deadlines, such as the deadline date to retain appeal rights;
- Including information about the availability of Low Income Taxpayer Clinics (LITCs) and TAS to help taxpayers;
- Including the Tax Court website and telephone number where relevant;
- Including links in the notices to additional explanations and content on TAS's toolkit and irs.gov websites; and
- Translating notices to languages other than English and including information on notices to direct taxpayers to those translated notices.

The IRS's Wage and Investment division is hosting a Taxpayer Correspondence Summit, most recently scheduled to take place in Summer 2019, to discuss plans to improve notices. This is a welcome step in the upcoming fiscal year.

22 Small Business/Self-Employed Division (SB/SE) is leading a study on Automated Collection System (ACS) LT11 notices (which explain CDP rights). The study will test four sample letters designed by SB/SE, as well as two letters designed by TAS, sending out the sample letters and evaluating their effectiveness based on a variety of metrics.

23 TAS will be designing additional sample LT11 notices and testing them in its own study, where notice design is not limited by an SB/SE template, as it is in the SB/SE-led study mentioned above. See National Taxpayer Advocate FY 2020 Objectives Report to Congress (TAS Research Initiatives), *infra*.

CONCLUSION

The National Taxpayer Advocate has many concerns with the current design of IRS notices, particularly the ones that have legal significance. The IRS must improve the design of its notices, and in the coming fiscal year, TAS plans to develop its own sample notices to demonstrate how certain notices may be improved to benefit taxpayer rights and understanding, as well as lessen taxpayer burden.

FOCUS FOR FISCAL YEAR 2020

In fiscal year 2020, TAS will:

- Establish teams to design sample notices to conform with TAS's suggestions to make rights-based notices for notices that have legal significance;
- Incorporate general improvements, including design insights from psychological, cognitive, and behavioral science and plain language principles in its sample notices;
- Translate select notices to languages other than English and provide information on notices to direct taxpayers to those translated notices;
- Solicit advice from the tax community on the design of TAS's sample notices; and
- Create links in the notices to additional explanations and content on TAS's toolkit and irs.gov websites.²⁴

²⁴ See National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress (Area of Focus: *TAS Is Developing an Electronic Roadmap Tool to Assist Taxpayers As They Navigate Through the Complex Tax System*), *supra*, for a discussion of efforts to create an electronic roadmap that will allow taxpayers to input their letter or notice number and see where they are in the tax administration roadmap, as well as receiving a plain language description of the purpose of the notice and what taxpayers need to do.

Area of Focus #7 **TAS Is Analyzing Its Cases to Identify Ways to Strengthen Earned Income Tax Credit (EITC) Advocacy and to Improve IRS EITC Audits**

TAXPAYER RIGHTS IMPACTED¹

- *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 a Fair and Just Tax System*

DISCUSSION

Background

The Earned Income Tax Credit (EITC) is one of the primary forms of public assistance for low income working taxpayers. However, the EITC is a complex law that involves eligibility rules based on a taxpayer's income, marital status, and parental or other caretaker arrangements, which can often change on a year-to-year basis. The population claiming the EITC is also constantly in flux, with approximately one-third of the eligible population changing every year.² At the same time, the population of taxpayers who rely on the EITC often share a common set of characteristics, such as limited education and high transiency, which create challenges for taxpayer compliance.³ In this environment of complex eligibility rules and potentially vulnerable taxpayers, it is easy to see how some taxpayers claim the EITC incorrectly (or not at all).⁴

The IRS consistently approaches this problem by focusing on compliance efforts (audits). In fact, in fiscal year (FY) 2018, approximately *37 percent of all individual returns selected for audit were selected on the basis of an EITC claim.*⁵ This rate of audit selection occurs despite the fact that EITC returns account for approximately 18 percent of all individual returns filed in calendar year 2017.⁶ Also, EITC misreporting is a relatively small portion of the tax gap—six percent of the gross tax gap and ten percent of the tax gap attributable to individual income tax misreporting.⁷ To address EITC noncompliance in

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 IRS, *EITC [Earned Income Tax Credit] Fast Facts*, <https://www.eitc.irs.gov/partner-toolkit/basic-marketing-communication-materials/eitc-fast-facts/eitc-fast-facts>.

3 National Taxpayer Advocate 2015 Annual Report to Congress 235-239.

4 For a thorough discussion of how a taxpayer could understandably claim a child incorrectly for the Earned Income Tax Credit (EITC), see *Cowan v. Commissioner*, T.C. Memo. 2015-85; National Taxpayer Advocate 2015 Annual Report to Congress 242.

5 IRS, *2018 Data Book*, table 9a (May 2019).

6 *Id.*

7 National Taxpayer Advocate 2018 Annual Report to Congress 98-99. The most recent estimate of the gross tax gap, based on data for tax years 2008-2010, is \$458 billion. A portion of the gross tax gap, \$264 billion, or 68 percent, is attributable to individual income tax misreporting. IRS, Research, Analysis & Statistics, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2008-2010*, Publication 1415, 1 (May 2016). Of the \$40 billion in misreported credits, \$26 billion is attributable to EITC misreporting. IRS, Research, Analysis & Statistics, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2008-2010*, Publication 1415, 19 (May 2016).

a *proportionate* manner, the IRS needs to adopt alternate strategies rather than just a disproportionate audit rate.⁸

To get a better understanding of how TAS can improve its advocacy for EITC taxpayers and how the IRS can better work its EITC cases, TAS plans to review 540 randomly selected EITC cases to identify points in the case history where advocacy opportunities were missed or places where TAS struggled to resolve the case with the IRS. By studying how TAS interacts with taxpayers and works its cases with the IRS, we will glean information about how EITC casework can be improved both by TAS and the IRS. Moreover by reviewing TAS cases we can identify areas of taxpayer confusion. With this knowledge, the IRS can do better education and outreach, including soft letters sent out before the filing season.⁹

TAS Is In a Unique Position to Study EITC Advocacy Opportunities

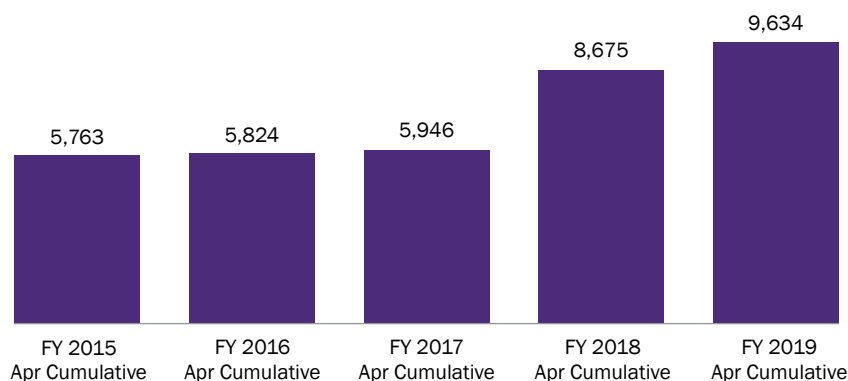
TAS case advocates (CAs) routinely work EITC cases. As Figure 4.7.1 shows, TAS receives a substantial number of EITC cases each year, a number which has grown in the last two years. In fact, *EITC cases make up the second highest cause of taxpayers coming to TAS in FY 2018 and through April FY 2019.*¹⁰ Through working EITC cases, TAS has been able to identify some issues facing taxpayers, such as extensive delays in evaluating documentation submitted by taxpayers.¹¹ And TAS improved its internal guidance in 2018 with Internal Revenue Manual (IRM) 13.1.24.4.1, which highlights EITC issues. In particular, IRM 13.1.24.4.1.1 now explains challenges faced by low income taxpayers, thereby alerting case advocates they may have to make extra efforts at communication and advocacy with this population.

8 For example, see National Taxpayer Advocate 2018 Annual Report to Congress 91-104; National Taxpayer Advocate 2017 Annual Report to Congress 141-150.

9 TAS Research has already shown the positive impact of sending educational notices to EITC taxpayers. See TAS Research Initiatives, *infra*; National Taxpayer Advocate 2017 Annual Report to Congress vol. 2 14-40; National Taxpayer Advocate 2016 Annual Report to Congress vol. 2 32-52.

10 Data obtained from Taxpayer Advocate Management Information System (TAMIS) (Apr. 1, 2018; Apr. 1, 2019).

11 National Taxpayer Advocate 2018 Annual Report to Congress 559-560.

FIGURE 4.7.1¹²**TAS Earned Income Credit (EIC) Receipts
FYs 2015 Through 2019 (Cumulative Through April)**

As for relief rates, the results are rather low, but improving slightly.¹³ Figure 4.7.2 shows the relief rate for TAS EITC cases between FYs 2015 and 2018, with FY 2019 cumulative through April. While the lowest relief rate, 60.6 percent, occurred in FY 2016, it has improved to a relief rate of 68.2 percent (for FY 2019 cumulative through April). If TAS is successfully advocating *and* educating taxpayers, we would hope to see this rate continue to improve. Improving this relief rate is a goal of the TAS case review.¹⁴

FIGURE 4.7.2, EITC Case Relief Rates, FYs 2015–2018, FY 2019 Cumulative Through April¹⁵

Fiscal Year	Relief Rate
2015	63.5%
2016	60.6%
2017	64.8%
2018	66.4%
2019	68.2%

¹² Data obtained from TAMIS (Apr. 1, 2015; Apr. 1, 2016; Apr. 1, 2017; Apr. 1, 2018; Apr. 1, 2019).

¹³ For information on TAS relief rates, see Internal Revenue Manual (IRM) 13.1.21.1.2.1.3, *TAO/Relief Assistance Codes* (Feb. 1, 2011).

¹⁴ A certain number of cases are closed each year because the case advocate (CA) could not provide relief or the taxpayer did not respond. In 2018, 27 percent of the EITC cases were closed for such reasons. While TAS could perhaps work to identify why taxpayers are unresponsive and improve this number, there will always be a population of cases that cannot obtain relief. Data obtained from TAMIS (Oct. 2, 2018).

¹⁵ In fiscal year (FY) 2015, TAS received 11,530 EITC cases and obtained relief in 7,319 cases. In FY 2016, TAS received 11,550 EITC cases and obtained relief in 7,003 cases. In FY 2017, TAS received 13,023 EITC cases and obtained relief in 8,441 cases. In FY 2018, TAS received 18,642 EITC cases and obtained relief in 12,377 cases. Data obtained from TAMIS (Oct. 1, 2016; Oct. 1, 2017; Oct. 1, 2018, and Apr. 1, 2019).

Cycle time represents the amount of time it took for TAS to work a case from receipt to completion of all issues presented in the case. Figure 4.7.3 shows the average cycle time for EITC cases between FYs 2015 and 2019 (cumulative through April). Cycle time for TAS to work EITC cases has decreased in recent years. In FY 2015 the average amount of time to work a case was 80.2 days. This average has decreased to 69.6 days in FY 2018.

Extended cycle times may result from the time it takes for taxpayers to gather necessary documents or for the IRS to analyze the documents and make a decision. Any delay in case processing can be harmful to a low income taxpayer who relies on the EITC. New internal guidance for TAS employees should help CAs work with taxpayers to identify adequate documentation sooner in the process.¹⁶ Likewise, TAS is provided with an advocacy opportunity when the IRS is taking an extraordinary amount of time to analyze a taxpayer's submitted documents. This is something the TAS case review will observe.

FIGURE 4.7.3, EITC Case Cycle Time, Fiscal Years 2015-2018¹⁷

Fiscal Year	Average Cycle Time in Days
2015	80.2
2016	85.2
2017	69.8
2018	69.6

The TAS Case Advocacy Process

When TAS does not have authority to take specific actions necessary to resolve taxpayer issues on its own, TAS must use Form 12412, *Operations Assistance Request (OAR)* to request actions from the IRS.¹⁸ For the OAR to be effective, the TAS CA must fully explain the case facts and legal standard to the IRS and provide necessary documentation to build a persuasive case. Generally this requires communication with the taxpayer and research into the case and applicable laws. TAS has provided explicit information to CAs on how to draft effective OARs in IRM 13.1.24.4.1.5. If the IRS does not agree to take the actions discussed in the OAR, the CA must elevate the case to his or her manager, who will then continue to negotiate with the IRS and may consider the issuance of a Taxpayer Assistance Order (TAO).¹⁹

Each step in this process provides an opportunity for advocacy. These steps include: initial contact with taxpayer, research on the case, communication with the IRS, and elevated communications between managers, if necessary.

16 IRM 13.1.24.4.1.5 (May 11, 2018); IRM 13.1.24.4.1.3 (May 11, 2018).

17 FY 2019 data is not included in this analysis due to the government shutdown. It would be impossible to calculate what could have occurred with casework during this time. Data obtained from TAMIS (Apr. 1, 2015; Apr. 1, 2016; Apr. 1, 2017; Apr. 1, 2018; Apr. 1, 2019).

18 IRM 13.1.19.1 (Nov. 14, 2014).

19 IRC § 7811; IRM 13.1.19.6 (May 5, 2016); IRM 13.1.20.2 (Feb. 1, 2011).

The TAS Review of Cases

As noted above, TAS is reviewing a random sample of 540 EITC cases. Some things that will be considered in the review include:

- Contact made by TAS to the taxpayer via phone or mail;
- How did the TAS employee research and analyze the case;
- Did the TAS employee explore alternative documentation with the taxpayer;
- Did the IRS employee explain the reasons for disallowance, whether in whole or in part; and
- Did the IRS employee disallow documents not specifically mentioned in IRM 4.19.14?

CONCLUSION

TAS plays a critical role in the EITC audit process through its interactions with taxpayers and the IRS as it works its cases. However, the current TAS relief rate for EITC cases of about 68 percent indicates that TAS needs to shore up its advocacy efforts for EITC taxpayers. This is particularly important given the complex nature of the EITC and the unique attributes of the taxpayers claiming it. One solution is to increase the assistance and education that taxpayers claiming the EITC receive. Another solution is to improve the education TAS and IRS employees receive.

FOCUS FOR FISCAL YEAR 2020

In fiscal year 2020, TAS will:

- Complete its review of EITC cases and analyze the results;
- Based on the results of the analysis, identify shortcomings in training provided to IRS and TAS employees and design and deliver the training where necessary; and
- Consider changes to guidance provided to TAS employees when working EITC cases, such as having a specialized review prior to submitting a case to the IRS and enhanced training for managers that could include a guide to advocating in elevated EITC cases.

Area of Focus #8 **Because Oversight Is Weak, the Risk of Erroneous Approvals of Form 1023-EZ Applications Continues to Be Great**

TAXPAYER RIGHTS IMPACTED¹

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

DISCUSSION

The National Taxpayer Advocate has for many years raised concerns about the length of time it takes the IRS to process Forms 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*.² The IRS's goal has been to process all applications within six months.³ If an application goes unanswered for 270 days (about nine months), taxpayers may request a declaratory judgment as to their status as an organization described in IRC § 501(c)(3).⁴

In 2014, when the Form 1023 processing time was 315 days, the IRS adopted Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, to address its Form 1023 inventory backlogs.⁵ Form 1023-EZ consists of checkboxes that allow applicants to attest, rather than require them to demonstrate, that they meet essential requirements for exempt status. By fiscal year (FY) 2016, Form 1023 cycle time had decreased to 96 days.⁶ Form

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 National Taxpayer Advocate 2017 Annual Report to Congress 64 (Most Serious Problem: *Exempt Organizations: Form 1023-EZ, Adopted to Reduce Form 1023 Processing Times, Increasingly Results in Tax Exempt Status for Unqualified Organizations, While Form 1023 Processing Times Increase*); National Taxpayer Advocate 2013 Annual Report to Congress 165 (Most Serious Problem: *Exempt Organizations: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*); National Taxpayer Advocate 2012 Annual Report to Congress 192 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*); National Taxpayer Advocate 2011 Annual Report to Congress 442 (Most Serious Problem: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*); National Taxpayer Advocate 2007 Annual Report to Congress 210 (Most Serious Problem: *Determination Letter Process*); National Taxpayer Advocate 2004 Annual Report to Congress 193, 203 (Most Serious Problem: *Application and Filing Burdens on Small Tax-Exempt Organizations*).

3 Jeff Carlson, *IRS Making Progress in Improving 501(c)(3) Application Process, Says Koskinen*, CCH News (Apr. 8, 2014), reporting on Comm'r Koskinen's testimony before the House Appropriations Committee Subcommittee on Financial Services and General Government on the Fiscal Year (FY) 2015 IRS budget at <http://tst-news.cchgroup.com.php56-7.ord1-1.websitetestlink.com/2014/04/08/irs-making-progress-in-improving-501c3-application-process-says-koskinen/>.

4 IRC § 7428(a)(2).

5 National Taxpayer Advocate FY 2015 Objectives Report to Congress 47-48 (Area of Focus: *Despite Improvements, TAS Remains Concerned About IRS Treatment of Taxpayers Applying for Exempt Status*). Processing time, or cycle time, is a 12-month rolling average of the number of days that elapse from the date the application is submitted through the date it is closed.

6 Tax Exempt and Government Entities (TE/GE) response to TAS information request (Aug. 31, 2017).

1023-EZ cycle time was 13 days, and the average cycle time for all applications processed by the Exempt Organization (EO) function was 54 days.⁷

Cycle times for applications other than Form 1023-EZ are higher now than they were in 2016 and the data available thus far indicates they may continue to rise. For example, average processing time for Form 1023 applications (and other applications other than Form 1023-EZ) was 100 days as of September 25, 2018, but had risen to 160 days as of December 11, 2018.⁸

The IRS did not process applications for exempt status in the 35-day period that began on December 22, 2018, when IRS appropriations lapsed. This interruption lengthened the Form 1023 processing times that were already increasing.⁹

As described below, in January 2018, the IRS revised Form 1023-EZ to elicit additional information from applicants. The average age of open Form 1023-EZ inventory, although rising, has remained relatively small (23 days at the end of September 2018, 36 days by mid-February 2019).¹⁰ Thus, on one hand, soliciting the additional information does not appear to be impeding the IRS from making determinations about Form 1023-EZ applicants within a reasonable amount of time. On the other hand, as discussed below, the IRS is not adequately evaluating the additional information it receives.

The IRS Has Not Changed Its Procedures in Light of Additional Information Form 1023-EZ Elicits Since It Was Revised in 2018

Since Form 1023-EZ was adopted in 2014, the National Taxpayer Advocate has been concerned that it does not elicit enough information to allow the IRS to make an informed determination about whether an organization qualifies for IRC § 501(c)(3) status.¹¹ As discussed below, in 2015, 2016, and 2017, TAS reviewed the articles of incorporation of representative samples of successful Form 1023-EZ applicants

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- 7 TE/GE response to TAS information request (Oct. 20, 2017). Almost all of the Exempt Organization (EO) function's processing work consists of Form 1023 or Form 1023-EZ applications, but EO also processes a relatively small number of applications for exempt status under other subsections of IRC § 501(c), or for other types of determinations. Of 95,529 applications EO received in FY 2018, 87,764, or 92 percent, were Form 1023 or Form 1023-EZ applications. TE/GE, *FY 2017 Accomplishments* 8 (Mar. 2018).
- 8 EO Tax Journal *Email Updates* 2018-188 (Sept. 25, 2018) and 2018-248 (Dec. 26, 2018), reporting remarks of the EO Division Director to members of the TE/GE Exempt Organizations Council. TAS plans to develop more complete cycle time data in this fiscal year.
- 9 EO Tax Journal *Email Updates* 2019-94 (May 13, 2019), reporting remarks of the EO Division Director to members of the TE/GE Exempt Organizations Council, who noted that "current case processing time for 1023 applications is 178 days. For the non-1023 cases it is slightly higher than that and those are running at about 186 days."
- 10 EO Tax Journal *Email Updates* 2019-51 (Mar. 14, 2019), reporting remarks of the EO Division Director to members of the TE/GE Exempt Organizations Council.
- 11 See, e.g., National Taxpayer Advocate FY 2015 Objectives Report to Congress 54-57 (Area of Focus: *Despite Improvements, TAS Remains Concerned About IRS Treatment of Taxpayers Applying for Exempt Status*).

from states whose articles were publicly available.¹² The study findings led the National Taxpayer Advocate to issue a Taxpayer Advocate Directive (TAD), which induced the IRS to revise the form.¹³

TAS reviewed the sampled organizations' articles of incorporation to ascertain whether they contained purpose and dissolution clauses as required by Treasury regulations, thereby conforming with the statutory organizational test for tax exempt status.¹⁴ The studies found that too often—between 26 and 42 percent of the time—the requirements for IRC § 501(c)(3) status were not met and the IRS approval was erroneous.¹⁵ However, Form 1023-EZ applications were approved over 90 percent of the time.¹⁶ The IRS's own data showed that it frequently conferred exempt status on Form 1023-EZ applicants in error.¹⁷

On September 26, 2016, the National Taxpayer Advocate issued a TAD directing the IRS, among other things, to revise Form 1023-EZ to require applicants to submit a brief narrative statement of their actual or planned activities, and the IRS acquiesced to that portion of the directive.¹⁸ Since January 2018, Form 1023-EZ has contained a field for the description. The instructions to the form direct applicants to “consider your past, present, and planned activities” and to briefly (in 255 characters or less) “describe your mission or most significant activities.”¹⁹

In light of the frequency with which Form 1023-EZ applications are approved erroneously, we expected that the IRS, armed with more complete information about applicants, would correspond with applicants whose brief narrative statement raised concern. Applicants could revise their organizing documents if needed or otherwise perfect their applications. However, current IRS procedures have not been revised to require applicants to submit their organizing documents or amended organizing

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- 12 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2 1-31 (*Study of Taxpayers That Obtained Recognition As IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*); National Taxpayer Advocate 2016 Annual Report to Congress 254 (Most Serious Problem: *Exempt Organizations: Form 1023-EZ: The IRS's Reliance on Form 1023-EZ Causes It to Erroneously Grant Internal Revenue Code § 501(c)(3) Status to Unqualified Organizations*); National Taxpayer Advocate 2017 Annual Report to Congress 64-72 (Most Serious Problem: *Form 1023-EZ, Adopted to Reduce Form 1023 Processing Times, Increasingly Results in Tax Exempt Status for Unqualified Organizations, While Form 1023 Processing Times Increase*).
- 13 The National Taxpayer Advocate has the authority to issue a Taxpayer Advocate Directive (TAD) “to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers.” See Delegation Order 13-31 (formerly DO-250, Rev. 1), *reprinted as Internal Revenue Manual (IRM) 1.2.50.4* (Jan. 17, 2001); see also *IRM 13.2.1.6* (July 16, 2009).
- 14 See *Treas. Reg. §§ 1.501(c)(3)-1(b)(1)(i)(a), (b); 1.501(c)(3)-1(b)(4); 1.501(c)(3)-1(b)(2)*.
- 15 See National Taxpayer Advocate 2015 Annual Report to Congress vol. 2 1-31 (*Study of Taxpayers That Obtained Recognition As IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*), finding a 37 percent erroneous approval rate; National Taxpayer Advocate 2016 Annual Report to Congress 254 (Most Serious Problem: *Form 1023-EZ: The IRS's Reliance on Form 1023-EZ Causes It to Erroneously Grant Internal Revenue Code § 501(c)(3) Status to Unqualified Organizations*), finding a 26 percent erroneous approval rate; National Taxpayer Advocate 2017 Annual Report to Congress 64-72 (Most Serious Problem: *Form 1023-EZ, Adopted to Reduce Form 1023 Processing Times, Increasingly Results in Tax Exempt Status for Unqualified Organizations, While Form 1023 Processing Times Increase*), finding a 42 percent erroneous approval rate.
- 16 See *Form 1023-EZ Update Report 4*, https://www.irs.gov/pub/irs-tege/form_1023ez_update_report_final.pdf, referenced in Tax Exempt and Government Entities FY 2017 Work Plan 2 (Sept. 28, 2016, as amended Mar. 8, 2017), noting a 94 percent approval rate of Form 1023-EZ applications.
- 17 *Id.* at 3-4, noting that “EO has approved 94% of all Form 1023-EZ applications closed to date. Through the predetermination review process [a process in which the IRS requests a few additional pieces of information from an applicant, such as organizing documents], approximately 79% of applications have been approved.”
- 18 Memorandum from the Deputy Commissioner for Services and Enforcement to the National Taxpayer Advocate (Oct. 25, 2016) sustaining in part National Taxpayer Advocate TAD 2016-1, *Revise Form 1023-EZ to Require Additional Information from Applicants, Require Review of Such Additional Information Before Making a Determination, and Explain Your Conclusions With Respect to Each of 149 Organizations Identified by TAS* (Oct. 5, 2016).
- 19 IRS, *Instructions for Form 1023-EZ 5* (Jan. 2018).

documents.²⁰ Thus, the IRS is not ensuring that organizations take curative steps, even when it identifies a defect in the application on the basis of the additional information the form elicits.²¹

The IRS plans to develop a revised electronic Form 1023, to be released in January 2020, and is including TAS in discussions about the process. While it may be appropriate to shorten Form 1023 as part of this process, TAS will seek to insure that the revised form does not undermine the IRS's oversight role of the tax exempt sector as occurred in 2014 with the introduction of Form 1023-EZ.

EO's Plan to Manage the Risk of Erroneous Approvals by Auditing Exempt Organizations Does Not Appear to Have Been Implemented

When it introduced Form 1023-EZ, the IRS recognized that using the form posed the following risks:

- Decreased IRS involvement in applicant engagement and education;
- Insufficient information on the form for the IRS to make an accurate determination;
- Increased likelihood of fraud;
- Perception that applicants could be treated inconsistently; and
- Possibility that application processing may be inadequate.²²

The IRS planned to mitigate these risks by:

- Providing extensive educational materials and clarifying instructions;
- Implementing the predetermination review process; and
- Implementing the post-determination compliance program.²³

The National Taxpayer Advocate agrees that the IRS should provide educational materials and helpful instructions, but the IRS's own data demonstrates that these measures have not sufficiently mitigated the identified risks. As noted above, the IRS's predetermination reviews show that a significant level of Form 1023-EZ applications are approved erroneously. As discussed below, its post-determination process does not appear to be mitigating the risks created by a lack of up-front oversight.

The IRS has always intended to substitute up-front oversight primarily with post-determination audits.²⁴ In 2016, EO identified for audit a random sample of 1,182 organizations whose Form 1023-EZ applications had been approved and who had been operating for at least a year.²⁵ As of March 29, 2018,

20 IRM 7.20.9.4 (11), *General Case Processing* (Sept. 9, 2018).

21 The IRS is also not denying Form 1023 or Form 1023-EZ applications more frequently. IRC § 6110 requires the IRS to publish final letters that revoke or deny an organization's exempt status, but with taxpayer identifying information deleted. The IRS posts redacted revocation and denial letters at *IRS Written Determinations*, <https://apps.irs.gov/app/picklist/list/writtenDeterminations.html;jsessionid=ae0lcixXzkTYpdDZKWMqaEHPPEljoPrD8KhdUcVM.-?value=&criteria=uilc&submitSearch=Find>. In addition, Tax Analysts, the publisher of Tax Notes, publishes these written determinations in *Tax Notes Today*. We identified 44 denial letters to organizations seeking IRC § 501(c)(3) status issued in calendar year 2017 and 43 in 2018.

22 *Form 1023-EZ Update Report 11*, https://www.irs.gov/pub/irs-tege/form_1023ez_update_report_final.pdf, referenced in Tax Exempt and Government Entities (TE/GE) FY 2017 Work Plan 2 (Sept. 28, 2016, as amended Mar. 8, 2017).

23 *Id.*

24 See, e.g., TE/GE, *Business Performance Review (BPR) First Qtr. FY 2015 30*, Appendix B, TE/GE Risk Register (Feb. 2015), noting that its response to "perceived inadequate oversight of the tax-exempt sector as we undertake strategic shifts in how we conduct the up-front review of applications for tax-exempt status..." included transferring that risk to the Exempt Organization Exam function. The risk would be mitigated in the future by "expanded compliance efforts."

25 *Form 1023-EZ Update Report 10*, https://www.irs.gov/pub/irs-tege/form_1023ez_update_report_final.pdf, referenced in TE/GE FY 2017 Work Plan 6 (Sept. 28, 2016, as amended Mar. 8, 2017), noting that 31 EO employees from the Determinations unit were realigned to the Examinations function.

51 percent of the randomly-selected organizations were noncompliant, or risked noncompliance, in some respect.²⁶

In 2018, EO hired 11 tax examiners to process Form 1023-EZ applications, and 20 EO Examinations employees volunteered for one year to process EO applications rather than conduct audits.²⁷ By 2019, in view of increased Form 1023 processing times, the IRS announced that “we are re-allocating resources basically from examination to help us with the determination inventory.”²⁸ Thus, the backstop to the truncated up-front reviews for Form 1023-EZ will be reduced.

CONCLUSION

The IRS has struggled for years to contain Form 1023 processing times. With Form 1023-EZ, the IRS reduced Form 1023 cycle times—at the cost of exercising actual oversight of the tax-exempt sector—only to see them rise again. Post-determination compliance efforts (*i.e.*, audits) were intended to correct for the lack of up-front oversight; however, the IRS is shifting resources away from these compliance efforts in order to keep up with its increasing cycle times. These developments, coupled with a potentially over-simplified revised Form 1023 application, mean that even more applicants will be recognized as IRC § 501(c)(3) organizations when they do not qualify for that status. Once exempt status is recognized, organizations will operate with a tax subsidy and will be subject to little compliance review by the IRS.

FOCUS FOR FISCAL YEAR 2020

In fiscal year 2020, TAS will:

- Review a representative sample of corporations in states that make articles of incorporation available online whose Form 1023-EZ was approved to determine how often the IRS confers IRC § 501(c)(3) status on organizations that do not qualify for that status;
- Report on Form 1023 and Form 1023-EZ cycle times;
- Report on EO Determinations and Examinations staffing levels;
- Report on post-determination revocations and audit outcomes of successful Form 1023-EZ applicants; and
- Advocate for a revised Form 1023 that is not oversimplified and that, unlike Form 1023-EZ, does not allow applicants to simply attest that they meet essential requirements for IRC § 501(c)(3) status without requiring documentation that they qualify for that status.

26 See TE/GE, *FY 2017 Accomplishments* 4 (Mar. 2018), reporting that 565 audits had closed, only 49 percent with no change. For a description of the type of noncompliance, see TE/GE, BPR Third Qtr. FY 2017 30 (Oct. 2017), reporting that as of Oct. 2017, 486 of these examinations had closed, of which only 250, or 51 percent, closed with no change: 144 organizations were issued advisories; 66 provided amendments to their organizing documents; four provided related returns or delinquent returns; two terminations; and one revocation of exempt status.

27 TE/GE, BPR, Fourth Qtr. FY 2018 7 (undated).

28 EO Tax Journal *Email Update* 2019-51 (Mar. 14, 2019), reporting remarks of the EO Division Director to members of the TE/GE Exempt Organizations Council. But see EO Tax Journal *Email Update* 2019-56 (Mar. 21, 2019) reporting remarks of the EO Examinations Director to members of the TE/GE Exempt Organizations Council, describing plans for April 2019 to hire approximately 50 revenue agents and 14 Tax Compliance Officers for EO Examinations work only, and to continue to hire Examination employees throughout the year.

Area of
Focus #9**The Office of Appeals' Relatively Narrow Geographic Footprint Creates Barriers to In-Person Conferences and Limits Appeals' Effectiveness****TAXPAYER RIGHTS IMPACTED¹**

- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

DISCUSSION

In several Annual Reports to Congress, the National Taxpayer Advocate has discussed the importance of in-person conferences to both taxpayers and the IRS Office of Appeals (Appeals).² An in-person conference is sometimes essential to properly explaining and settling a controversy, particularly for cases involving factual or legal complexity, credibility of witnesses, or hazards of litigation settlements.³

Closely linked to the availability and effectiveness of in-person conferences is the taxpayer's physical proximity to the Appeals Technical Employee (ATE) assigned to the case. If a taxpayer must travel hundreds of miles to obtain a desired in-person conference, or if the ATE has little understanding of the taxpayer's local circumstances, then the communication and commonality often necessary for case resolution can be compromised. TAS has long urged Appeals to address these related concepts and will continue to monitor developments throughout fiscal year (FY) 2020.

Appeals Has Taken Positive Steps to Make All Taxpayers Eligible for In-Person Conferences

Taxpayers whose cases are assigned to Appeals field offices have historically had access to in-person conferences.⁴ By contrast, Appeals campus cases were made ineligible for such conferences in October 2016.⁵ This action created a particular hardship for low and middle income taxpayers, whose cases are disproportionately assigned to the campuses.⁶

To its credit, Appeals, taking to heart the urgings of the National Taxpayer Advocate and other stakeholders, has recently changed its policy and reinstated the right of campus taxpayers to transfer their cases to field offices in order to accommodate an in-person conference.⁷ Appeals has also indicated

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 National Taxpayer Advocate 2018 Annual Report to Congress 307-313; National Taxpayer Advocate 2017 Annual Report to Congress 195-202; National Taxpayer Advocate 2016 Annual Report to Congress 206-210; National Taxpayer Advocate 2014 Annual Report to Congress 46-54; National Taxpayer Advocate 2014 Annual Report to Congress 311-314.

3 Letter from American College of Tax Counsel to Kirsten Wielobob, Chief, Appeals (Oct. 10, 2016), 2016 TNT 197-16. See also Letter from Texas Soc'y of Cert. Pub. Accts. to John Koskinen, Comm'r of IRS (Jan. 24, 2017), 2017 TNT 16-16; ABA Members Comment on Recent Appeals Division Practice Changes, 2017 TNT 89-10 (May 10, 2017).

4 IRS, Interim Guidance Memorandum (IGM) AP-08-1017-0017, *Appeals Conference Procedures* (Oct. 13, 2017).

5 Effective October 1, 2016, Internal Revenue Manual (IRM) 8.6.1.2.2, *Transfers for the Convenience of Taxpayers*, was deleted, eliminating the right of taxpayers to transfer cases out of campuses.

6 National Taxpayer Advocate 2018 Annual Report to Congress 307-313.

7 IRS, IGM AP-08-1118-0013, *Appeals Conference Procedures* (Nov. 30, 2018).

that it will continue to pursue additional strategies aimed at ensuring that taxpayers' requests for in-person conferences are accommodated, regardless of whether the assigned ATE is located in a campus or in the field.⁸ This progress in facilitating in-person conferences should continue and could serve as an important step along the path toward providing taxpayers with meaningful choice regarding the type and location of their Appeals conferences.

The National Taxpayer Advocate applauds Appeals for undertaking its recent policy change with respect to in-person conferences. This progress, however, does not alone eliminate the larger systemic problems attributable to the channeling of taxpayers' cases to campus locations.⁹ For example, a taxpayer whose case remains in a campus will not have access to a highly graded ATE, even when the complexity of the case might warrant such an assignment. Ninety-four percent of ATEs in field offices are Grade 13 or above, whereas all ATEs in campuses are Grade 12 or below.¹⁰ Further, although Appeals' new transfer policy is beneficial, it does not adequately address geographic access to in-person conferences and thereby minimizes Appeals' effectiveness in resolving cases.

Appeals' Reliance on Campuses Presents Physical Barriers to In-Person Conferences and Makes It Difficult for Campus Taxpayers to Have Their Cases Heard by Higher-Graded, Locally Based Appeals Technical Employees

Appeals has only six campus locations spread throughout the United States: Philadelphia, Pennsylvania; Brookhaven, New York; Fresno, California; Ogden, Utah; Memphis, Tennessee; and Florence, Kentucky.¹¹ Fifty-three percent of Appeals cases are assigned to these campuses.¹² By contrast, the remaining 47 percent are spread among Appeals' 67 field offices.¹³ The geographic dispersal of the campuses and field offices is shown in Figure 4.9.1.

8 IRS, IGM AP-08-1118-0013, *Appeals Conference Procedures* (Nov. 30, 2018).

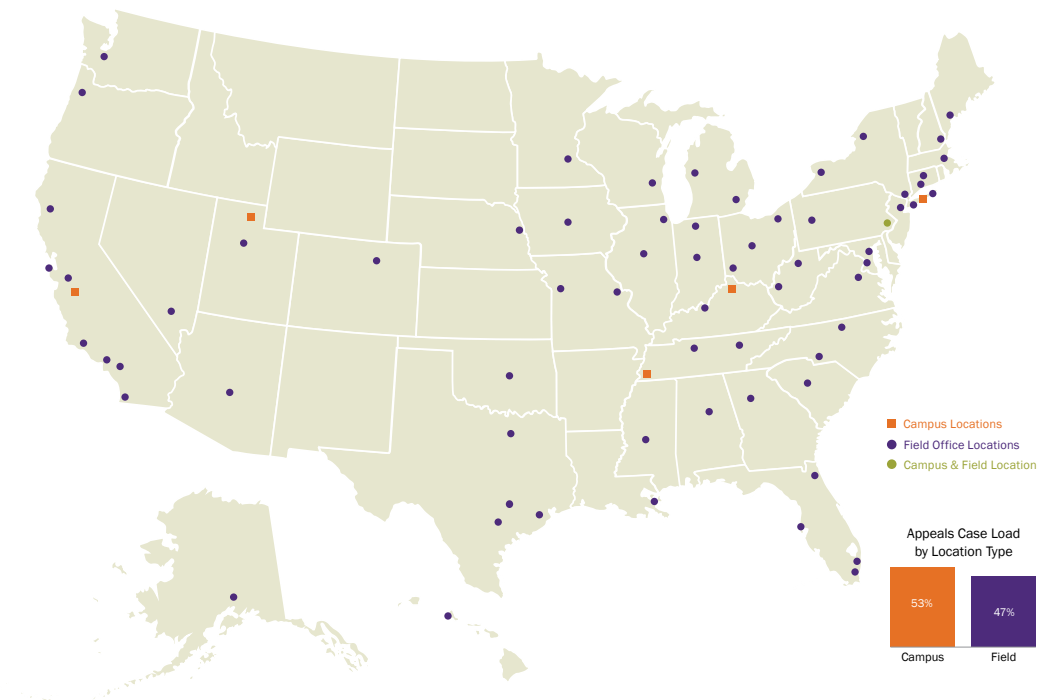
9 National Taxpayer Advocate 2018 Annual Report to Congress 307-313.

10 IRS response to TAS information request (Oct. 26, 2018).

11 IRS response to TAS information request (May 7, 2018).

12 IRS response to TAS information request (Oct. 26, 2018).

13 *Id.*

FIGURE 4.9.1, Appeals Campus and Field Locations¹⁴

Thanks to Appeals' reinstatement of campus taxpayers' right to seek a case transfer to facilitate an in-person conference, taxpayers are no longer inextricably bound to campuses. Nevertheless, Appeals' campus-centric approach can make this right difficult to exercise. Appeals states that it will use its best efforts to schedule an in-person conference at a location that is reasonably convenient for taxpayers and Appeals. However, given the geographic scarcity of field offices, which are the primary venues for in-person conferences, and the fact that twelve states and Puerto Rico lack a field office altogether, taxpayers wishing for an in-person conference may well be required to travel substantial distances and incur significant cost in order to attend an in-person conference.¹⁵

The circumstance that 53 percent of all Appeals cases are decided out of only six widely scattered offices is problematic because Appeals best serves taxpayers when it has a broad and diverse geographic footprint.¹⁶ This presence allows ATEs to negotiate case resolutions based on an understanding of the local economic circumstances and prevailing community issues faced by taxpayers. Similarly, taxpayers are more likely to develop a rapport with, and respect the decisions of, ATEs with whom they share common experiences.¹⁷ An Appeals function that is embedded within communities provides a more effective environment for establishing trust and achieving case resolutions.¹⁸ This optimal environment,

14 This map was developed based on information provided in the IRS response to TAS information request (May 7, 2018).

15 IRS response to TAS fact check (Nov. 21, 2018).

16 Although 68 field offices would appear ample in comparison with only six campus locations, that number is insufficient to cover the entirety of the U.S., its territories, and the District of Columbia. Currently, 12 states and Puerto Rico lack any Appeals presence offering in-person conferences. Appeals response to TAS information request (Oct. 26, 2018).

17 National Taxpayer Advocate Fiscal Year (FY) 2019 Objectives Report to Congress 138.

18 *Id.*

however, is systematically denied to campus taxpayers unless they opt for an in-person conference, which they may or may not need to resolve their cases. Additionally, given Appeals' current staffing model, Appeals may lack any personnel whatsoever located within a taxpayer's vicinity.

Appeals could expand its geographic footprint and minimize its reliance on campuses by using attrition from the campuses to increase staffing in local field offices with ATEs of various grades and designations such that the office could cover cases ranging from the Earned Income Tax Credit (EITC) to itemized deductions to Schedule C controversies.¹⁹ Likewise, Appeals could enhance its case assignment flexibility by re-designating technically or factually complex case categories, such as those involving EITC claims, so that they could be assigned to higher-graded ATEs where appropriate.²⁰ These steps would not only expand Appeals' geographic footprint and facilitate the accessibility of in-person conferences, but would lay the foundation for a structure that more effectively and equitably serves both campus and field taxpayers.

FOCUS FOR FISCAL YEAR 2020

In fiscal year 2020, TAS will:

- Monitor the availability of in-person conferences in both campus and field cases;
- Encourage and work with Appeals to expand its geographic footprint; and
- Advocate for taxpayers who do not receive a high-quality independent appeal by maintaining close contact with the tax practitioner community, entering into issue- and case-specific dialogues with Appeals, and issuing taxpayer assistance orders where appropriate.

¹⁹ Appeals explains its reluctance to allow case transfers out of the campuses because Appeals concentrates specialized knowledge in particular campuses and because Appeals Technical Employees (ATEs) in campuses are typically lower graded than those in the field and therefore handle less complex cases. Andrew Velarde, *IRS Appeals Confident That In-Person Campus Conferences Will Return*, 2018 TNT 21-63 (May 21, 2018).

²⁰ This step was recommended by the National Taxpayer Advocate to the Chief of Appeals as part of a May 31, 2016, meeting. In that meeting, the then-Chief of Appeals expressed the view that Earned Income Tax Credit (EITC) cases were less complex and therefore best suited for lower-graded ATEs. Given the often challenging factual scenarios and legal issues involved in these cases, however, this perspective should be reevaluated.

Area of Focus #10 **TAS Will Continue to Assist Taxpayers in Exercising Their Administrative Rights While They Face Passport Consequences**

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *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*

In early 2018, the IRS began implementing the legislatively directed program to certify taxpayers' seriously delinquent tax debts to the Department of State.² Under the law, the Department of State must deny an individual's passport application and may revoke or limit an individual's passport if the IRS has certified the individual as having a seriously delinquent tax debt. This term refers to an "unpaid, legally enforceable federal tax liability of an individual," which has been assessed, is greater than \$52,000, 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 § 6331.³ The law requires only two forms of notice to taxpayers: language in CDP hearing notices and a notice sent "contemporaneously" with the certification the IRS sends to the Department of State.⁴

The statute provides exceptions to passport certification for debts timely paid through installment agreements (IAs) and offers in compromise (OICs), and for debts for which collection is suspended because the taxpayer has a requested or pending CDP hearing or has requested relief from joint liability (known as innocent spouse relief). Additionally, the IRS has exercised its discretion to create exceptions for debts that:

- Are determined to be in Currently not Collectible (CNC) status due to hardship;
- Result from identity theft;
- Belong to a taxpayer in a disaster zone;
- Belong to a taxpayer in bankruptcy;
- Belong to a deceased taxpayer;
- Are included in a pending OIC or IA; and
- For which there is a pending claim, and the resulting adjustment is expected to result in no balance due⁵ or an adjustment to the account that reduces the original certification amount below the threshold.⁶

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 Pub. L. No. 114-94, Div. C, Title XXXII, § 32101, 129 Stat. 1312, 1729-32 (2015) (codified at IRC § 7345) (hereinafter Fixing America's Surface Transportation (FAST) Act).

3 IRC § 7345(b)(1). The \$52,000 amount has been adjusted for inflation.

4 IRC §§ 6320(a)(3)(E), 6331(d)(4)(E), 7435(d).

5 Internal Revenue Manual (IRM) 5.19.1.5.19.4, *Discretionary Certification Exclusions* (Dec. 26, 2017) and IRM 5.1.12.27.4, *Discretionary Exclusions from Certification* (Dec. 20, 2017).

6 IRM 5.1.12.27.8, *Reversal of Certification* (Dec. 20, 2017) and IRM 5.19.1.5.19.9 *Reversal of Certification* (Dec. 26, 2017).

As of May 17, 2019, the IRS had sent almost 389,000 certification notices to taxpayers, which includes repeat certifications for taxpayers who were certified, decertified, and then certified again.⁷ Also, as of mid-May 2019, the IRS had decertified about 100,000 taxpayers.⁸ The top three reasons for decertification were taxpayers in a disaster zone, taxpayers with a pending IA request, and taxpayers for whom the statutory period of limitation on collection had expired.⁹ Although the IRS began certifying eligible taxpayers in phases, TAS understands the IRS anticipates being able to certify all eligible individual taxpayer accounts by September 1, 2019.¹⁰

TAS Continues to Help Taxpayers Meet Exclusions From Certification or Become Decertified, Despite the IRS's Refusal to Exclude Already Open TAS Cases

Recognizing the significant rights that may be abridged when a person's passport is taken, Congress intended for passport certification to occur only once a taxpayer's administrative rights have been exhausted or lapsed. Taxpayers working with TAS are exercising important administrative rights—rights expressly granted to them by Congress. As part of the *right to a fair and just tax system*, taxpayers have the right to seek assistance from TAS if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels. However, the IRS continues to certify taxpayers who are already working with TAS, declining to follow the Taxpayer Advocate Directive issued by the National Taxpayer Advocate in 2018.¹¹

Since the start of the passport certification program, TAS has issued over 1,000 Taxpayer Assistance Orders (TAOs) related to passport issues. Almost 800 of these TAOs were issued in early 2018, requesting exclusion from certification for taxpayers with cases already open within TAS. While the IRS complied with these initial TAOs, it has since refused to exclude any taxpayers from certification solely based on their preexisting cases with TAS.

During fiscal year (FY) 2019 through May 31, 2019, TAS issued 342 TAOs related to passport certification, including:

- 128 TAOs requesting exclusion from passport certification based on an already open TAS case;
- 127 TAOs requesting the IRS take an action that would resolve the taxpayer's debt and qualify the taxpayer for decertification;
- 58 TAOs requesting expedited decertification;
- 29 TAOs requesting a manual decertification where a taxpayer was eligible for decertification, but a systemic decertification had not or would not occur.¹²

The IRS expressed concerns that excluding already open TAS cases would allow taxpayers to circumvent the statute and allow cases to stay open for extended periods of time, however, the data simply does not

7 This number also includes taxpayers who were certified for one tax year, then certified for an additional tax year. IRS response to TAS information request (May 23, 2019).

8 This number includes taxpayers who received a certification letter, but whose certification was never sent to the Department of State because they no longer had a seriously delinquent tax debt or met a certification exclusion prior to their name being transmitted to the Department of State. IRS response to TAS information request (May 23, 2019).

9 *Id.*

10 *Id.*

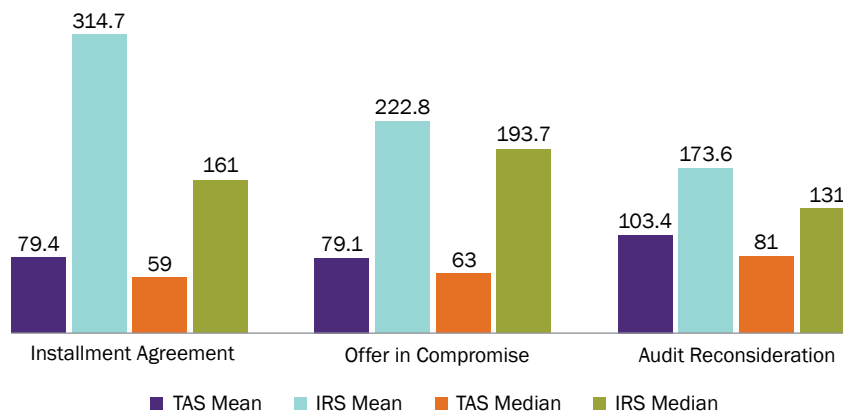
11 See National Taxpayer Advocate Fiscal Year (FY) 2019 Objectives Report to Congress 87-113 (Appendix A: *Taxpayer Advocate Directive 2018-1, TAS Passport Exclusion*).

12 An example of a situation where a systemic decertification would not occur would be if the taxpayer's liability was reduced through an audit reconsideration to below the \$52,000 threshold, but not eliminated completely.

bear this out. In cases where taxpayers resolved their debts, TAS taxpayers accomplished debt resolution, which is the fundamental purpose of the passport statute, significantly faster than those working on their own with the IRS, as shown in figure 4.10.1.

FIGURE 4.10.1¹³

Cycle Times (in Days) for TAS Cases vs. Non-TAS Cases



In terms of already certified taxpayers, of 919 cases TAS closed during the first half of FY 2019, TAS achieved decertification for approximately one-third of taxpayers, with the most common reasons being an IA and CNC hardship status, as shown in Figure 4.10.2.¹⁴

13 Accounts Receivable Dollar Inventory for Individuals and the Individual Master File for FY 2018 as of week 8 of 2019; Enforcement Revenue Information System Audit Reconsideration database (Jan. 2019). These cycle times are for all taxpayers, not just those with a seriously delinquent tax debt. In the case of installment agreements (IAs) and offers in compromise (OICs), the IRS cycle time captures the time from when a case was assigned by the IRS to collection status (Automated Collection System or the field) to when the case was placed in IA or OIC status. For the IA and OIC cycle times for TAS cases, the cycle time measures the length of time between when the taxpayer opened the TAS case and when the case was placed in IA or OIC status.

14 The 919 cases included all cases that were closed during FY 2019 through the end of February involving a taxpayer whose seriously delinquent tax debt had been certified.

FIGURE 4.10.2, Resolved TAS Passport Certification Cases by Type of Resolution

Resolution	Percentage
Installment Agreement	26%
Currently Not Collectible	24%
Other	19%
Audit Reconsideration	10%
Offer in Compromise	7%
Full Pay	6%
Amended Return	4%
Collection Due Process	2%
Bankruptcy	1%
Innocent Spouse	1%
Identity Theft	1%

TAS will continue advocating and issuing TAOs requesting individual taxpayers already working with TAS be excluded from passport certification.

TAS Helps Taxpayers Become Decertified, Who Often Are Not Aware of the Passport Certification Until After They Are Certified and Need to Travel

As explained above, the law only requires two forms of notice to affected taxpayers: a contemporaneous notice issued to the taxpayer at the time of the certification or reversal and language included 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.

First, this lack of notice raises due process concerns by depriving taxpayers of a notice and an opportunity to be heard prior to their fundamental right to travel being infringed.¹⁵ Second, it leads to an unnecessary strain on resources—including those of TAS, the IRS, and Department of State, who must process certifications and decertifications for taxpayers who may have resolved their liabilities prior to being certified if they were notified in advance.

In one TAS case during 2018, the IRS reinstated the taxpayer's IA after the taxpayer had stopped paying due to a serious health problem, but the Revenue Officer neglected to input the IA into the system.¹⁶ The taxpayer first learned of this failure not with a pre-certification notice that would have allowed the taxpayer to alert the IRS to the problem, but instead with a notice that the taxpayer's debt had already been certified to the Department of State, despite the taxpayer meeting a statutory exception to certification. In another TAS case, the taxpayer, who also had serious health problems, had paid the liability in full. However, the payment was not input in the system until eight days later due to computer system limitations, and this was the same date the taxpayer's account was pulled by the IRS

15 See Nina E. Olson, NTA BLOG, *The IRS's New Passport Program: Why Notice to Taxpayers Matters (Part 1 of 2)* (June 7, 2017), <https://taxpayeradvocate.irs.gov/news/the-irs-s-new-passport-program-why-notice-to-taxpayers-matters-part-1-of-2?category=TaxNews>.

16 In this example, as well as the one directly following it, TAS received written consent from the taxpayers to discuss publicly the facts of their individual cases.

for certification. A full two weeks after the account showed a zero balance, the IRS sent a passport certification notice to the taxpayer.¹⁷

In many cases, the unnecessary certifications require extra resources for the IRS to process expedited decertifications for taxpayers with impending travel. Since the implementation of the passport program, the IRS has issued 969 expedited decertification requests. A 30-day notice sent prior to certification could mitigate these issues.

TAS continues to hear from practitioners concerned about the IRS's inability to provide the passport certification and decertification notices to taxpayers' representatives. Our understanding is that currently, due to restrictions based on how the notices are generated, the IRS does not send passport notices to any representatives at all, even if they have a valid power of attorney on file that includes all the tax years that comprise the seriously delinquent tax debt. TAS advocated for the IRS to update the CP508 Certification Notice to make this clear to taxpayers by stating "You will need to contact your POA directly since this notice will not be sent to your POA." While the IRS agreed to make this change, we understand the work order to complete this change will not be completed until the beginning of 2020. TAS will continue to explore what steps can be taken to allow the passport certification and decertification notices to be sent to representatives where such disclosure is authorized under the law.

TAS has noted in some cases certified taxpayers are not aware of the certification when they come to TAS for assistance. Although TAS pulled a representative sample of its own cases to gauge how widespread the lack of knowledge was, there was difficulty in determining from the case files whether taxpayers knew of the certification. TAS will research this problem further and try to pinpoint potential causes, including lack of notice to Powers of Attorney (POAs), undelivered mail, and timing of the notice.

TAS Is Limited in Which Taxpayers It Can Assist With Expedited Decertification Due to IRS Requirements

Although not required by statute, the IRS has created an expedited decertification procedure for taxpayers who live abroad or have plans to travel within 45 days. Although this process has proven highly beneficial to a number of taxpayers, including those working with TAS, there is a major limitation. Expedited decertification is only available to taxpayers with a pending passport application, despite the fact that taxpayers who are certified and have current passports run the risk of having their passports revoked under the statute at any time.

In one TAS case, a certified taxpayer was stranded abroad, needing to return to the United States to obtain an equity loan to pay his federal tax balance.¹⁸ The consulate in the foreign country confiscated the taxpayer's passport when he applied for renewal and refused to issue him a limited passport for return only to the United States. Although the taxpayer worked with TAS to meet a criterion that qualified him for decertification, the consulate initially refused to process the taxpayer's passport application (and thus provide a pending passport application number) until he could provide proof that he had resolved his IRS issue. At the same time, the IRS refused to grant the taxpayer's request for an expedited decertification until the taxpayer could supply a passport application number. Although the

17 Although TAS understands that in this case the IRS was able to prevent the actual certification to the Department of State from occurring, the taxpayer nonetheless received a letter stating that he or she had been certified, creating unnecessary anxiety and further communication with the IRS to confirm the taxpayer was not actually certified.

18 The taxpayer in this case has signed a written consent allowing TAS to discuss publicly the facts of his individual case.

consulate ended up accepting a tax transcript as proof that the taxpayer had resolved the issue, this case demonstrates the problems with requiring a pending passport application for expedited decertification.

In addition to the above example, TAS is aware of numerous instances of taxpayers with seriously delinquent tax debts having their passports revoked, such as certified taxpayers who sought consular services for replacement pages for a passport or for registering the birth of a child. For example, merely contacting the Department of State to ask about the ability to use one's passport can result in revocation of the passport and removal from an airplane. Clearly, there is a need for taxpayers with current passports to receive expedited decertification if they have imminent travel planned. TAS will continue to request expedited decertification for any taxpayers with an urgent need to travel.

Taxpayers Are Reporting Difficulty Requesting the Emergency and Humanitarian Exception

The law provides that the Department of State may issue a passport to a certified taxpayer in emergency circumstances or for humanitarian reasons.¹⁹ However, TAS has heard from multiple taxpayers expressing frustration with the ability to request this exception. Taxpayers have reported to TAS receiving inconsistent information from Department of State employees, for example, that the emergency/humanitarian exception applied only to "officers" who need to travel back to the United States or it does not apply if the family member one is visiting is not a U.S. citizen. Other taxpayers have reported simply that the Department of State employee they spoke with was unfamiliar with the exception.

The IRS has acknowledged that it "has the discretion to request a decertification for other reasons [in addition to the statutory provisions requiring decertification]."²⁰ However, the IRS has not created a discretionary exclusion formally listed in the IRM for emergency and humanitarian purposes. For taxpayers who are in regular contact with the IRS and working on resolving their tax liabilities, creating a formal IRS administered decertification exception for emergency and humanitarian purposes could prevent irreparable harm to taxpayers who are being prevented from traveling in an emergency. The IRS could prevent taxpayers from taking improper advantage of this exception by subsequently making a revocation recommendation for any taxpayers who were temporarily granted an emergency or humanitarian exception, but no longer should be excluded from passport certification.

CONCLUSION

In implementing the passport provisions of the Fixing America's Surface Transportation (FAST) Act, the IRS has been proactive in some areas by taking actions not required by Congress to protect taxpayer rights. For example, the IRS created discretionary exceptions to passport certification and an expedited decertification process. However, there are some longstanding problems that the IRS has not addressed, such as the lack of a stand-alone notice prior to passport certification, the refusal to exclude already open TAS cases, and the inability for representatives to receive copies of passport correspondence. Additionally, the IRS is missing opportunities to protect taxpayer rights by ensuring expedited decertification is available to all taxpayers who have a need for it.

19 FAST Act § 32101(e)(1)(B).

20 IRM 5.19.1.5.19.9, *Reversal of Certification* (Dec. 26, 2017).

FOCUS FOR FISCAL YEAR 2020

In fiscal year 2020, TAS will:

- Update technical guidance to TAS employees working cases to take into account revised expedited decertification and revocation recommendation procedures;
- Compile detailed TAS case data regarding cycle time, outcomes, taxpayer notification, and other metrics on passport cases for certified and not yet certified taxpayers;
- Further research the limitations that prevent the IRS from issuing the passport notices to authorized representatives and make recommendations for how the IRS could address this problem;
- Meet with the Department of State to discuss taxpayer problems in requesting the emergency/humanitarian exception, updates to the expedited decertification process, and the possibility of including TAS language on the Department of State passport notices;
- Issue a Taxpayer Rights Impact Statement proposing categories for an IRS administered emergency/humanitarian exception that would qualify a taxpayer for decertification;
- Continue to issue TAOs requesting exclusion from passport certification for already open TAS cases; and
- Assist taxpayers in having their accounts timely decertified to the Department of State.

Area of Focus #11 Facilitate Digital Interaction Between the IRS and Taxpayers While Still Maintaining Strict Security of Taxpayer Information

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Confidentiality*

DISCUSSION

The IRS continually expands its offerings of digital service options for taxpayers in an effort to meet taxpayer demand, as well as provide more efficient service delivery methods. While TAS acknowledges that many taxpayers prefer to interact with the IRS electronically in certain transactions, we also continue to advocate for the IRS to maintain an omnichannel service environment.² Further, we believe that the IRS should apply the results of two pilot programs, the Taxpayer Digital Communications Secure Messaging (TDC) pilot and the Office of Appeals WebEx Virtual Conference pilot, to improve its digital service offerings. Accordingly, during fiscal year (FY) 2020, TAS plans to explore the following issues:

- During the TAS TDC pilot, taxpayers expressed concerns over the burdensome e-authentication requirements where they merely wanted to submit documentation or payments to the IRS. TAS will meet with representatives of the National Institute of Standards and Technology (NIST) to determine if there is a less burdensome approach for these types of interactions.
- The results of the Appeals WebEx pilot support the expansion of the technology to other various customer service and enforcement programs within the agency, including TAS.

Participants in the TAS Taxpayer Digital Communications Pilot Expressed Concerns Over the Burden Imposed by e-Authentication Requirements

The Taxpayer Advocate Service, along with several other organizations within the IRS, conducted a pilot of the TDC system.³ The pilot used the same three-factor e-authentication requirements as the IRS online account application, Secure Access.⁴ The TDC pilot enabled the participating IRS organizations to send and receive electronic webmail, along with certain digital documents (including uploaded

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).
- 2 See National Taxpayer Advocate 2017 Annual Report to Congress 22-35 (Most Serious Problem: *Telephones: The IRS Needs to Modernize the Way It Serves Taxpayers Over the Telephone, Which Should Become an Essential Part of an Omnichannel Customer Service Environment*).
- 3 In addition to TAS, the following organizations conducted a Taxpayer Digital Communications (TDC) pilot: Small Business/Self Employed (SB/SE) Exam, Large Business and International (LB&I). IRS response to TAS information request (Nov. 22, 2017).
- 4 The three-factor requirements for Secure Access include: (1) personal information, including: name, email address, tax identification number, tax filing status, and mailing address; (2) financial account information from one of the following: credit card (no American Express, debit or corporate cards), student loan, mortgage, home equity loan, home equity line of credit (HELOC), or auto loan; and (3) mobile phone linked to the taxpayer's name (alternatively, the taxpayer can provide a mailing address and receive an activation code by mail). See IRS, *Secure Access: How to Register for Certain Online Self-Help Tools*, <https://www.irs.gov/individuals/secure-access-how-to-register-for-certain-online-self-help-tools> (last visited Apr. 28, 2019).

scanned or photographed documents), to and from taxpayers through a secure portal. The pilot also enabled taxpayers to communicate within the system using computers, smartphones, or tablets.⁵

TAS conducted the pilot in two phases. Phase I started in April 2017 and paused September 30, 2017, due to an IRS Secure Access vendor change. Phase II of the pilot started June 18, 2018, and ended November 30, just prior to the installation of a new version of the system software. Combined, Phase I and Phase II covered approximately one year.

The Phase I pilot included unrepresented taxpayers with Earned Income Tax Credit (EITC) or levy cases.⁶ TAS expanded the pilot in Phase II to include cases with open audits, audit reconsiderations, innocent spouse, offers in compromise (all types), currently not collectible, other installment agreements, Affordable Care Act Premium Tax Credit, and all series of liens.⁷ In both phases of the pilot, very few taxpayers participated in the program. In Phase I, out of the about 750 taxpayers who were invited to participate in the pilot, fewer than ten taxpayers passed the Secure Access e-authentication requirements necessary to open an account.⁸ In Phase II, the number of invitations to participate increased by approximately 50 percent (over 1,100 offers made in Phase II), yet only about a dozen taxpayers were able pass Secure Access.⁹

During both phases of the TAS pilot, the strict e-authentication requirements created a barrier to participation. Many pilot participants (both TAS Case Advocates and taxpayers) noted that the e-authentication requirements were a main reason for not opening an account. The requirements were either too burdensome or the taxpayers did not have the necessary information to pass Secure Access.¹⁰ They also noted that it was simply easier to use another method of communication to provide information, such as fax, phone, or correspondence.¹¹

TAS pilot participants raised concerns about the unnecessarily burdensome e-authentication requirements where the taxpayer merely wanted to electronically submit documents.¹² They raised a valid point: when confidential taxpayer information is only flowing *into* the IRS, there is little risk that the IRS will wrongly disclose confidential information, especially once the IRS has already established personal contact with taxpayer.¹³ For example, when a taxpayer is submitting documentation for an audit or providing evidence of economic hardship to TAS, the taxpayer is not receiving information from the IRS. In such circumstances, it seems unnecessarily burdensome to require the user of the

5 TAS TDC Summary - Cumulative Data from 6/18/2018 Through 12/3/2018 (Dec. 3, 2018).

6 TAS conducted the pilot in the following four offices: Dallas, Nashville, New Orleans, and Cleveland. TAS TDC Summary - Cumulative Data from 6/18/2018 Through 12/3/2018 (Dec. 3, 2018).

7 TAS Fiscal Year (FY) 2018 Quarter 2 Business Performance Review Report Commissioner's Briefing; TAS TDC Summary - Cumulative Data from 6/18/2018 Through 12/3/2018, *Participation Agreement Information by Primary Issue, 6/18/2018 Through 12/3/2018*, 29 (Dec. 3, 2018).

8 TAS, *Working Data for Taxpayer Digital Communications Project* (Figures shown from 04/05/2017 to 09/30/2017).

9 TAS TDC Summary - Cumulative Data from 6/18/2018 Through 12/3/2018, *Participation Agreement Information by Primary Issue, 6/18/2018 Through 12/3/2018* (Dec. 3, 2018).

10 TAS TDC Summary - Cumulative Data from 6/18/2018 Through 12/3/2018 (Dec. 3, 2018); IRS response to TAS information request (Nov. 22, 2017).

11 *TAS Taxpayer Digital Communication (TDC) Pilot: TAS Online Survey Report 5* (2018).

12 *Id.*

13 There is always a risk of criminals attempting to hack into IRS systems or sending attachments with malware, but the IRS has methods other than Secure Access to protect against these risks. The purpose of Secure Access is to prevent unauthorized IRS disclosure of confidential taxpayer information. Internal Revenue Manual (IRM) 21.2.1.58, *Secure Access eAuthentication* (Oct. 9, 2018).

online application to pass the strict three-factor requirements of Secure Access.¹⁴ A taxpayer submitting documentation by mail or fax is not subject to authentication requirements because the IRS does not disclose confidential tax return information in this one-way inbound communication. In addition, while in some instances an identity thief might submit false documents, this is not a security risk, and the IRS has procedures in place to review and determine the legitimacy of documents.¹⁵

The IRS has previously indicated that online transactions should be as easy and simple as policy, process, and technology will allow, especially for inbound document submission processes where taxpayers are attempting to voluntarily comply with tax obligations.¹⁶ The IRS must follow guidelines issued by NIST, which released updated guidelines in June 2017.¹⁷ The IRS subsequently developed an omnichannel authentication strategy and is in the process of applying the new NIST standards to each online application.¹⁸ For example, the IRS implemented an enhanced security two-factor authentication requirement for limited online applications. The two-factor authentication is less burdensome and is currently applied to the Online Payment Agreement applications.¹⁹ Figure 4.11.1 includes the verification rates for the various types of e-authentication levels from FY 2017 to FY 2019 (through March 23, 2019).

FIGURE 4.11.1, e-Authentication Verification Rates, FYs 2017–2019 (through March 23, 2019)²⁰

Type of e-Authentication	FY 2017	FY 2018	FY 2019 (through March 23)
Legacy Two-Factor Verification Rate	82.5%	78.9%	76.7%
Enhanced Two-Factor Verification Rate (beg. July 2018)	N/A	74.3%	65.9%
Three-Factor Verification Rate	33.3%	39.2%	37.2%

- 14 For a detailed description of the information required to pass Secure Access requirements, see IRS, *Secure Access: How to Register for Certain Online Self-Help Tools*, <https://www.irs.gov/individuals/secure-access-how-to-register-for-certain-online-self-help-tools> (last visited Apr. 28, 2019).
- 15 We acknowledge that the IRS is under significant pressure to increase its online security controls to battle continuous cybersecurity threats and we firmly believe that strict e-authentication is necessary to promote a high level of confidence in the tax system in general and online services in particular. See *The Internal Revenue Service's Taxpayer Online Authentication Efforts: Hearing Before the H. Subcomm. on Oversight of the H. Comm. on Ways and Means*, 115th Cong. (Sept. 26, 2018) (statement of Michael E. McKenney, Deputy Inspector General for Audit, Treasury Inspector General for Tax Administration).
- 16 IRS Response to Recommendation 3-3, National Taxpayer Advocate FY 2019 Objectives Report vol. 2 36 (*IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in the 2017 Annual Report to Congress*).
- 17 National Institute of Standards and Technology, Special Publication 800-63-3, *Digital Identity Guidelines* (June 2017). The IRS must also comply with Office of Management and Budget M-04-04, *E-Authentication Guidance for Federal Agencies* (Dec. 16, 2003).
- 18 IRS Identity Assurance Operations, IRS Office of Privacy, Governmental Liaison and Disclosure (PGLD), *Secure Access Verification Rates* (Apr. 25, 2019); IRS Response to Recommendation 3-3, National Taxpayer Advocate FY 2019 Objectives Report vol. 2 36 (*IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in the 2017 Annual Report to Congress*).
- 19 IRS Identity Assurance Operations, PGLD, *Secure Access Verification Rates* (Apr. 25, 2019). With two-factor authentication, the user is required to create a profile, which involves the IRS verifying personal information and mailing address, and either (1) verify a financial account, (2) activate via SMS (phone verification), or (3) activate via postal activation code. Authentication, Authorization, and Access (A3) Executive Governance Board Meeting (Apr. 11, 2019).
- 20 IRS Identity Assurance Operations, PGLD, *Secure Access Verification Rates* (Apr. 25, 2019). In July 2018, the IRS enhanced the legacy Level of Assurance (LOA) 2 with additional security and began migrating legacy applications, including Online Payment Agreement (OPA). For three-factor, FY 2018 represents activity since the December 10, 2017, relaunch (after the October to December 2017 temporary shut-down).

To address the needs of taxpayers expressed during the TDC pilot, TAS plans to meet with representatives of NIST to evaluate the feasibility of creating a method to electronically submit documents to the IRS with reduced e-authentication standards, while still maintaining compliance with the new NIST standards. The platform we envision should be the digital functional equivalent to faxing or mailing documents to the IRS. It would be easier for both the taxpayer and the IRS if the taxpayer had the ability to submit documents electronically while still on a call with the IRS. It would save time for both parties because they could both review and discuss the documents in real time and immediately address any concerns. However, requiring a taxpayer to first pass three-factor Secure Access in order to submit documents electronically is going to keep out a substantial number of taxpayers.

TAS Plans to Evaluate the Office of Appeals WebEx Pilot and Advocate for Expansion to Other Service and Compliance Initiatives

From August 1, 2017 through September 30, 2018, the IRS Office of Appeals conducted a pilot using Cisco WebEx Meeting Server (WebEx) technology for virtual face-to-face conferences with taxpayers and representatives.²¹ For the pilot, Appeals used videoconference, document viewing, and chat features available on WebEx software. Appeals did not record WebEx meetings and, although documents can be shared onscreen, no actual file transfer took place.²²

Over 80 Appeals Officers, Settlement Officers and other Appeals employees who routinely interact with taxpayers and representatives volunteered to participate in the pilot.²³ Participating volunteers provided the taxpayer the option of conducting a WebEx conference. Those taxpayers who agreed to participate in the pilot needed a computer, tablet, or other mobile device with an internet connection. The IRS also requested the taxpayer to install WebEx, a free commercial software, on their device, but there was also an option to run a temporary application, which did not require installation but also had less optimal performance, to join the meeting. In addition, while it was preferable that the taxpayer's device had video camera capabilities, taxpayers without this capability could still participate in a WebEx conference for audio and the visual sharing of documents.²⁴

The pilot produced overall favorable results. Over 3,500 taxpayers and representatives were offered to use the technology and almost 40 percent of the Appeals volunteers conducted 130 WebEx conferences. On average, participating taxpayers and representatives rated the experience between very good and excellent (4.28 on a 5-point scale) and about 90 percent indicated that they preferred it over telephone conferences.²⁵

A WebEx conference had both benefits and limitations for both taxpayers and the IRS. The program benefits include: (1) providing a virtual face-to-face opportunity to meet, ensuring engagement and facilitating communication; (2) reducing the time and effort associated with taxpayer travel to an Appeals office; and (3) allowing visual presentation of information in real time. However, technical difficulties also arose as audio and video efficiency are affected by internet connectivity, bandwidth,

21 IRS Office of Appeals, *Appeals' WebEx Pilot – Final Results and Recommendations* (Nov. 6, 2018).

22 IRS, Appeals Virtual Conferences – WebEx, <https://www.irs.gov/appeals/appeals-virtual-conferences-webex> (last visited Apr. 17, 2019).

23 IRS Office of Appeals, *Appeals' WebEx Pilot – Final Results and Recommendations* (Nov. 6, 2018).

24 IRS, Appeals Virtual Conferences – WebEx, <https://www.irs.gov/appeals/appeals-virtual-conferences-webex> (last visited Apr. 17, 2019).

25 IRS Office of Appeals, *Appeals' WebEx Pilot – Final Results and Recommendations* (Nov. 6, 2018).

and the equipment and operating systems used by each party to the conference.²⁶ In addition, the WebEx server was taken offline in late April due to an apparent attempt to “hack” the related audio conference bridge. The IRS brought the server back online on May 22, 2018, after it deployed upgraded programming.²⁷

Appeals has indicated that it intends to expand the use of WebEx by incorporating the technology into conference practices more broadly, going forward.²⁸ In addition, the favorable results of the pilot support the expansion of WebEx technology for virtual conferences in other areas of the IRS. In fact, TAS plans to conduct a pilot of the technology beginning in FY 2020.²⁹

FOCUS FOR FISCAL YEAR 2020

In fiscal year 2020, TAS will:

- Meet with representatives of the National Institute of Standards and Technology (NIST) to determine if most recent standards allow for the creation of less burdensome e-authentication requirements for interactions limited to the inbound transfer of information, such as when the taxpayer submits documents to the IRS and the IRS does not release any taxpayer-specific data in return; and
- Conduct a pilot using WebEx virtual conference technology with TAS cases and model the terms of such pilot on the one conducted by Appeals.

26 IRS, Appeals Virtual Conferences – WebEx, <https://www.irs.gov/appeals/appeals-virtual-conferences-webex> (last visited Apr. 17, 2019).

27 IRS Office of Appeals, *Business Performance Review (BPR), Third Quarter - Fiscal Year 2018 2* (Aug. 23, 2018).

28 IRS Office of Appeals, *Appeals’ WebEx Pilot – Final Results and Recommendations* (Nov. 6, 2018); IRS Office of Appeals, FY 2019 Appeals Program Letter 1-3.

29 For a detailed discussion of the planned development of TAS WebEx pilot, see *Efforts to Improve Taxpayer Advocacy, infra*.

Area of Focus #12 TAS Will Advocate for Greater Clarity and Certainty With Respect to the IRS's Updated Voluntary Disclosure Practice

TAXPAYER RIGHTS IMPACTED¹

- *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 Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DISCUSSION

Over the years, the IRS has developed various programs to encourage taxpayers who learn they could be subject to draconian civil and criminal penalties to come into compliance voluntarily. Pursuant to its longstanding voluntary disclosure practice (VDP), the IRS would take a person's voluntary disclosure into account in determining whether to refer them for criminal prosecution (*i.e.*, a disclosure would significantly reduce the risk for a taxpayer being referred for criminal prosecution).² To qualify, the person had to (a) make a timely disclosure (*i.e.*, generally before the government begins an investigation or learns of the noncompliance), (b) cooperate with the IRS, and (c) arrange to pay the liability in full.³

Historically, taxpayers who made a voluntary disclosure could often avoid civil penalties as well.⁴ Some practitioners advised that if penalties did apply to a voluntary disclosure involving an offshore account, they would typically amount to 12 to 15 percent of the balance of the undisclosed account in question.⁵ However, people could often achieve a similar result (*i.e.*, no criminal penalties and little or no civil

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 Internal Revenue Manual (IRM) 9.5.11.9, *Voluntary Disclosure Practice* (Dec. 2, 2009). Technically, the IRS can still refer a taxpayer who makes a voluntary disclosure for criminal prosecution, but it must consider the disclosure in making that decision. *Id.*

3 *Id.* The voluntary disclosure practice (VDP) is not available to those with illegal-source income. *Id.*

4 See, e.g., Mark E. Matthews and Scott D. Michel, *IRS's Voluntary Disclosure Program for Offshore Accounts: A Critical Assessment After One Year*, 181 DTR J-1, 5 (Sept. 21, 2010) (noting that before the offshore voluntary disclosure program (OVDP), "taxpayers rarely paid any penalties in connection with voluntary disclosures on offshore accounts. Indeed, most taxpayers, relying on the advice of skilled tax professionals, many of whom have decades of prior experience in the Justice Department (DOJ), or IRS, simply filed amended returns and paid the tax and interest. They were never audited. No penalties were ever asserted...").

5 Baker and McKenzie, *Undeclared Money Held Offshore: U.S. Voluntary Compliance Programs (Part 2)*, 21 J. INT'L. TAX'N 36, 43 (2010).

penalties) by making a “quiet” disclosure—filing an amended return and paying any tax delinquency—without making a formal voluntary disclosure.⁶

Beginning in 2009, the IRS offered a series of offshore voluntary disclosure (OVD) programs to settle with taxpayers who had failed to report offshore income and file one or more related information returns (e.g., Form 114, *Report of Foreign Bank and Financial Accounts (FBAR)*). As the National Taxpayer Advocate described in prior reports, these programs applied a one-size-fits-all approach designed for “bad actors” who intentionally tried to evade taxes, to “benign actors” who inadvertently violated the rules, requiring them to opt-in and then opt-out, and threatening them with lengthy examinations and draconian civil and criminal penalties.⁷

Overview of Initiatives Available for Taxpayers With Unfiled Returns or Unreported Income

On September 28, 2018, the IRS ended its latest variation of the OVD program.⁸ In lieu of an OVD program, the IRS recently announced changes to its VDP.⁹

Like the longstanding VDP, the objective of the updated VDP is to provide an avenue for taxpayers with potential exposure to criminal liability with a means “to come into compliance with the law and potentially avoid criminal prosecution.”¹⁰ The updated VDP provides continued opportunities to make domestic or offshore voluntary disclosures.¹¹ However, the updated VDP gives examiners less discretion in the application of civil penalties.¹²

6 See, e.g., Mark E. Matthews and Scott D. Michel, *IRS’s Voluntary Disclosure Program for Offshore Accounts: A Critical Assessment After One Year*, 181 DTR J-1 (Sept. 21, 2010); Baker and McKenzie, *Undeclared Money Held Offshore: U.S. Voluntary Compliance Programs (Part 2)*, 21 J. INT’L. TAX’N 36, 43 (2010) (“most practitioners generally recommended to their clients the use of informal or ‘quiet’ disclosures. In theory, the taxpayer ran the risk of being ‘caught’ but, in practice, the taxpayer rarely heard anything back from the Service or DOJ. Further, if one did participate in the formal voluntary disclosure process, most, if not all, penalties generally were abated.”).

7 The National Taxpayer Advocate discussed the IRS’s OVD in eleven reports to Congress and in Taxpayer Advocate Directive (TAD) 2011-1, which was elevated to former Commissioner of Internal Revenue Douglas Shulman. See, e.g., National Taxpayer Advocate Fiscal Year (FY) 2018 Objectives Report to Congress 43-50; National Taxpayer Advocate 2017 Annual Report to Congress vol. 2 210-228; National Taxpayer Advocate FY 2016 Objectives Report to Congress vol. 2 32-35; National Taxpayer Advocate FY 2015 Objectives Report to Congress vol. 2 91-95; National Taxpayer Advocate FY 2014 Objectives Report to Congress 36-39; National Taxpayer Advocate 2014 Annual Report to Congress 79-93; National Taxpayer Advocate FY 2013 Objectives Report to Congress 21-29; National Taxpayer Advocate 2013 Annual Report to Congress 222-237; National Taxpayer Advocate FY 2012 Objectives Report to Congress 23-24; National Taxpayer Advocate 2012 Annual Report to Congress 134-153; National Taxpayer Advocate 2011 Annual Report to Congress 206-272 (including TAD 2011-1 and the IRS response). See also *IRS Reform: Lessons Learned from the National Taxpayer Advocate: Hearing Before the H. Comm. on Ways and Means, Subcomm. on Oversight* 115th Cong. 24 (2017) (testimony of Nina E. Olson, National Taxpayer Advocate).

8 See IRS, *IRS to End Offshore Voluntary Disclosure Program; Taxpayers With Undisclosed Foreign Assets Urged to Come Forward Now*, IR-2018-52 (Mar. 13, 2018).

9 Memorandum for Division Commissioners, Chief, Criminal Investigation, *Updated Voluntary Disclosure Practice* (Nov. 20, 2018). The VDP permits both domestic and offshore disclosures. *Id.*

10 *Id.*

11 *Id.*

12 *Id.*

Taxpayers who are not concerned about criminal liability can still make “quiet” disclosures, or in certain circumstances they may be eligible for the:

- (1) Streamlined Filing Compliance Procedures (SFCP);¹³
- (2) Delinquent FBAR Submission Procedures;¹⁴ or
- (3) Delinquent International Information Return Submission Procedures.¹⁵

None of these options provide the taxpayer with the finality that their tax issues are resolved because the IRS can still audit their returns and theoretically even refer them for criminal prosecution.¹⁶

Taxpayers May Be Unclear About Which Option to Use

A taxpayer may be confused whether a voluntary disclosure is appropriate because the IRS is routing all voluntary disclosures from the IRS Criminal Investigation Division to the Large Business & International (LB&I) Division and then from LB&I to the appropriate IRS division.¹⁷ This may create the perception that the updated VDP is only available for LB&I taxpayers.¹⁸ Additionally, having LB&I serve as a routing function could result in increased timeframes for non-corporate, domestic filers because of the additional routing involved and the possibility of increased errors in routing from LB&I to the appropriate function.

Additionally, some taxpayers may not know whether their conduct was willful, and therefore subject to enhanced penalties, including the possibility of criminal prosecution. Given this uncertainty, some who were not even clearly negligent are going to want to apply to the VDP to reduce the already-low possibility that they might have to pay to defend themselves in public against criminal charges.

Because “willfulness” can be inferred based on various facts and circumstances, taxpayers who feel they have acted reasonably might still be concerned that the IRS would view their conduct as willful and

13 For additional information about the Streamlined Filing Compliance Program, see IRS, *Streamlined Filing Compliance Procedures*, <https://www.irs.gov/individuals/international-taxpayers/streamlined-filing-compliance-procedures> (last visited Apr. 5, 2019). The IRS indicated it may end the Streamlined Filing Compliance Program in the future. IRS, *IRS Reminds Those With Foreign Assets of Annual April 15 FBAR Deadline*, IR-2019-63 (Apr. 4, 2019); IRS, *IRS To End Offshore Voluntary Disclosure Program; Taxpayers With Undisclosed Foreign Assets Urged to Come Forward Now*, IR-2018-52 (Mar. 13, 2018).

14 For additional information about the Delinquent Report of Foreign Bank and Financial Accounts (FBAR) Submission Procedures, see IRS, *Delinquent FBAR Submission Procedures*, <https://www.irs.gov/individuals/international-taxpayers/delinquent-fbar-submission-procedures> (last visited Apr. 5, 2019).

15 For additional information about the Delinquent International Informational Return Submission Procedures, see IRS, *Delinquent International Informational Return Submission Procedures*, <https://www.irs.gov/individuals/international-taxpayers/delinquent-international-informational-return-submission-procedures> (last visited Apr. 5, 2019).

16 Returns filed under the Streamlined Filing Compliance Procedures will not be acknowledged by the IRS and will not result in a closing agreement. See IRS, *Streamlined Filing Compliance Procedures*, <https://www.irs.gov/individuals/international-taxpayers/streamlined-filing-compliance-procedures> (last visited Apr. 5, 2019). FBARs may be selected for audit through existing audit selection procedures. See IRS, *Delinquent FBAR Submission Procedures*, <https://www.irs.gov/individuals/international-taxpayers/delinquent-fbar-submission-procedures> (last visited Apr. 5, 2019). Information returns filed with amended returns may be selected for audit through existing audit selection procedures. See IRS, *Delinquent International Informational Return Submission Procedures*, <https://www.irs.gov/individuals/international-taxpayers/delinquent-international-informational-return-submission-procedures> (last visited Apr. 5, 2019).

17 Memorandum for Division Commissioners, Chief, Criminal Investigation, *Updated Voluntary Disclosure Practice* (Nov. 20, 2018).

18 The Large Business & International (LB&I) Division serves corporations, subchapter S corporations, and partnerships with assets greater than \$10 million. See IRS, *Large Business and International Division At-a-Glance*, <https://www.irs.gov/businesses/international-businesses/large-business-and-international-division-at-a-glance> (last visited Apr. 8, 2019). The LB&I Division also serves international taxpayers. See IRS, *Full List of LB Large Business and International Campaigns*, <https://www.irs.gov/businesses/full-list-of-lb-large-business-and-international-campaigns> (last visited Apr. 8, 2019).

assert draconian civil and possibly even criminal penalties.¹⁹ To avoid this risk and to settle the matter with finality, some will apply to the VDP. When they do, taxpayers will find they face the choice of paying penalties designed for criminals or proving their innocence without the normal procedural protections.

The Updated VDP Is More Favorable to Taxpayers Who Engaged in Willful or Criminal Behavior

The burden of proving fraud has always been the responsibility of the IRS.²⁰ However, the updated VDP *presupposes* fraud.²¹ While the guidance permits a taxpayer to seek a penalty other than civil fraud, the guidance says “imposition of lesser penalties is expected to be exceptional.”²² The IRS is avoiding its legal responsibility by starting with the premise that fraud exists and then requiring the taxpayer to bear the burden of proving a lesser penalty.

A taxpayer who has engaged in willful or criminal behavior, such as the purposeful underreporting of their offshore income by hiding income in offshore accounts, will likely benefit from the VDP. By cooperating and agreeing with the examiner, the taxpayer will be assessed either a civil fraud penalty or a fraudulent failure to file penalty for the one tax year with the highest tax liability.²³

However, taxpayers who joined the VDP merely because they were concerned they may have a scintilla of criminal exposure will have a greater threshold to overcome to obtain a reasonable settlement. These taxpayers will have to convince the examiner that their conduct is not fraudulent. Additionally, if the examiner perceives a taxpayer as not agreeing or being uncooperative, the examiner could apply the fraud penalty to all six years of the disclosure period or beyond.²⁴

Taxpayers May Fear Requesting an Independent Appeal if They Do Not Agree With the Examiner

Unlike the OVD programs, the updated VDP guidance allows taxpayers the right to request an appeal with the Office of Appeals.²⁵ The Office of Appeals is an impartial, independent organization within the IRS available to taxpayers to resolve tax disputes with the IRS.²⁶ Allowing such appeals is consistent with the taxpayer’s *right to appeal an IRS decision in an independent forum*.²⁷

However, the VDP makes it seem risky for taxpayers to request an appeal. An appeals conference is generally requested at the conclusion of an exam, by filing a written protest, after the taxpayer has failed to reach an agreement with the examiner.²⁸ Disturbingly, the VDP guidance states that if a voluntary

19 Although willfulness is generally not inferred in a criminal context, taxpayers whose conduct the IRS deems willful for the purpose of civil penalties might still be concerned about the cost and burden of defending criminal charges. See, e.g., IRC § 7201.

20 See, e.g., IRC § 7454(a); *DiLeo v. Comm’r*, 96 T.C. 858, 873 (1991), *aff’d*, 959 F.2d 16 (2d Cir. 1992).

21 Memorandum for Division Commissioners; Chief, Criminal Investigation, *Updated Voluntary Disclosure Practice* (Nov. 20, 2018).

22 *Id.*

23 *Id.*

24 *Id.*

25 *Id.*

26 IRS, *About the Office of Appeals*, <https://www.irs.gov/appeals> (last visited Apr. 8, 2019).

27 IRC § 7803(a)(3)(E).

28 IRS, *Requesting An Appeal*, <https://www.irs.gov/appeals/preparing-a-request-for-appeals> (last visited Apr. 8, 2019).

disclosure is “not resolved by an agreement,” the examiner has the discretion to expand the scope and to assert the maximum penalties under the law.²⁹

This suggests that after a taxpayer requests an appeal, the examiner could expand the scope of the examination, and assert maximum penalties under the law. Without further clarification, the guidance sends the message to taxpayers that they could be punished for exercising their rights.

Additional VDP Guidance is Warranted

The IRS should provide guidance about what constitutes full payment for the disclosure period. The guidance should clarify whether a taxpayer is permitted to enter into an installment agreement to satisfy the taxes, interest, and penalties resulting from a voluntary disclosure.

The IRS should also provide additional guidance regarding the application of penalties. The guidance should describe the facts and circumstances in which examiners may apply the civil fraud or fraudulent failure to file penalty to more than one year, including when other penalties such as when the failure to file information returns and willful FBAR penalties, will be imposed and to which tax years.

CONCLUSION

The IRS should modify the VDP so that those who fear their particular circumstances may rise to criminal exposure do not have to convince the IRS of their innocence. Additionally, the IRS should clarify that examiners should not expand the scope of a disclosure or assess more penalties solely because a taxpayer may disagree with the examiner and requests an appeals conference. Lastly, the IRS should provide additional guidance on whether installment agreements will be permitted, and what facts and circumstances will allow an examiner to assess additional penalties.

FOCUS FOR FISCAL YEAR 2020

In fiscal year 2020, TAS will:

- Advocate for taxpayers experiencing problems with the IRS’s VDP and streamlined programs, including issuing Taxpayer Assistance Orders where appropriate;
- Advocate for the IRS to modify its VDP guidance to clarify that an examiner will not expand the scope of the disclosure or assess more penalties just because a taxpayer has exercised his or her appeal rights; and
- Propose VDP guidance changes to expressly allow installment agreements and to clarify what facts and circumstances will result in additional penalties under the VDP.

²⁹ Memorandum for Division Commissioners, Chief, Criminal Investigation, *Updated Voluntary Disclosure Practice* (Nov. 20, 2018).